

**KING REPORT
ON CORPORATE GOVERNANCE
FOR SOUTH AFRICA
2002**

KING COMMITTEE ON CORPORATE GOVERNANCE



LOGO : PROUDLY SOUTH AFRICAN

MARCH 2002

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RICHARD S. WILKINSON
Executive Director
Institute of Directors

PREFACE

The guidelines for the review of the King Report 1994 on corporate governance and the remits of the task teams are set out in Appendix II.

The task teams considered boards and directors, accounting and auditing, internal audit and risk management, non-financial matters, and compliance and enforcement.

The work of the task teams was studied and debated by the King Committee, who distilled their recommendations into the Code of Corporate Practices and Conduct. For the full background to and an understanding of the Code the sections, aligned with each task team's work, should be read. On this reading, it will be seen that the Code is in line with best international practices. This is necessary in our borderless world of the information age.

I want to record my thanks and appreciation for the work done by the task teams and my Committee. Hundreds of hours went into the compilation of this Report, which we decided to issue as a work of reference with aspirational recommendations from which the Code evolved. In particular I want to thank the convenors of the task teams and more particularly the convenor of convenors and principal editor, Philip Armstrong, who not only had to deal with the various task teams but with my interventions, amendments and suggestions.

Thanks are due to the Institute of Directors, under whose auspices the King Committee was initiated and especially Richard Wilkinson who has provided the Secretariat and been a member of the Committee from inception.

I was inspired in my work on this Report by the fact that so many prominent South Africans gave of their time on an honorary basis. None of us even attempted to recover our disbursements in preparing this Report.

The King Committee is proud that some major investors and institutions have said that South Africa has the best governance of listed companies in emerging economies. It will be adequate reward for our work if in the future, South African directors of our listed companies continue to be recognised as practitioners of good corporate governance. It will be better than adequate if all affected companies implement the Code.

The Code of Corporate Practices and Conduct contained in this Report will replace the present Code contained in the first King Report 1994 with effect from 1 March 2002.

MERVYN E. KING S.C
Chairperson

MARCH 2002

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INTRODUCTION AND BACKGROUND

“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interests of individuals, corporations and society.”

*Sir Adrian Cadbury
Corporate Governance Overview, 1999
World Bank Report*

1. Corporate governance in South Africa was institutionalised by the publication of the *King Report on Corporate Governance* (“King Report 1994”) in November 1994.
2. The King Committee on Corporate Governance was formed in 1992, under the auspices of the Institute of Directors, to consider corporate governance, of increasing interest around the world, in the context of South Africa. This coincided with profound social and political transformation at the time with the dawning of democracy and the re-admission of South Africa into the community of nations and the world economy.
3. The purpose of the King Report 1994 was, and remains, to promote the highest standards of corporate governance in South Africa.
4. Unlike its counterparts in other countries at the time, the King Report 1994 went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice. In adopting a participative corporate governance system of enterprise with integrity, the King Committee in 1994 successfully formalised the need for companies to recognise that they no longer act independently from the societies and the environment in which they operate.
5. But a distinction needs to be made between accountability and responsibility:
 - 5.1. One is liable to render an account when one is accountable and one is liable to be called to account when one is responsible. In governance terms, one is accountable at common law and by statute to the company if a director, and one is responsible to the stakeholders identified as relevant to the business of the company. The stakeholder concept of being accountable to all legitimate stakeholders must be rejected for the simple reason that to ask boards to be accountable to everyone would result in their being accountable to no one. The modern approach is for a board to identify the company’s stakeholders, including its shareowners, and to agree policies as to how the relationship with those stakeholders should be advanced and managed in the interests of the company. Wherever the term “stakeholder” is applied in this Report, it is used in the sense enunciated in this paragraph.

- 5.2. In decades past, if people had gathered in order to establish a company to produce goods, they would have applied to a regulator for a licence, hired premises, bought plant, and proceeded to manufacture without much regard to the impact on the environment, or the interests of other stakeholders. The permission from the regulator to manufacture the goods would have been the “licence to operate”. Today, the licence to operate a company is much more complex. Boards have to consider not only the regulatory aspect, but also industry and market standards, industry reputation, the investigative media, and the attitudes of customers, suppliers, consumers, employees, investors, and communities (local, national and international), ethical pressure groups, public opinion, public confidence, political opinion, etc.
- 5.3. The inclusive approach recognises that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers need to be considered when developing the strategy of a company. The relationship between a company and these stakeholders is either contractual or non-contractual.
6. The inclusive approach requires that the purpose of the company be *defined*, and the values by which the company will carry on its daily life should be *identified* and *communicated* to all stakeholders. The stakeholders relevant to the company’s business should also be identified. These three factors must be combined in developing the strategies to achieve the company’s goals. The relationship between the company and its stakeholders should be mutually beneficial. A wealth of evidence has established that this inclusive approach is the way to create sustained business success and steady, long-term growth in shareowner value.
7. However, it must constantly be borne in mind that entrepreneurship and enterprise are still among the important factors that drive business:
 - 7.1. Emerging economies have been driven by entrepreneurs, who take business risks and initiatives. With successful companies, come successful economies. Without satisfactory levels of profitability in a company, not only will investors who cannot earn an acceptable return on their investment look to alternative opportunities, but it is unlikely that the other stakeholders will have an enduring interest in the company.
 - 7.2. The key challenge for good corporate citizenship is to seek an appropriate balance between enterprise (performance) and constraints (conformance), so taking into account the expectations of shareowners for reasonable capital growth and the responsibility concerning the interests of other stakeholders of the company. This is probably best encapsulated in the statement attributed to the President of the World Bank, Jim Wolfensohn, that “[t]he proper governance of companies will become as crucial to the world economy as the proper governing of countries”. Proper governance embraces both performance and conformance.
8. Conforming to corporate governance standards results in constraints on management. Boards have to balance this with performance for financial success and the sustainability of the company’s business. Tomorrow’s Company in the United Kingdom developed the concept of three corporate sins, namely *sloth*, being a loss of flair when enterprise gives way to administration; *greed*, when executives might make a short-term decision because it has greater impact

on their share options and bonuses, than a decision that might create longer term prosperity for the company; and *fear*, where executives become subservient to investors and ignore the drive for sustainability and enterprise.

9. Corporate governance principles were developed, *inter alia*, because investors, with the era of the professional manager, were worried about the excessive concentration of power in the hands of management. This protection against greed could encourage the sins of sloth and fear, with an erosion of enterprise and an encouragement of subservience. A balance is needed.
10. While the King Committee remains firmly committed to the above governance concepts, a number of the far-reaching recommendations contained in the King Report 1994 have been superseded by legislation in the social and political transformation that coincided with its release. Some of the more significant have been the Labour Relations Act (No. 66 of 1995), Basic Conditions of Employment Act (No. 75 of 1997), Employment Equity Act (No. 55 of 1998) and the National Environmental Management Act (No. 107 of 1998) amongst a number of others. The intervening period has also seen the listings requirements of the JSE Securities Exchange South Africa (formerly Johannesburg Stock Exchange) ("JSE") comprehensively revised in 1995 and again in 2000 to ensure that they remain current with international best practice. During this time some of the recommendations for statutory amendments to the Companies Act (No. 61 of 1973) ("Companies Act") contained in the King Report 1994 were promulgated thereby permitting companies to obtain liability insurance cover indemnifying their directors and officers¹, compelling disclosure of the identity of beneficial owners of shares held by nominees², and making the appointment of the company secretary mandatory for public companies with a share capital³.
11. Other legislative developments since the publication of the King Report 1994 include the introduction of the Insider Trading Act (No. 135 of 1998) providing for more rigorous supervision and monitoring of insider trading, the Public Finance Management Act (No. 1 of 1999) bringing into force more stringent provisions for reporting and accountability by adopting an approach to financial management in government that focuses on outputs and responsibilities rather than the rule driven approach under previous legislation, and a comprehensive update of the provisions and regulations governing the Banks Act (No. 94 of 1990) enforcing substantially higher levels of corporate governance compliance and risk reporting in banking institutions. Also notable in this period has been the priority accorded to corporate governance practices in state enterprises culminating in the release of the *Policy Framework for State Owned Enterprises* by the Department of Public Enterprises in August 2000, which is in the process of being comprehensively updated.
12. A dominant feature of business since 1994 has been the emergence of information technology in all its facets, as a key driver of business strategy and decisions. The proliferation of cheap, accessible communication via the internet has facilitated a potent form of information exchange across all spectrums of society. Information technology has now become an integral part of internal controls and reporting information. At the same time, there are fiduciary

¹ Paragraph 24.7 of the King Report 1994 by way of an amendment to section 247 of the Companies Act

² Paragraph 24.4 of the King Report 1994 by the introduction of section 140A of the Companies Act

³ Paragraph 24.8 of the King Report 1994 by the introduction of sections 268A to 268J of the Companies Act

implications because of the electronic formation of contracts, the integrity of electronic communications, the retention of records etc.

13. Consequently, directors need to ensure that the necessary skills are in place for them to discharge their responsibility for internal controls. While technology can be used to improve reporting and transparency, directors must be aware of the blurring of organisational barriers as a consequence of e-business.
14. The “company” remains a key component of modern society. In fact, in many respects, companies have become a more immediate presence to many citizens and modern democracies than either governments or other organs of civil society. As a direct consequence, companies remain the legitimate and necessary focal point for profit-making activities in market economies. They are also increasingly a target for those discontented with business liberalisation and globalisation, an agenda that companies are perceived as driving. In the global economy, there are many jurisdictions to which a company can run to avoid regulation and taxes or to reduce labour costs. But, there are few places where a company can hide its activities from sceptical consumers, shareowners or protestors.⁴ In short, in the age of electronic information and activism, no company can escape the adverse consequences of poor governance.
15. It is becoming difficult for companies to account for profitability alone. In a report by an international institutional investor,⁵ while South Africa ranked among the top five of 25 emerging markets in terms of corporate governance, it rated poorly in terms of disclosure and transparency. The minimalist approach to corporate governance adopted by many local companies needs to change. While South Africa may arguably offer investment returns comparable with some of the best in the world, even after accounting for political, currency and other risks, it must visibly demonstrate impeccable governance standards in all sectors of commercial activity not only in principle, but also in practice, if it is to remain a destination of choice for emerging market global investors.
16. If there is a lack of good corporate governance in a market, capital will leave that market with the click of a mouse. As Arthur Levitt, the former Chairperson of the US Securities and Exchange Commission has said, *“If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country – regardless of how steadfast a particular company’s practices may be – suffer the consequences. Markets must now honour what they perhaps, too often, have failed to recognise. Markets exist by the grace of investors. And it is today’s more empowered investors that will determine which companies and which markets will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors’ capital”*
17. There is a move from the single to the triple bottom line, which embraces the economic, environmental and social aspects of a company’s activities:

⁴ Canadian Democracy & Corporate Accountability – An Overview of Issues, The Democracy & Corporate Accountability Commission, Canada
website: www.corporate-accountability.ca

⁵ *The Tide’s Gone Out: Who’s Swimming Naked?* – CLSA Emerging Markets, October 2000

- 17.1. The economic aspect involves the well-known financial aspects as well as the non-financial ones relevant to that company's business. The environmental aspects include the effect on the environment of the product or services produced by the company. The social aspects embrace values, ethics and the reciprocal relationships with stakeholders other than just the shareowners. There is an endeavour now through the Global Reporting Initiative to lay down guidelines on how a company should report on the triple bottom line.
- 17.2. It is now generally accepted by multinationals operating in various jurisdictions that *“demonstrating concern creates an atmosphere of trust and a better understanding of corporate aims, so that when the next crisis comes (and these are inevitable for big companies) there will be a greater goodwill to help the company survive”*⁶.
- 17.3. This triple bottom line reporting also stems from the in-depth study now being done on the importance of ownership in business. Ownership is not unique to companies. It is a societal phenomenon. With ownership comes responsibilities. The logic has been that shareowners are entitled to expect directors to run the company in their sole interests – the so-called shareowner dominant theory. This approach has been rejected by Courts in various jurisdictions, because on incorporation the company becomes a separate persona in law and no person whether natural or juristic can be owned. Courts have also held that shareowners have no direct interest in the property, business or assets owned by a company, their only rights being a right to vote and a right to dividends. Shareowners also change from time to time while as the owner, the company remains constant. Consequently, directors, in exercising their fiduciary duties, must act in the interest of the company as a separate person.
- 17.4. Shareowners obtain their power from the democratic process of voting by which means they can elect or dismiss directors, who carry out the objectives of the company.
- 17.5. The relationship between the company and the shareowners arises out of the articles of association, which are nothing more than a contract between them. This is the only means of shareowner protection, which is quite ineffective in practice. Because the shareowners have little or no protection, the quality of governance is of absolute importance to them.
18. It would be useful, at this point, to illustrate what can be regarded as constituting the seven characteristics of good corporate governance⁷:
- 18.1. ***Discipline***
- Corporate discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognised and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to, the underlying principles of good governance, particularly at senior management level.

⁶ Reputation Assurance
⁷ Source: CLSA Emerging Markets

18.2. ***Transparency***

Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company.

18.3. ***Independence***

Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

18.4. ***Accountability***

Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide investors with the means to query and assess the actions of the board and its committees.

18.5. ***Responsibility***

With regard to management, responsibility pertains to behaviour that allows for corrective action and for penalising mismanagement. Responsible management would, when necessary, put in place what it would take to set the company on the right path. While the board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company.

18.6. ***Fairness***

The systems that exist within the company must be balanced in taking into account all those that have an interest in the company and its future. The rights of various groups have to be acknowledged and respected. For example, minority shareowner interests must receive equal consideration to those of the dominant shareowner(s).

18.7. ***Social responsibility***

A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.

19. One of the difficulties, and challenges, has been to provide sufficient empirical evidence that good corporate governance pays:

19.1. In recent years, research has been developed that increasingly supports this proposition. In its *Investor Opinion Survey* published in June 2000, McKinsey & Co., working with Institutional Investors Inc., found that good governance could be quantified and was significant. For the survey, well-governed companies were defined as:

- having a clear majority of outsiders on the board, with no management ties;
- holding formal evaluations of directors;
- having directors with significant stakes in the company and receiving a large proportion of their pay in the form of stock options; and
- being responsive to investor requests for information on governance issues.

19.2. The survey found that:

- more than 84% of the more than 200 global institutional investors, together representing more than US\$3 trillion in assets, indicated a willingness to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record;
- three-quarters of these investors indicated that board practices were at least as important as financial performance, when evaluating companies for potential investment; and
- the actual premium these investors would be willing to pay varied from country to country. In the United Kingdom, they would pay 18% more for the shares of a well-governed company than for the shares of a company with similar financial performance but poorer governance practices. In emerging markets or markets perceived to have poor governance practices, this premium escalated to 22% for a well-governed Italian company and to as much as 27% for one in Venezuela or Indonesia.

19.3. The implications for companies are profound. Simply by developing good governance practices, managers can potentially add significant shareowner value. The results of this survey should also be apparent to policy makers and regulators in recognising that the creation of a good governance climate can make countries, especially in the emerging markets, a magnet for global capital. This survey emphasised that companies not only need to be well-governed, but also need to be perceived in the market as being well governed.

20. Other similar surveys support the contentions put forward by McKinsey⁸. In March 2001, Stanford University issued a report on corporate governance in emerging markets, re-enforcing the McKinsey findings. Add to this the immense influence of US pension funds, where the proportion of overall foreign holdings of some US\$410 billion in 1999 held by the top 25 pension funds leapt from 42% in 1998 to 66%. Amongst these are many of the funds that have been at the forefront of the governance movement in the United States, such as CalPERS, TIAA-CREF, CalSTRS, and the States of Wisconsin and Florida. It is notable that these funds are developing activist strategies abroad, and that a number of such funds are invested in South African companies. Moreover, over the past year or so, the South African market has experienced a rise in shareowner activism that is gathering momentum. Corporate governance is at the heart of most of the issues that have arisen thus far.
21. In the information age everyone, willingly or not, is a member of the global market place:
- 21.1. As members of this global club, everyone lives in a borderless world, not one as envisaged by the World Trade Organisation with no geographic trading borders but one where information crosses borders with the “click of a mouse”. Relying on this information, capital flows across geographic borders as if they were non existent.
- 21.2. It follows that the information must be trustworthy before an investor will decide to invest. The measurement for this trust and confidence is the quality of the governance of the company imparting the information.
- 21.3. In their own self-interest global investors are promoting good governance in companies. Thus, the Association of Unit Trusts and Investment Funds in the United Kingdom requires member funds routinely to inform their investors in annual reports about how they have promoted good corporate governance in the companies in which they invest. Under the Employment, Retirement and Income Security Act in the United States, the vote of an investor is seen as a trust “asset” and must be treated with the same level of care as the cash and other assets under the management of a company. The trend now is that fiduciaries should be required to vote and disclose how they have voted. The International Trade Union movement, amongst many others, is driving to mobilise labour-orientated funds as shareowner activists. The goal is the pooling of financial power across borders to press shared interests in corporate governance and social issues.
- 21.4. The era of deference of shareowners and society to the company generally, has gone. Shareowner activism has taken root globally, notwithstanding that share ownership is now dispersed through institutions throughout the world. Institutional investors, both national and global, are drafting criteria for investment and for how investors can improve the corporate governance in companies in which they invest.

8

Some examples of other surveys include the research undertaken by Russell Reynolds in its *Corporate Governance in the New Economy – 2000 International Survey of Institutional Investors* and that conducted by R LaPorta, F Lopez-de-Silanes, A Schleifer and R Vishny *Investor Protection and Corporate Value* – NBER Working Paper 7403. Findings in both instances indicated a close correlation between investors' perceptions of good governance practices and companies, and the influence this had on their investment decision process

22. Apart from the value added to a company by good corporate governance, interest in such practices has been fuelled by the international financial crises of the 1990s. In East Asia, in 1997 and 1998, it was demonstrated that macro-economic difficulties could be worsened by systemic failure of corporate governance, stemming from:
- 22.1. weak legal and regulatory systems;
 - 22.2. poor banking regulation and practices;
 - 22.3. inconsistent accounting and auditing standards;
 - 22.4. improperly regulated capital markets; and
 - 22.5. ineffective oversight by corporate boards, and scant recognition of the rights of minority shareowners.
23. The significance of corporate governance is now widely recognised, both for national development and as part of international financial architecture, as a lever to address the converging interests of competitiveness, corporate citizenship, and social and environmental responsibility. It is also an effective mechanism for encouraging efficiency and combating corruption. Companies are governed within the framework of the laws and regulations of the country in which they operate. Communities and countries differ in their culture, regulation, law and generally the way business is done. In consequence, as the World Bank has pointed out, there can be no single generally applicable corporate governance model. Yet there are international standards that no country can escape in the era of the global investor. Thus, international guidelines have been developed by the Organisation for Economic Co-operation and Development (OECD), the International Corporate Governance Network, and the Commonwealth Association for Corporate Governance. The four primary pillars of fairness, accountability, responsibility and transparency are fundamental to all these international guidelines of corporate governance.
24. The 19th century saw the foundations being laid for modern corporations: this was the century of the entrepreneur. The 20th century became the century of management: the phenomenal growth of management theories, management consultants and management teaching (and management gurus) all reflected this pre-occupation. As the focus swings to the legitimacy and the effectiveness of the wielding of power over corporate entities worldwide, the 21st century promises to be the century of governance.
25. Historically, whilst the focus on governing corporations has been financial, a balance sheet is only a record of one moment in time of the financial affairs of a company. Investors now want a forward-looking approach to reporting. Thus the balanced scorecard approach, which results in information at a glance so that companies can be measured against defined goals, has been developed. What stakeholders want is a form of reporting from which they can see whether or not a company is likely to have sustained success.⁹ For example, if working capital

⁹ Clearly the notion of providing a balanced scorecard does not entail the disclosure of competitive or sensitive information that could be detrimental to a company's legitimate interests. However, the extent to which companies withhold disclosure of information must be carefully weighed against the expectation by investors and others with a legitimate interest in the affairs of the company for full and frank disclosure without prejudicing corporate interests for which directors carry fiduciary responsibility. On the other hand, excessive secrecy on the part of boards and

needs to be reduced, the company would aim to reduce its debt/equity ratio and its working capital to sales ratio by a stated percentage at a fixed time in the future, such as at the next annual general meeting date.

26. Some companies have appointed corporate reputation officers (CRO) to monitor how third parties view the company and to report to the chief executive on their findings. Further, the CRO reports on matters such as customer satisfaction and customer perception of key service areas. Of even greater importance in the information age, particularly in IT companies, is the report on human resources aspects such as morale, skills, training, incentivisation, attraction of talent and succession. Other examples of so-called non-financial aspects of company performance include innovation, training, reciprocal relationships with defined stakeholders, management credibility as seen by third parties, technology (as compared with the technology of competitors), internal audit, management information systems, risk management, service standards, productivity levels, benchmarking, etc.
27. What stakeholders are looking for are reports that evidence good stewardship by the directors. While communicating in financial terms is retrospective, this is in a common language that is understandable to all stakeholders. The difficulty with communicating the less defined sustainability, or non-financial aspects is that no universal reporting standard or language has yet been developed.

What shareowners, especially institutional investors want are understandable measurements, to enable them to judge stewardship, performance, conformance and sustainability on a common basis.

28. In the context of all the above, the King Committee considered it appropriate to review corporate governance standards and practices for South Africa against developments that have taken place since the advent of the King Report 1994 in November 1994.
29. Four primary Guiding Principles were established for the purposes of this review:
 - 29.1. to review the King Report 1994 and to assess its currency against developments, locally and internationally, since its publication on 29 November 1994;
 - 29.2. to review and clarify the earlier proposal in the King Report 1994 for an “inclusive approach” for the sustainable success of companies;
 - 29.3. to recognise the increasing importance placed on non-financial issues worldwide, and to consider and to recommend reporting on issues associated with social and ethical accounting, auditing and reporting (“SEAAR”) and safety, health and environment (“SHE”); and
 - 29.4. to recommend how compliance with a new Code of Corporate Governance for South Africa can be measured and based on outcomes, that is, how the success of companies can be measured through the “balanced scorecard” approach for reporting.

companies may lose the trust of those they are attempting to convince, particularly should events subsequently arise where in hindsight it may have been better to have informed investors and other legitimate stakeholders

30. A number of task teams was established to undertake a detailed review of specified areas of corporate governance, namely:
- 30.1. The *Boards and Directors* task team looked into issues regarding board practice, the status and responsibilities associated with executive, non-executive and independent directors, executive and non-executive director remuneration. It also re-visited the “Business Judgment Rule”. This task team was chaired by Roy Andersen.
 - 30.2. The *Accounting and Auditing* task team considered developments surrounding auditing and non-audit services, accounting standards in relation to international developments, auditor skills required for reporting on non-financial aspects and the King Committee’s previous recommendations regarding legal backing for accounting standards in South Africa. This task team was chaired by Malcolm Dunn.
 - 30.3. The *Internal Audit, Control and Risk Management* task team reviewed the role and function of internal audit and the scope and status of the internal auditor in relation to developments since 1994 against international best practice. It also investigated recommendations introducing risk management as a criterion for boards and companies in corporate governance. This task team was chaired by Nigel Payne.
 - 30.4. The *Integrated Sustainability Reporting* task team perhaps had the most compelling brief in that it had to analyse a wide range of complex, and in some cases undefined, areas of reporting of a non-financial nature. Topics ranged from stakeholder engagement to ethics and ethical reporting, as well as societal and transformation issues including black economic empowerment for example. This task team was chaired by Reuel Khoza.
 - 30.5. The *Compliance and Enforcement* task team was required to consider the supervision and enforcement of existing statutory and regulatory provisions governing companies in South Africa and to make recommendations to improve compliance with governance guidelines. This task team was chaired by Michael Katz.¹⁰
31. The task teams, comprising some 50 or so individuals in total, represented a cross-section of South African business and society in both the private and public sectors.
32. Extensive consultation was sought by the task teams themselves, and the draft Report was subject to exhaustive public consultation, both in South Africa and internationally.
33. Many of the observations and recommendations contained in the King Report 1994 remain current and, for completeness and where appropriate, have been repeated in this Report.
34. While it has been noted that some of the recommendations contained in the King Report 1994 have subsequently been superseded by legislation, this should only be seen as addressing the minimum acceptable standards. As society in South Africa has evolved since 1994 through local developments and international

¹⁰ Read with paragraph 40 below

circumstances, it is clear that business in this country continues to be faced with many challenges in a complex environment of political imperatives, globalisation and increasing relevance of stakeholder interests. While this Report attempts to discuss many of these issues, it cannot presume to prescribe the detailed course of conduct for each company and its board. It can only recommend some priorities that directors and boards need to blend into the particular circumstances of the companies for which they are responsible and accountable, so as to derive a balanced scorecard approach to corporate governance standards according to international best practice.

35. The responsibilities of a board under the inclusive approach in the 21st century will be to define the purpose of the company and the values by which the company will perform its daily existence and to identify the stakeholders relevant to the business of the company. The board must then develop a strategy combining all three factors and ensure that management implements this strategy. The board's duty then is to monitor that implementation. The board must also deal with the well-known financial aspects. The key risk areas and the key performance indicators must be identified, as well how those risks are to be managed. In regard to the obligation to report as a going concern, the directors need to ensure that the facts and assumptions they rely on in coming to that conclusion are recorded. The board needs regularly to monitor the human capital aspects of the company in regard to succession, morale, training, remuneration, etc. In addition, the board must ensure that there is effective communication of its strategic plans and ethical code, both internally and externally. The board must see to it that there are adequate internal controls and that the management information systems can cope with the strategic direction in which the company is headed. There must be a "licence to operate" check in language understandable to all those to whom it is communicated.
36. Against this, companies in South Africa must recognise that they co-exist in an environment where many of the country's citizens disturbingly remain on the fringes of society's economic benefits.
37. Hence, it is the King Committee's unanimous view that the inclusive approach is fundamental to doing business in South Africa in order to ensure that companies succeed at balancing economic efficiency and society's broader objectives.
38. Governance in any context reflects the value system of the society in which it operates. Accordingly, it would be pertinent to observe and to take account of the African worldview and culture in the context of governance of companies in South Africa, some aspects of which are set out as follows:¹¹
 - 38.1. Spiritual Collectiveness, is prized over individualism. This determines the communal nature of life, where households live as an interdependent neighbourhood.

¹¹ These principles and philosophies were taken from an article that appeared in *Directorship* (March 2001) titled *African Imperatives and Transformation Leadership* by Shepherd Shonhiwa – a Fellow and a Vice-Chairperson of the Institute of Directors in Southern Africa. In the public comment received by the King Committee, various interpretations were attached to this piece. It is important to recognise the diversity that exists in South Africa in relation to culture, religion, ethnicity, etc. What this attempts to highlight, is the need for companies and boards operating in South Africa to take account of this wide range of value systems and rich diversity in defining its corporate ethos and conduct – both internally and externally

- 38.2. An inclination towards consensus rather than dissension, helps to explain the loyalty of Africans to their leadership.
 - 38.3. Humility and helpfulness to others is more important than criticism of them.
 - 38.4. In the main, African culture is non-discriminatory and does not promote prejudice. This explains the readiness with which Africans embrace reconciliation at political and business levels.
 - 38.5. Co-existence with other people is highly valued. The essence of *ubuntu* (humanity) that cuts across Africa is based on the premise that you can be respected only because of your cordial co-existence with others.
 - 38.6. There is also an inherent trust and belief in fairness of all human beings. This manifests itself in the predisposition towards universal brotherhood, even shared by African-Americans.
 - 38.7. High standards of morality are based on historical precedent. These are bolstered by the close kinship observed through totem or clan names and the extended family system.
 - 38.8. An hierarchical political ideology is based on an inclusive system of consultation at various levels. The tradition of consultation as practised by the chiefs since time immemorial should form the basis of modern labour relations and people management practices.
 - 38.9. Perpetual optimism is due to strong belief in the existence of an omniscient, omnipotent and omnipresent superior being in the form of the creator of mankind.
39. Corporate governance, is essentially about leadership:
- 39.1. leadership for efficiency in order for companies to compete effectively in the global economy, and thereby create jobs;
 - 39.2. leadership for probity because investors require confidence and assurance that the management of a company will behave honestly and with integrity in regard to their shareowners and others;
 - 39.3. leadership with responsibility as companies are increasingly called upon to address legitimate social concerns relating to their activities; and
 - 39.4. leadership that is both transparent and accountable because otherwise business leaders cannot be trusted and this will lead to the decline of companies and the ultimate demise of a country's economy.
40. Monitoring and supervision across the entire spectrum of economic and commercial enterprise is impossible by any measure, and thus the recommendations contained in this Report remain self-regulatory – although conformance can be encouraged in various ways. It is the submission of the King Committee, however, that it would be in the enlightened self-interest of every enterprise to take careful cognisance of the recommendations outlined in this Report and to adhere to these to the extent practicable and applicable.

41. In summary, successful governance in the world of the 21st century requires companies to adopt an inclusive and not an exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the tests of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company also but responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company.

CODE OF CORPORATE PRACTICES AND CONDUCT

1. Application of Code

- 1.1. The Code applies to the following business enterprises (hereinafter referred to as “affected companies”):
 - 1.1.1. All companies with securities listed on the JSE Securities Exchange South Africa.
 - 1.1.2. Banks, financial and insurance entities as defined in the various legislation regulating the South African financial services sector.
 - 1.1.3. Public sector enterprises and agencies that fall under the Public Finance Management Act and the Local Government: Municipal Finance Management Bill (still to be promulgated) including any department of State or administration in the national, provincial or local sphere of government or any other functionary or institution:
 - exercising a power or performing a function in terms of the Constitution or a provincial constitution; or
 - exercising a public power or performing a public function in terms of any legislation, but not including a Court or a judicial officer,unless otherwise prescribed by legislation.
- 1.2. All companies, in addition to those falling within the categories listed above, should give due consideration to the application of this Code insofar as the principles are applicable. Stakeholders interacting with such companies are encouraged to monitor the application by these companies of the principles set out in this Code (to the extent applicable).
- 1.3. While it is acknowledged that certain forms of State enterprises may not lend themselves to some of the principles set out in this Code, it is recommended that the principles should be adapted appropriately by such enterprises. To assist entities falling within this category, National Treasury will be issuing “Good Practice Guides” as official directives in line with the overall framework for financial management for the public sector.
- 1.4. All references to “company” or “companies” in this Code and the accompanying Report should be taken to refer to “affected companies” as defined in 1.1 above.
- 1.5. The Code is a set of principles and does not purport to determine the detailed course of conduct of directors on any particular matter. Clearly, companies and their boards will be required to measure the principles set out in this Code against all other statutes, regulations and other authoritative directives regulating their conduct and operation with a view to applying not only the most applicable requirements but also to seek to

adhere to the best available practice that may be relevant to the company in its particular circumstances.

- 1.6. The Code will be effective in respect of affected companies whose financial years commence on or after 1 March 2002. The Code should be seen as a “living document” that may require to be updated from time to time by the King Committee to ensure the currency of its recommended principles of corporate practices and conduct.

2. **Boards and Directors**

2.1. ***The Board***

- 2.1.1. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and affairs of the company. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board and its directors of their duties and responsibilities.
- 2.1.2. Given the positive interaction and diversity of views that take place between individuals of different skills, experience and background, the unitary board structure with executive and non-executive directors interacting in a working group remains appropriate for South African companies.
- 2.1.3. The board must give strategic direction to the company, appoint the chief executive officer and ensure that succession is planned.
- 2.1.4. The board must retain full and effective control over the company, and monitor management in implementing board plans and strategies.
- 2.1.5. The board should ensure that the company complies with all relevant laws, regulations and codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form.
- 2.1.6. The board should define levels of materiality, reserving specific power to itself and delegating other matters with the necessary written authority to management. These matters should be monitored and evaluated on a regular basis.
- 2.1.7. The board should have unrestricted access to all company information, records, documents and property. The information needs of the board should be well defined and regularly monitored.
- 2.1.8. The board should consider developing a corporate code of conduct that addresses conflicts of interest, particularly relating to directors and management, which should be regularly reviewed and updated as necessary.

- 2.1.9. The board should have an agreed procedure whereby directors may, if necessary, take independent professional advice at the company's expense.
- 2.1.10. Every board should consider whether or not its size, diversity and demographics makes it effective.
- 2.1.11. The board must identify key risk areas and key performance indicators of the business enterprise. These should be regularly monitored, with particular attention given to technology and systems.
- 2.1.12. The board should identify and monitor the non-financial aspects relevant to the business of the company.
- 2.1.13. The board should record the facts and assumptions on which it relies to conclude that the business will continue as a going concern in the financial year ahead or why it will not, and in that case, what steps the board is taking to remedy the situation.
- 2.1.14. The board should ensure that each item of special business included in the notice of the annual general meeting, or any other shareowners' meeting, is accompanied by a full explanation of the effects of any proposed resolutions.
- 2.1.15. The board should encourage shareowners to attend annual general meetings and other company meetings, at which the directors should be present. More particularly, the chairpersons of each of the board's committees, especially the audit and remuneration committees, should be present at the annual general meeting.
- 2.1.16. A brief CV of each director standing for election or re-election at the annual general meeting should accompany the notice contained in the annual report.
- 2.1.17. Every board should have a charter setting out its responsibilities, which should be disclosed in its annual report. At a minimum, the charter should confirm the board's responsibility for the adoption of strategic plans, monitoring of operational performance and management, determination of policy and processes to ensure the integrity of the company's risk management and internal controls, communications policy, and director selection, orientation and evaluation.
- 2.1.18. The board must find the correct balance between conforming with governance constraints and performing in an entrepreneurial way.

2.2. **Board Composition**

- 2.2.1. Companies should be headed by an effective board that can both lead and control the company. 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 so that shareowner interests

(including minority interests) can be protected. An obvious consideration for South African companies would be to consider the demographics in relation to the composition of the board.

- 2.2.2. Procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive directors, of whom the majority should be independent, and be chaired by the board chairperson.
- 2.2.3. Board continuity, subject to performance and eligibility for re-election, is imperative, and a programme ensuring a staggered rotation of directors should be put in place by the board to the extent that this is not already regulated.

2.3. ***Chairperson and Chief Executive Officer***

- 2.3.1. There should be a clearly accepted division of responsibilities at the head of the company, to ensure a balance of power and authority, such that no one individual has unfettered powers of decision-making.
- 2.3.2. The chairperson should preferably be an independent non-executive director.
- 2.3.3. Given the strategic operational role of the chief executive officer, this function should be separate from that of the chairperson.
- 2.3.4. Where the roles of the chairperson and chief executive officer are combined, there should be either an independent non-executive director serving as deputy chairperson or a strong independent non-executive director element on the board. Any such decision to combine roles should be justified each year in the company's annual report.
- 2.3.5. The board should appraise performance of the chairperson on an annual or such other basis as the board may determine. If the roles of chairperson and chief executive officer are combined, then the independent deputy chairperson should play a leading part in the evaluation process.
- 2.3.6. The chairperson, or a sub-committee appointed by the board, should appraise the performance of the chief executive officer. The board should satisfy itself that an appraisal of the chief executive officer is performed at least annually. The results of such appraisal should also be considered by the Remuneration Committee to guide it in its evaluation of the performance and remuneration of the chief executive officer.

2.4. ***Directors***

- 2.4.1. The board should ensure that there is an appropriate balance of power and authority on the board, such that no one individual or block of individuals can dominate the board's decision taking.

- 2.4.2. Non-executive directors should be individuals of calibre and credibility, and have the necessary skill and experience to bring judgment to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standards of conduct and evaluation of performance.
- 2.4.3. In the annual report, the capacity of the directors should be categorised as follows:
- Executive director – an individual that is involved in the day-to-day management and/or is in full time salaried employment of the company and/or any of its subsidiaries.
 - Non-executive director - an individual not involved in the day to day management and not a full-time salaried employee of the company or of its subsidiaries. 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.
 - Independent director – is a non-executive director who:
 - (i) is not a representative of a shareowner who has the ability to control or significantly influence management;
 - (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;
 - (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;
 - (iv) is not a professional advisor to the company or the group, other than in a director capacity;
 - (v) is not a significant supplier to, or customer of the company or group;
 - (vi) has no significant contractual relationship with the company or group; and
 - (vii) 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.

- 2.4.4. A “shadow director” is considered to be a person in accordance with whose directions or instructions (whether they extend over the whole or part of the activities of the company) the directors of the company are accustomed to act. Shadow directors should be discouraged.
- 2.4.5. Executive directors should be encouraged to hold other non-executive directorships only to the extent that these do not interfere with their immediate management responsibilities. Non-executive directors should carefully consider the number of appointments they take in that capacity so as to ensure that the companies on which they serve enjoy the full benefit of their expertise, experience and knowledge.
- 2.4.6. The board should establish a formal orientation programme to familiarise incoming directors with the company’s operations, senior management and its business environment, and to induct them in their fiduciary duties and responsibilities. Directors should receive further briefings from time to time on relevant new laws and regulations as well as on changing commercial risks.
- 2.4.7. New directors with no or limited board experience should receive development and education to inform them of their duties, responsibilities, powers and potential liabilities.
- 2.4.8. Boards should ascertain whether potential new directors are fit and proper and are not disqualified from being directors. Prior to their appointment, their backgrounds should be investigated along the lines of the approach required for listed companies by the JSE and under the Banks Act. The nomination committee would prove useful for this purpose.

2.5. **Remuneration**

- 2.5.1. Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.
- 2.5.2. Companies should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company’s framework of executive remuneration and to determine specific remuneration packages for each of the executive directors. This is, ultimately, the responsibility of the board. This committee must be chaired by an independent non-executive director. In order to obtain his or her input on the remuneration of the other executives the committee should consult the chief executive officer, who may attend meetings by invitation. However, a chief executive should play no part in decisions regarding his/her own remuneration.
- 2.5.3. Membership of the remuneration committee or board committee that considers executive remuneration, must be disclosed in the annual report and the chairperson of such committee should attend annual general meetings to answer any questions from shareowners.

- 2.5.4. Companies should provide full disclosure of director remuneration on an individual basis, giving details of earnings, share options, restraint payments and all other benefits.
- 2.5.5. Performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with those of the shareowners, and should be designed to provide incentives to perform at the highest operational standards.
- 2.5.6. Share options may be granted to non-executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of independence, in some international markets the view is that non-executive directors should preferably receive shares rather than share options.
- 2.5.7. In regard to the allocation of share options, boards should be mindful of the following:
- A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, but should also have regard to the possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing and any perceived impact on their independence.
 - Where it is proposed to re-price share options, this should be the subject of prior shareowner approval. Details of the share options of each executive and non-executive director who stands to benefit from any such proposal should be provided and should be subject to shareowner approval individually for each director.
 - If share options are to be issued at a discount to the ruling price, shareowners should vote separately on this clause in the trust deed at its inception. Any subsequent amendments proposed to an existing trust deed that would permit allocations of share options at a discount must be subject to the specific approval of shareowners.
- 2.5.8. The overriding principle of full disclosure by directors, on an individual basis, should apply to all share schemes and any other incentive schemes proposed by management.
- 2.5.9. It is not considered appropriate that an executive director's fixed-term service contract, if any, should exceed three years. If so, full disclosure of this fact with reasons should be given and the consent of shareowners should be obtained.
- 2.5.10. Companies should establish a formal and transparent procedure for developing a policy on executive and director remuneration

which should be supported by a Statement of Remuneration Philosophy in the annual report.

- 2.5.11. The remuneration or such other similar board committee should play an integral part in the succession planning, particularly in respect of the chief executive officer and executive management.
- 2.5.12. The remuneration committee should consider, and recommend, to the board the fees to be paid to each non-executive director. The proposed fees, as confirmed by the board, should be submitted to the shareowners in general meeting for approval prior to implementation and payment. The practice of paying non-uniform fees to non-executive directors should also be carefully considered. The level of fees should preferably be determined according to the relative contributions of each non-executive director and their participation in the activities of the board and its committees.

2.6. **Board Meetings**

- 2.6.1. The board should meet regularly, at least once a quarter if not more frequently as circumstances require, and should disclose in the annual report the number of board and committee meetings held in the year and the details of attendance of each director (as applicable).
- 2.6.2. Efficient and timely methods should be determined for informing and briefing board members prior to meetings while each board member is responsible for being satisfied that, objectively, they have been furnished with all the relevant information and facts before making a decision.
- 2.6.3. Non-executive directors should have access to management and may even meet separately with management, without the attendance of executive directors. This should, however, be agreed collectively by the board usually facilitated by the non-executive chairperson or lead independent non-executive director.
- 2.6.4. The board should regularly review processes and procedures to ensure the effectiveness of the company's internal systems of control, so that its decision-making capability and the accuracy of its reporting are maintained at a high level at all times.
- 2.6.5. The board should ensure that it receives relevant non-financial information going beyond assessing the financial and quantitative performance of the company, and should look at other qualitative performance factors that involve broader stakeholder interests.

2.7. **Board Committees**

- 2.7.1. Board committees are an aid to assist the board and its directors in discharging their duties and responsibilities, and boards cannot shield behind these committees (see 2.1.1).

- 2.7.2. There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation, to enable the board to properly discharge its duties and responsibilities and to effectively fulfil its decision taking process.
- 2.7.3. Board committees with formally determined terms of reference, life span, role and function constitute an important element of the process in 2.7.2 and should be established with clearly agreed upon reporting procedures and written scope of authority.
- 2.7.4. As a general principle, there should be transparency and full disclosure from the board committee to the board, except where the committee has been mandated otherwise by the board.
- 2.7.5. At a minimum, each board should have an audit and a remuneration committee. Industry and company specific issues will dictate the requirement for other committees.
- 2.7.6. Non-executive directors must play an important role in board committees.
- 2.7.7. All board committees should preferably be chaired by an independent non-executive director, whether this is the board chairperson or some other appropriate individual. Exceptions should be a board committee fulfilling an executive function.
- 2.7.8. Board committees should be free to take independent outside professional advice as and when necessary.
- 2.7.9. Committee composition, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the annual report. The chairpersons of the board committees, particularly those in respect of audit, remuneration and nomination, should attend the company's annual general meeting.
- 2.7.10. Board committees should be subject to regular evaluation by the board to ascertain their performance and effectiveness (see 2.8.1).

2.8. ***Board and Director Evaluation***

- 2.8.1. The board, through its nomination committee or similar board committee, should regularly review its required mix of skills and experience and other qualities such as its demographics and diversity in order to assess the effectiveness of the board. This should be by means of a self-evaluation of the board as a whole, its committees and the contribution of each individual director.
- 2.8.2. The evaluations in 2.8.1 should be conducted at least annually.

2.9. ***Dealings and Securities***

- 2.9.1. Every listed company should have a practice prohibiting dealing in its securities by directors, officers and other selected employees for a designated period preceding the announcement of its

financial results or in any other period considered sensitive, and have regard to the listings requirements of the JSE in respect of dealings of directors.

- 2.9.2. The practice in 2.9.1 should be determined by way of a formal policy established by the board and implemented by the company secretary.

2.10. **Company Secretary**

- 2.10.1. The company secretary, through the board, has a pivotal role to play in the corporate governance of a company.
- 2.10.2. The board should be cognisant of the duties imposed upon the company secretary and should empower the company secretary accordingly to enable him or her to properly fulfil those duties.
- 2.10.3. In addition to extensive statutory duties, the company secretary must provide the board as a whole and directors individually with detailed guidance as to how their responsibilities should be properly discharged in the best interests of the company.
- 2.10.4. The company secretary has an important role in the induction of new or inexperienced directors, and in assisting the chairperson and chief executive officer in determining the annual board plan and the administration of other issues of a strategic nature at the board level.
- 2.10.5. The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of ethics and good governance.
- 2.10.6. The Company secretary should be subjected to a fit and proper test in the same manner as is recommended for new director appointments under 2.4.8.

3. **Risk Management**

3.1. **Responsibility**

- 3.1.1. The board is responsible for the total process of risk management, as well as for forming its own opinion on the effectiveness of the process. Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the company.
- 3.1.2. The board should set the risk strategy policies in liaison with the executive directors and senior management. These policies should be clearly communicated to all employees to ensure that the risk strategy is incorporated into the language and culture of the company.
- 3.1.3. The board must decide the company's appetite or tolerance for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives. The board has the responsibility to ensure

that the company has implemented an effective ongoing process to identify risk, to measure its potential impact against a broad set of assumptions, and then to activate what is necessary to proactively manage these risks.

3.1.4. The board should make use of generally recognised risk management and internal control models and frameworks in order to maintain a sound system of risk management and internal control to provide reasonable assurance regarding the achievement of organisational objectives with respect to:

- effectiveness and efficiency of operations;
- safeguarding of the company's assets (including information);
- compliance with applicable laws, regulations and supervisory requirements;
- supporting business sustainability under normal as well as adverse operating conditions;
- reliability of reporting; and
- behaving responsibly towards all stakeholders.

3.1.5. The board is responsible for ensuring that a systematic, documented assessment of the processes and outcomes surrounding key risks is undertaken, at least annually, for the purpose of making its public statement on risk management. It should, at appropriately considered intervals, receive and review reports on the risk management process in the company. This risk assessment should address the company's exposure to at least the following:

- physical and operational risks;
- human resource risks;
- technology risks;
- business continuity and disaster recovery;
- credit and market risks; and
- compliance risks.

3.1.6. A board committee, either a dedicated committee or one with other responsibilities, should be appointed to assist the board in reviewing the risk management process and the significant risks facing the company.

- 3.1.7. Risk management and internal control should be practiced throughout the company by all staff, and should be embedded in day-to-day activities.
- 3.1.8. In addition to the company's other compliance and enforcement activities, the board should consider the need for a confidential reporting process ("whistleblowing") covering fraud and other risks.

3.2. ***Application and Reporting***

- 3.2.1. A comprehensive system of control should be established by the board to ensure that risks are mitigated and that the company's objectives are attained. The control environment should also set the tone of the company and cover ethical values, management's philosophy and the competence of employees.
- 3.2.2. Risks should be assessed on an on-going basis and control activities should be designed to respond to risks throughout the company. Pertinent information arising from the risk assessment, and relating to control activities should be identified, captured and communicated in a form and timeframe that enables employees to carry out their responsibilities properly. These controls should be monitored by both line management and assurance providers.
- 3.2.3. Companies should develop a system of risk management and internal control that builds more robust business operations. The systems should demonstrate that the company's key risks are being managed in a way that enhances shareowners' and relevant stakeholders' interests. The system should incorporate mechanisms to deliver:
 - a demonstrable system of dynamic risk identification;
 - a commitment by management to the process;
 - a demonstrable system of risk mitigation activities;
 - a system of documented risk communications;
 - a system of documenting the costs of non-compliance and losses;
 - a documented system of internal control and risk management;
 - an alignment of assurance of efforts to the risk profile; and
 - a register of key risks that could affect shareowner and relevant stakeholder interests.
- 3.2.4. The board must identify key risk areas and key performance indicators of the company, and monitor these factors as part of a regular review of processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-

making and the accuracy of its reporting are maintained at a high level at all times.

3.2.5. Reports from management to the board should provide a balanced assessment of significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be covered in the reports, including the impact that they have had, or may have had, on the company and the actions being taken to rectify them.

3.2.6. The board is responsible for disclosures in relation to risk management and should, at a minimum disclose:

- that it is accountable for the process of risk management and the system of internal control, which is regularly reviewed for effectiveness and for establishing appropriate risk and control policies and communicating these throughout the company;
- that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, that has been in place for the year under review and up to the date of approval of the annual report and financial statements;
- that there is an adequate system of internal control in place to mitigate the significant risks faced by the company to an acceptable level. Such a system is designed to manage, rather than eliminate, the risk of failure or maximise opportunities to achieve business objectives. This can only provide reasonable, but not absolute, assurance;
- that there is a documented and tested process in place that will allow the company to continue its critical business processes in the event of a disastrous incident impacting on its activities;
- where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these recommendations. Alternative sources of risk management and internal control assurance applied to these activities should be disclosed, where these exist;
- that any additional information in the annual report to assist understanding of the company's risk management processes and system of internal control should be provided as appropriate; and
- where the board cannot make any of the disclosures set out above, it should state this fact and provide a suitable explanation.

3.2.7. Risk should not only be viewed from a negative perspective. The review process may identify areas of opportunity, such as where

effective risk management can be turned to competitive advantage.

4. Internal Audit

4.1. *Status and Role*

- 4.1.1. Companies should have an effective internal audit function that has the respect and co-operation of both the board and management. Where the board, in its discretion, decides not to establish an internal audit function, full reasons must be disclosed in the company's annual report, with an explanation as to how assurance of effective internal controls, processes and systems will be obtained.
- 4.1.2. Consistent with the Institute of Internal Auditors' ("IIA") definition of internal auditing in an internal audit charter approved by the board, the purpose, authority and responsibility of the internal audit activity should be formally defined.
- 4.1.3. The IIA has succinctly set out the role and function of internal audit in its *Standards for the Professional Practice of Internal Auditing*, including the code of ethics and the definition of internal audit, which is fully endorsed by the King Committee.
- 4.1.4. Internal audit should report at a level within the company that allows it to fully accomplish its responsibilities. The head of internal audit should report administratively to the chief executive officer, and should have ready and regular access to the chairperson of the company and the chairperson of the audit committee.
- 4.1.5. Internal audit should report at all audit committee meetings.
- 4.1.6. The appointment or dismissal of the head of the internal audit should be with the concurrence of the audit committee.
- 4.1.7. If the external and internal audit functions are carried out by the same accounting firm, the audit committee and the board should satisfy themselves that there is adequate segregation between the two functions in order to ensure that their independence is not impaired (see also 6.1.5).

4.2. *Scope of Internal Audit*

- 4.2.1. Internal audit is an independent, objective assurance and consulting activity to add value and improve a company's operations. It helps a company accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
- 4.2.2. An effective internal audit function should provide:

- assurance that the management processes are adequate to identify and monitor significant risks;
 - confirmation of the effective operation of the established internal control systems;
 - credible processes for feedback on risk management and assurance; and
 - objective confirmation that the board receives the right quality of assurance and information from management and that this information is reliable.
- 4.2.3. The internal audit plan should be based on risk assessment as well as on issues highlighted by the audit committee and senior management. The risk assessment process should be of a continuous nature as to identify not only residual or existing but emerging risks and should be conducted formally at least annually, but more often in complex organisations. This risk assessment should be co-ordinated with the board's own assessment of risk.
- 4.2.4. The audit committee should approve the internal audit work plan.
- 4.2.5. The internal audit function should co-ordinate with other internal and external providers of assurance to ensure proper coverage of financial, operational and compliance controls and to minimise duplication of effort.

5. **Integrated Sustainability Reporting**

5.1. ***Sustainability Reporting***

- 5.1.1. Every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. The board must determine what is relevant for disclosure, having regard to the company's particular circumstances.
- 5.1.2. Stakeholder reporting requires an integrated approach. This would be best achieved gradually as the board and the company develop an understanding of the intricate relationships and issues associated with stakeholder reporting. Companies should categorise issues into the following levels of reporting:
- First level would be disclosures relating to acceptance and adoption of business principles and/or codes of practice that can be verified by reference to documents, board minutes or established policies and standards.
 - Second level should address the implementation of practices in keeping with accepted principles involving a review of steps taken to encourage adherence to these principles evidenced by board directors, designated policies and

communiqués, supported by appropriate non-financial accounting mechanisms.

- Third level should involve investigation and demonstration of changes and benefits that have resulted from the adoption and implementation of stated business principles and/or codes of practice.

5.1.3. When making such disclosures, boards will be required to consider the following:

- Clarity on the nature of the disclosing entity, the scope of issues subject to disclosure, performance expectations as an integral aspect of the “going concern” concept, the period under review and the extent to which items disclosed are directly attributable to the company’s own action or inaction.
- Disclosure of non-financial information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines on economic, environmental and social performance.
- Criteria and guidelines for materiality should be developed by each company for consistency, having regard to international models and guidelines, as well as national statutory definitions.

5.1.4. Matters requiring specific consideration should include:

- Description of practices reflecting a committed effort to reducing workplace accidents, fatalities, and occupational health and safety incidents against stated measurement targets and objectives and a suitable explanation where appropriate. This would cover the nature and extent of the strategy, plan and policies adopted to address and manage the potential impact of HIV/AIDS on the company’s activities.
- Reporting on environmental corporate governance must reflect current South African law by the application of the “Best Practicable Environmental Option” standard (defined as that option that has most benefit, or causes the least damage to the environment at a cost acceptable to society).
- Policies defining social investment prioritisation and spending and the extent of initiatives to support black economic empowerment, in particular with regard to procurement practices and investment strategies.
- Disclosure of human capital development in areas such as the number of staff, with a particular focus on progress

against equity targets, achievement of corporate training and development initiatives, age, employee development and financial investment committed. This should also address issues that create the conditions and opportunities for previously disadvantaged individuals, in particular women, to have an equal opportunity to reach executive levels in the company and to realise their full potential. It should include progress made in this regard, and mechanisms to positively reinforce the richness of diversity and the added value and contribution from this diversity.

5.2. ***Organisational Integrity / Code of Ethics***

5.2.1. Every company should engage its stakeholders in determining the company's standards of ethical behaviour. It should demonstrate its commitment to organisational integrity by codifying its standards in a code of ethics.

5.2.2. Each company should demonstrate its commitment to its code of ethics by:

- creating systems and procedures to introduce, monitor and enforce its ethical code;
- assigning high level individuals to oversee compliance to the ethical code;
- assessing the integrity of new appointees in the selection and promotion procedures;
- exercising due care in delegating discretionary authority;
- communicating with, and training, all employees regarding enterprise values, standards and compliance procedures;
- providing, monitoring and auditing safe systems for reporting of unethical or risky behaviour;
- enforcing appropriate discipline with consistency; and
- responding to offences and preventing re-occurrence.

5.2.3. Disclosure should be made of adherence to the company's code of ethics against the above criteria. The disclosure should include a statement as to the extent the directors believe the ethical standards and the above criteria are being met. If this is considered inadequate there should be further disclosure of how the desired end-state will be achieved.

5.2.4. Companies should strongly consider their dealings with individuals or entities not demonstrating its same level of commitment to organisational integrity.

6. Accounting and Auditing

6.1. *Auditing and Non-audit Services*

- 6.1.1. The audit committee should draw up a recommendation to the board for consideration and acceptance by the shareowners for the appointment of the external auditors.
- 6.1.2. The auditors should observe the highest level of business and professional ethics and in particular, their independence must not be impaired in any way.
- 6.1.3. Companies should aim for efficient audit processes using external auditors in combination with the internal audit function.
- 6.1.4. Management should encourage consultation between external and internal auditors. Co-ordination of efforts involves periodic meetings to discuss matters of mutual interest, the exchange of working papers and management letters and reports, and a common understanding of audit techniques, methods and terminology.
- 6.1.5. The audit committee should set the principles for recommending using the accounting firm of the external auditors for non-audit services. In addition to the related Companies Act requirement, there should be separate disclosure of the amount paid for non-audit services with a detailed description in the notes to the annual financial statements of the nature thereof together with the amounts paid for each of the services described.

6.2. *Reporting of Financial and Non-financial Information*

- 6.2.1. The audit committee should consider whether or not an interim report should be subject to an independent review by the external auditor.
- 6.2.2. In the case of an independent review, the audit committee's report commenting on an interim report and the auditors' review report, should be tabled at the board meeting held to adopt the interim report. Where an independent review was not conducted, the audit committee should table the reasons at the board meeting.
- 6.2.3. The board should minute the facts and assumptions used in the assessment of the going concern status of the company at the year end.
- 6.2.4. At the interim reporting stage, the directors should consider their assessment at the previous year end of the company's ability to continue as a going concern and determine whether or not any of the significant factors in the assessment have changed to such an extent that the appropriateness of the going concern assumption at the interim reporting stage has been affected. The board should minute the conclusion reached by the directors at the interim reporting stage.

- 6.2.5. Where non-financial aspects of reporting have been subject to external validation, this fact be stated and details provided in the annual report.
- 6.2.6. Companies should make every effort to ensure that information is distributed via a broad range of communication channels, including the Internet, having regard for its security and integrity while bearing in mind the need that critical financial information reaches all shareowners simultaneously.

6.3. **Audit Committee**

- 6.3.1. The board should appoint an audit committee that has a majority of independent non-executive directors. The majority of the members of the audit committee should be financially literate.
- 6.3.2. The chairperson should be an independent non-executive director and not the chairperson of the board. The better view is that the board chairperson should not be a member of the audit committee at all, but could be invited to attend meetings as necessary by the chairperson of that committee. The board should consider whether or not it is desirable for the chief executive officer to be a member of the audit committee, or to attend only by invitation.
- 6.3.3. The audit committee should have written terms of reference that deal adequately with its membership, authority and duties.
- 6.3.4. Companies should, in their annual report disclose whether or not the audit committee has adopted formal terms of reference and, if so, whether the committee has satisfied its responsibilities for the year, in compliance with its terms of reference.
- 6.3.5. Membership of the audit committee should be disclosed in the annual report. The chairperson of the committee should be available at the annual general meeting to answer questions about its work.

7. **Relations with Shareowners**

- 7.1. Companies should be ready where practicable, to enter into dialogue with institutional investors based on constructive engagement and the mutual understanding of objectives. This should take due regard of statutory, regulatory and other directives regulating the dissemination of information by companies and their directors and officers.
- 7.2. When evaluating a company's corporate governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention and to any specific arrangements to eliminate unnecessary variations in criteria and measurement of performance.
- 7.3. Companies should ensure that each item of special business included in the notice of annual general meeting is accompanied by a full explanation of the effects of a proposed resolution. In the course of the annual general

meeting, as should be the case with other shareowner meetings, the chairperson should provide a reasonable time for discussion.

- 7.4. Companies should consider conducting meetings on the basis of a poll in relation to special business, or where contentious issues are under consideration, in order to ensure that all votes of shareowners (whether in person, by proxy or representation) at company meetings are taken into account. The results of all decisions taken at company meetings should be publicly disseminated, in the most appropriate form, immediately on conclusion of the meeting to ensure that all shareowners (particularly those who were not in attendance or were unable to attend) are promptly informed or at least have ready access to such information.

8. **Communication**

- 8.1. It is the board's duty to present a balanced and understandable assessment of the company's position in reporting to stakeholders. The quality of the information must be based on the principles of openness and substance over form. Reporting should address material matters of significant interest and concern to all stakeholders.
- 8.2. Reports and communications must be made in the context that society now demands greater transparency and accountability from companies regarding their non-financial matters.
- 8.3. Reports should present a comprehensive and objective assessment of the activities of the company so that shareowners and relevant stakeholders with a legitimate interest in the company's affairs can obtain a full, fair and honest account of its performance. In communicating with its stakeholders, the board should take into account the circumstances of the communities in which the company operates.
- 8.4. The directors should report on the following matters in their annual report:
 - 8.4.1. that it is the directors' responsibility to prepare financial statements that fairly present the state of affairs of the company as at the end of the financial year and the profit or loss and cash flows for that period;
 - 8.4.2. that the auditor is responsible for reporting on whether the financial statements are fairly presented;
 - 8.4.3. that adequate accounting records and an effective system of internal controls and risk management have been maintained;
 - 8.4.4. that appropriate accounting policies supported by reasonable and prudent judgments and estimates have been used consistently;
 - 8.4.5. that applicable accounting standards have been adhered to or, if there has been any departure in the interest of fair presentation, this must not only be disclosed and explained but quantified;
 - 8.4.6. that there is no reason to believe the business will not be a going concern in the year ahead or an explanation of any reasons otherwise; and

8.4.7. that the Code of Corporate Practices and Conduct has been adhered to or, if not, where there has not been compliance to give reasons.

9. Implementation of the Code

All boards and individual directors have a duty and responsibility to ensure that the principles set out in this Code are observed.

RECOMMENDATIONS REQUIRING STATUTORY AMENDMENT AND OTHER ACTIONS¹²

1. Urgent liaison should be initiated between the leadership of the business community and the State with a view to determining how the business community can enhance the resources and capacity of the State to handle breaches of criminal law by delinquent directors and officers. In this regard, the role of the State is vital. It is equally essential that the office of the Registrar of Companies be provided with sufficient resources to monitor the implementation of the Companies Act. The resources of the South African Police Services and those of the judicial system also need to be enhanced to ensure that complaints are adequately investigated.
2. An approach should be made to the General Council of the Bar and to the Law Society of South Africa for the use of contingency fees in the context of delinquency in the management of a company in promoting easier access to the law for minority shareowners. The Law Society, South African Law Commission and the Standing Advisory Committee on Company Law should be asked to lobby for the formulation of Rules of Court for the purposes of permitting a more liberal use of class actions.
3. Regulators, including the Financial Services Board, JSE Securities Exchange South Africa, Registrar of Companies, Registrar of Banks and others such as the Auditor-General, should ensure that the rules and regulations of good corporate governance under their control are rigorously enforced with particular reference to enforcing sanctions against delinquent directors.
4. Legislators are encouraged to review the regulations introduced by the Registrar of Banks in regard to directors and corporate governance of banking institutions with a view to some or all of these requirements being extended to the Companies Act as applicable.
5. The office of the Registrar of Companies should be encouraged to establish a register of delinquent directors, being those who have been disqualified from acting as such under the Companies Act. This register should be available on its website, and the list of such directors regularly updated. The Registrar should work in conjunction with other regulators, such as the JSE and FSB with the aim of creating a database of delinquent directors for public information.¹³
6. Section 424 of the Companies Act is a very effective sanction for the punishment of delinquent directors and officers, but proceedings under this provision are both difficult and expensive to implement. Consideration should be given to the means by which section 424 can be more effectively implemented.

¹² It should be noted that these recommendations were identified in the course of the detailed review culminating in the King Report on Corporate Governance for South Africa 2002 and accompanying Code, but which fall outside of the remit of the King Committee. The recommendations, therefore, are offered for consideration. To the extent that any of these recommendations are accepted, the precise construction for their implementation will be a matter for the relevant bodies and/or authorities to determine and is beyond the discretion of the King Committee to prescribe. The King Committee will naturally, as it did with the King Report 1994, monitor and (where requested) participate in the development for implementation of any of these recommendations

¹³ Steps have been initiated by the authorities for the implementation of this proposal following the issue of the draft Report released in July 2001 for public comment

7. While it is important to ensure that the existing quorum threshold for company meetings is sufficient to readily permit access of shareowners to management through this forum, consideration should be given to amending the Companies Act to prescribe a minimum threshold for the passing of ordinary resolutions at a suggested level of at least 25% of the total shares in issue having voting rights (that would align with the existing requirements relating to special resolutions). This would encourage companies to solicit attendance at meetings or receipt of proxies and highlight the need for shareowners to give due consideration to the use of their votes.¹⁴
8. Given the move towards a greater application of information technology to speed up communication and transmission of information, the Companies Act should be reviewed to identify areas where electronic communication would improve governance and communication between companies and their shareowners. A particular area for consideration, in line with developing international practice, is electronic voting by shareowners and the electronic transmission of proxies.¹⁵
9. The Companies Act should be amended to provide for legal backing for accounting standards, approved by the proposed Financial Reporting Accounting Standards Council. In addition, provision should be made for the accounting standard-setting, monitoring and enforcement processes. These should be in line with the recommendations of the Accounting Practices Board and SAICA in terms of the recommendations and structure set out in chapter 3 of Section 5 of the Report. Government is urged to provide the initial funding for these processes of setting and monitoring standards.¹⁶
10. The Companies Act audit requirement should be re-considered for dormant and inactive wholly owned subsidiaries.
11. The Companies Act should be amended to provide for summarised or abbreviated annual financial statements, otherwise termed Concise Financial Reports, to be issued to shareowners, but on the basis that the full set of annual financial statements can be obtained if required.
12. Consideration should be given to amending the Companies Act to require certain categories of private companies to file their annual financial statements with the Registrar of Companies, thus making them available for public inspection.

¹⁴ Considerable public comment was received suggesting that this recommendation was both impractical and unduly onerous. It is the considered view of the King Committee, taking into account these observations, that in an open and transparent governance environment it should be in each company's interest to solicit more active participation by shareowners in company meetings

¹⁵ The Companies Amendment Act (No. 35 of 2001) has introduced provisions permitting electronic communication in certain limited respects, on dates to still be promulgated, including the dissemination of annual reports and financial statements. Specific legislation dealing broadly with electronic communication is being progressed by the authorities arising out of the proposals of the Green Paper released for public comment in 2001

¹⁶ Considerable progress has been achieved by SAICA and the relevant authorities since the release of these recommendations for public comment that will, in due course, lead to the implementation of legislation regulating the legal backing for accounting standards and accompanying review requirements.

13. The question of directors' and officers' liability insurance requires to be revisited, as the current section 247 of the Companies Act is ambiguous and does not fully cover the original King Committee 1994 recommendation.¹⁷
14. Schedule 3 to the Companies Act should be amended to require reference to corporate governance in prospectuses.
15. Current legislation does not require specific disclosures to be made on ethical matters. There is a case for the adoption of measures similar to the US *Federal Sentencing Guidelines* appropriately adapted for the South African situation. In this regard, the Public Finance Management Act should be studied for an example of reporting ethical and disciplinary matters in the public sector.
16. Directors or officers may, by their acts of commission or omission, have contributed to a company's failure. They should be held liable for any conduct leading to a company's failure. Damages against auditors for company failures are becoming a matter of grave concern. Directors and auditors should only be held liable for damages on a basis proportional to their contribution to the failure. Consideration should be given to amending the Apportionment of Damages Act (No. 34 of 1956) accordingly.
17. To encourage best practice and compliance with respect to environmental corporate governance, it is proposed that consideration be given to extending the existing incentives under Section 10(1)(cH)(i) of the Income Tax Act beyond mining operations to all companies, or perhaps at least to those industries considered to be environmentally risky.
18. Institutional shareowners in South Africa have been notable for their apathy towards participating actively in shareowner meetings. Therefore, it is recommended that the bodies representing these institutions look to the steps taken by bodies such as the National Association of Pension Funds and Association of British Insurers in the United Kingdom in setting benchmark standards expected of companies in respect of conformance with good corporate governance.
19. Institutional investors and pension fund managers should make publicly available their voting policies, providing explanations where appropriate, by communicating this information to their own constituencies on a regular basis (probably annually) or by making it accessible to the public at large in line with international standards of practice.
20. The Investment Analysts Society of Southern Africa is encouraged to rate corporate governance performance in their analysis of companies. Shareowner organisations should be encouraged and promoted.
21. Financial markets regulators are urged to provide definitive guidelines, such as those issued by the Financial Services Authority in the United Kingdom, regulating the manner and basis on which communication may occur between investors (specifically institutional) and companies in order to provide a clear guide for market conduct between institutional analysts and investors and companies.

¹⁷

Paragraph 24.7 as read with paragraph 23.3 of the King Report 1994

22. Given the developments internationally around pension fund trustees and their role in the governance process, as well as that of institutions managing such funds, consideration should be given to determining the application of those principles in relation to the South African environment. In particular, it is recommended that investigations should be conducted into establishing that trustees of pension funds have a fiduciary duty to give due consideration to voting the shares in which their funds are invested. Pension funds should, in addition, be obliged to indicate in their Statement of Investment Principles and Policies, or an equivalent document, the extent to which corporate governance issues are taken into consideration in investment decisions relating to funds under their control and/or the extent to which such policies are required to be taken into account by investment managers with whom such funds might have been placed.
23. The business community is encouraged to give every assistance, whether by means of the provision of bursaries or otherwise, to facilitate the development of financial journalism in South Africa as an appropriate monitor of corporate conduct.
24. Institutional investors should be more transparent in their dealings with companies and should be encouraged to demand the highest governance standards.
25. Boards and regulators should be encouraged to censure directors found wanting in their fiduciary obligations.
26. The question of whether the business judgment rule should be statutorily adopted in South Africa should be addressed as part of the overall reform of our corporate legislation.
27. Everyone should view the implementation of qualitative governance standards as a dynamic process. A sub-committee of the King Committee should be established, in conjunction with the Institute of Directors, to monitor the progress of enforcement of the principles embodied in this Report and to address areas where insufficient action has been taken.

SECTION 1 - BOARDS AND DIRECTORS

“The importance of corporate governance lies in its contribution both to business prosperity and to accountability.”

*Paragraph 1.1
Committee on Corporate Governance: Final Report
Hampel Committee, 1998*

Chapter 1

Role and Function of the Board

1. All companies should be headed by an effective board, which can both lead and control the company. It should have executive and non-executive directors (including independent directors) to the extent appropriate. The concept of a unitary board, consisting of executive directors, with their intimate knowledge of the business and non-executive directors who can bring a broader view to the company’s activities, remains the favoured board structure for companies in South Africa. Management of business risk and the exercise of commercial judgment on behalf of the company can be positively enhanced by this mutual association and exchange of business experience and knowledge. The board has a collective responsibility to provide effective corporate governance that involves a set of relationships between the management of the company, its board, its shareowners and other relevant stakeholders, in a manner whereby the board should:
 - 1.1. determine the company’s purpose and values;
 - 1.2. determine the strategy to achieve its purpose (that is, its strategic intent and objectives as a business enterprise) and to implement its values (that is, its organisational behaviour and norms to achieve its purpose) in order to ensure that it survives and thrives;
 - 1.3. exercise leadership, enterprise, integrity and judgment in directing the company so as to achieve continuing prosperity for the company;
 - 1.4. ensure that procedures and practices are in place that protect the company’s assets and reputation;
 - 1.5. monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans;
 - 1.6. ensure that the company complies with all relevant laws, regulations and codes of best business practice;
 - 1.7. ensure that technology and systems used in the company are adequate to run the business properly and for it to compete through the efficient use of its assets, processes and human resources;
 - 1.8. identify key risk areas and key performance indicators of the business enterprise in order for the company to generate economic profit, so as to

enhance shareowner value in the long term (the wider interests of society should at the same time be recognised);

- 1.9. regularly assess its performance and effectiveness as a whole, and that of individual directors, including the chief executive officer, and
 - 1.10. ensure that the company has developed a succession plan for its executive directors and senior management.
2. The board should strive to focus on “performance” in directing the commercial and economic fortunes of the company, and not only concentrate on issues of “conformance”. Enterprise is the disposition to engage in undertakings of risk. Business is the undertaking of risk for reward. The entire board must contribute to that enterprise and thus the board should be constituted in a manner that provides a balance between enterprise and control. All board members must have absolute integrity to meet their onerous obligations and responsibilities.
 3. 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 for minority interests to be protected. The perceived lack of available and sufficiently experienced directors in our economy should not be a reason or excuse for boards not to seek to constitute the majority of their non-executive directors as individuals independent of management and the company. However, the actual proportion and balance of executive, non-executive and independent directors (see paragraph 9.3 of Chapter 4) will often depend on the circumstances and nature of business of each company. It is also important, in considering the balance, that cognisance is taken of gender and racial mix.
 4. The board should be composed of individuals of integrity, who can bring a blend of knowledge, skills, objectivity, experience and commitment to the board under the firm and objective leadership of a chairperson (preferably an independent non-executive director), and who accepts the responsibilities and duties that the post entails, to provide the direction necessary for an effective board.
 5. The board should be able to exercise objective judgment on the corporate affairs of the business enterprise, independent from management but with sufficient management information to enable a proper and objective assessment to be made by the directors collectively. The board should guide and set the pace of the company’s current operations and future developments. In so doing, the board should regularly review and evaluate the present and future strengths, weaknesses and opportunities of, and threats to, the company. Comparisons with competitors, locally and internationally, and best practice are important ingredients in this process – especially in the era of the global economy and the rapid transmission of information electronically.
 6. Transactions between the company and its managers, directors or large/dominant shareowners are rife with potential conflicts of interest. The personal interests of a director, or persons closely associated with the director, must not take precedence over those of the company and its shareowners. A director should avoid conflicts of interest, even where these could be perceived to be as such. Full and timely disclosure of any conflict, or potential conflict, must be made known to the board. Where an actual or potential conflict does arise, on declaring their interest, a director can participate in the debate and/or vote on the matter but must give careful consideration to their own integrity in such

circumstances and the potential consequences it may have for the board, company and themselves personally. In the extreme case of continuing material conflict of interest, the director might consider resigning from the board. Any director who is appointed to a board at the instigation of a party with a substantial interest in the company, such as a major shareholder or a substantial creditor or significant supplier or advisor, should recognise the potential for a conflict of interest and accept that their primary duty and responsibility is to always act in the interests of the company.

7. The board, in motivating management and employees effectively and productively, should promote a culture that supports enterprise and innovation with appropriate short- and long-term performance-related rewards that are fair and achievable. It is imperative that the board seeks to drive the business enterprise proficiently through proper and considered decision-making processes, and recognises entrepreneurial endeavour amongst its management without contravening laws and regulations. A particularly important role the board can play is to identify stakeholders with a relevant interest in the company's activities and to ensure that the company develops reciprocal relationships with these parties.
8. Boards should recognise that companies do not act independently from the societies in which they operate. Accordingly, corporate actions must be compatible with societal objectives concerning social cohesion, individual welfare and equal opportunities for all. At times, however, there may well be a trade-off between short-term social costs in respect of decisions that will derive longer term benefits for the company and thereby those having an interest in it. Nonetheless, this presents some intricate and complex challenges that require to be balanced carefully by a competent board. This does not remove the fundamental tenet, in law, that the board is accountable to the company for the performance of the business, but all the same the modern inclusive approach expects a company to act responsively to and responsibly towards relevant stakeholders.
9. The board should determine a policy for the frequency, purpose, conduct and duration of its meetings and those of its formally established committees. It should also adopt efficient and timely methods for informing and briefing board members before meetings. The information needs of the board should be well defined and regularly monitored. Each board member should be allowed to play a full and constructive role in its affairs and has a responsibility to be satisfied that the board has been furnished with all the relevant information before making a decision. While boards have traditionally met at least once a quarter, there is increasing evidence that this is no longer sufficient given the substantial demands now placed on directors and particularly non-executive directors. The result is that boards of larger and more complex organisations meet as often as six to eight times a year – based on up to five formally scheduled meetings and another two or so special ones convened to consider specific matters.
10. The board should define its own levels of materiality, reserving specific powers to itself and delegating other matters to management with the necessary written authority. Any such delegations by the board must have due regard for the directors' statutory and fiduciary responsibilities to the company, while taking into account strategic and operational effectiveness and efficiencies.
11. The strategies, policies, mutually agreed management performance criteria and business plans of the company must be clearly defined and reliably measurable.

Each aspect requires a comprehensive assessment against accurate and relevant financial and non-financial information as appropriate, and should be obtained from the company's own internal reporting systems as well as from external sources so that an informed assessment can be made of all issues facing the board and the company. Accordingly, the board should ensure that internal control procedures provide reliable and valid information for monitoring and evaluation. Internal controls include not only financial matters but also operational and compliance controls and management of the business risk associated with the company. This is dealt with in more detail elsewhere in this Report see Sections 2 and 3.

Recommendations

- Every board should have a charter setting out its responsibilities, which should be disclosed in its annual report. At a minimum, the charter should confirm the board's responsibility for the adoption of strategic plans, monitoring of operational performance and management, determination of policy and processes to ensure the integrity of the company's risk management and internal controls, communications policy, and director selection, orientation and evaluation.
- The board should determine the company's purpose, values and stakeholders relevant to the business of the company and develop strategies combining all three elements. The board should ensure that procedures are in place to monitor and evaluate the implementation of its strategies, policies, senior management performance criteria and business plans.
- In directing the company the board should exercise leadership, enterprise, integrity and judgment based on fairness, accountability, responsibility and transparency.
- Given the positive interaction and diversity of views that takes place between individuals of different skills, experience and background, the unitary board structure with executive and non-executive directors remains appropriate for South African companies.
- The board must give strategic direction to the company, appoint the chief executive officer and ensure that succession is planned.
- The board must retain full and effective control over the company, and monitor management in carrying out board plans and strategies.
- Companies should be headed by an effective board that can both lead and control the company. 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 for shareowner interests (including minority interests) to be protected. An obvious consideration for South African companies would be to consider the demographics in relation to the composition of the board.

Recommendations continued

- The board should ensure that the company complies with all relevant laws, regulations and codes of best business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form.
- The board should regularly review processes and procedures to ensure the effectiveness of the company's internal systems of control, so that its decision-making capability and the accuracy of its reporting are maintained at a high level at all times.
- The board should meet regularly, at least once a quarter if not more frequently as circumstances require, and should disclose in the annual report the number of board and committee meetings held in the year and the details of attendance of each director (as applicable).
- The board should define levels of materiality, reserving specific powers to itself and delegating other matters with the necessary written authority to management. These matters should be monitored and evaluated on a regular basis.
- The board should have unrestricted access to all company information, records, documents and property. The information needs of the board should be well-defined and regularly monitored.
- The board should consider developing a corporate code of conduct that addresses conflicts of interest, particularly relating to directors and management, which should be regularly reviewed and updated as necessary.
- The board should have an agreed procedure whereby directors may, if necessary, take independent professional advice at the company's expense.
- Efficient and timely methods should be determined for informing and briefing board members prior to meetings while each board member is responsible for being satisfied that, objectively, they have been furnished with all the relevant information and facts before making a decision.
- Every board should consider whether or not its size, diversity and demographics makes it effective.
- Non-executive directors should have access to management and may even meet separately with management, without the attendance of executive directors. This should, however, be agreed collectively by the board usually facilitated by the non-executive chairperson or lead independent non-executive director.

Recommendations continued

- The boards should ensure that each item of special business included in the notice of annual general meeting, or any other shareowners' meeting, is accompanied by a full explanation of the effects of any proposed resolutions.
- The board should encourage shareowners to attend annual general meetings, at which the directors should be present, and more particularly the chairpersons of each of the board's committees – especially the audit and remuneration committees.
- A brief CV of each director standing for election or re-election at the annual general meeting should accompany the notice contained in the annual report.
- The board must identify key risk areas and key performance indicators of the business enterprise. These should be regularly monitored, with particular attention given to technology and systems.
- The board should identify and monitor the non-financial aspects relevant to the business of the company.
- The board should record the facts and assumptions on which it relies to conclude that the business will continue as a going concern in the financial year ahead or why it will not, and in that case, the steps the board is taking.
- The board must find the correct balance between conforming with governance constraints and performing in an entrepreneurial way.

Chapter 2

Role and Function of the Chairperson

1. As dealt with in chapter 1, all boards should be subject to the firm and objective leadership of a chairperson who brings out the best in each director.
2. The chairperson's primary function is to preside over meetings of directors and to ensure the smooth functioning of the board in the interests of good governance. The chairperson will usually also preside over the company's shareowner meetings.
3. The role and function of the chairperson will be influenced by such matters as the size or particular circumstances of the company, the complexity of its operations, the qualities of the chief executive officer (to the extent that the positions are separated), the management team, and the skills and experience of each board member. There are a number of common, core functions performed by the chairperson, which usually include:
 - 3.1. providing overall leadership to the board without limiting the principle of collective responsibility for board decisions;

- 3.2. actively participating in the selection of board members, as well as overseeing a formal succession plan for the board, chief executive officer and senior management;
 - 3.3. arranging for new directors appointed to the board to be properly inducted and oriented, and monitoring and evaluating board and director appraisals;
 - 3.4. determining, normally in conjunction with the chief executive officer and the company secretary, the formulation of an annual work plan for the board against agreed objectives and goals, as well as playing an active part in setting the agenda for board meetings;
 - 3.5. acting as the main informal link between the board and management, and particularly between the board and the chief executive officer;
 - 3.6. maintaining relations with the company's shareowners and perhaps, some of its important stakeholders, although the latter may be more in the nature of an operational issue to be conducted by the chief executive officer and the senior management team;
 - 3.7. ensuring that all directors play a full and constructive role in the affairs of the company and taking a lead role in removing non-performing or unsuitable directors from the board; and
 - 3.8. ensuring that all the relevant information and facts, objectively speaking, are placed before the board to enable the directors to reach an informed decision.
4. While recognising that there may be circumstances justifying the combination of the roles of chairperson and chief executive officer, in principle it is better that these two distinctive functions are kept separate. The chairperson is primarily responsible for the working of the board. This position is made more onerous by the complex environment in which many modern companies now operate. The chief executive officer's task is to run the business and to implement the policies and strategies adopted by the board.
 5. If it is deemed appropriate to combine the roles of chairperson and chief executive officer, then the company must explain the reason in its annual report and demonstrate that the necessary governance controls are in place. Reasons may include the deputy chairperson being an independent non-executive director or the board may have a substantial majority of non-executive directors providing a strong independent element.

Recommendations

- There should be a clearly accepted division of responsibilities at the head of the company to ensure a balance of power and authority, so that no one individual has unfettered powers of decision-making.
- The chairperson should preferably be an independent non-executive director.

Recommendations continued

- Where the roles of the chairperson and chief executive officer are combined, there should be either an independent non-executive director serving as deputy chairperson or a strong independent non-executive director element on the board, and any such decision to combine roles should be justified each year in the company's annual report.
- The board should appraise the performance of the chairperson on an annual or such other basis as the board may determine. If the roles of chairperson and chief executive officer are combined, then the independent deputy chairperson must play a leading part in the evaluation process.

Chapter 3

Role and Function of the Chief Executive Officer

1. The chief executive officer has a critical and strategic role to play in the operational success of a company's business. For this reason, as already indicated, the role of the chief executive officer should be separate from that of the chairperson.
2. Some of the important functions that a chief executive officer fulfils are usually to:
 - 2.1. develop and recommend to the board a long-term strategy and vision for the company that will generate satisfactory levels of shareowner value and positive, reciprocal relations with relevant stakeholders;
 - 2.2. develop and recommend to the board annual business plans and budgets that support the company's long-term strategy;
 - 2.3. strive consistently to achieve the company's financial and operating goals and objectives, and ensure that the day-to-day business affairs of the company are appropriately monitored and managed;
 - 2.4. ensure continuous improvement in the quality and value of the products and services provided by the company, and that the company achieves and maintains a satisfactory competitive position within its industry(ies);
 - 2.5. ensure that the company has an effective management team and to actively participate in the development of management and succession planning (including the chief executive officer's own position);
 - 2.6. formulate and oversee the implementation of major corporate policies; and
 - 2.7. serve as the chief spokesperson for the company.
3. The chief executive officer should also maintain a positive and ethical work climate that is conducive to attracting, retaining and motivating a diverse group of top-quality employees at all levels of the company. In addition, the chief

executive officer is expected to foster a corporate culture that promotes ethical practices, encourages individual integrity, and fulfils social responsibility objectives and imperatives.

Recommendations

- Given the strategic operational role of the chief executive officer, this function should be separate from that of the chairperson.
- The chairperson, or a sub-committee appointed by the board, should appraise the performance of the chief executive officer. The board should satisfy itself that an appraisal of the chief executive officer is performed at least annually. The results of such appraisal should also be considered by the Remuneration Committee to guide it in its evaluation of the performance and remuneration of the chief executive officer.

Chapter 4

Role of the Executive and Non-Executive Director

1. All directors, both executive and non-executive, are bound by fiduciary duties and duties of care and skill. Non-executive directors perform such duties intermittently and have less regular access to the books and records of the company than do executive directors. Executive directors, on the other hand, must always manage the conflict between their management responsibilities and their fiduciary duties as a director in the best interests of the company. Non-executive directors play a particularly important role in providing independent judgment in such circumstances.
2. Some general guidelines require that directors:
 - 2.1. must ensure that they have the time to devote to properly carry out their responsibilities and duties to the company;
 - 2.2. must exercise the utmost good faith, honesty and integrity in all their dealings with or on behalf of the company and must act independently of any outside fetter or instruction;
 - 2.3. must, in line with modern trends worldwide, not only exhibit the degree of skill and care as may be reasonably expected from persons of their skill and experience (which is the traditional legal formulation), but must also:
 - exercise both the care and skill any reasonable persons would be expected to show in looking after their own affairs as well as having regard to their actual knowledge and experience; and
 - qualify themselves on a continuous basis with a sufficient (at least a general) understanding of the company's business and the effect of the economy so as to discharge their duties properly, including where necessary relying on expert advice;

- 2.4. must always act in the best interests of the company and never for any sectoral interest;
 - 2.5. must never permit a conflict of duties and interests and must disclose potential conflicts of interest at the earliest possible opportunity;
 - 2.6. must be informed about the financial, industrial and social milieu in which the company operates;
 - 2.7. must be satisfied that they are in a position to take informed decisions;
 - 2.8. must treat any confidential matters relating to the company, learned in their capacity as a director, as strictly confidential and not divulge them to anyone without the authority of the company;
 - 2.9. must insist that board papers and other important information regarding the company are provided to them in time for them to make informed decisions;
 - 2.10. must ensure that procedures and systems are in place to act as checks and balances on the information being received by the board and ensure that the company prepares annual budgets and regularly updated forecasts against which the company's performance can be monitored;
 - 2.11. must be diligent in discharging their duties to the company, regularly attend all meetings and must acquire a broad knowledge of the business of the company so that they can meaningfully contribute to its direction;
 - 2.12. must be prepared and able, where necessary, to express disagreement with colleagues on the board including the chairperson and chief executive officer;
 - 2.13. must act with enterprise for and on behalf of the company and always strive to increase shareowners' value, while having regard for the interests of all stakeholders relevant to the company; and
 - 2.14. must, if in doubt about any aspect of their duties, obtain independent professional advice at the earliest opportunity.
3. An executive director is generally taken to be an individual in the full-time employment of the company with executive functions. On the other hand, the non-executive directors should be free from any major business relationship with the company and should fulfil their duties intermittently at board meetings and any other meetings of the company that they are required to attend.
 4. Non-executive directors bring an external judgment on issues of strategy, performance, resources and standards of conduct and evaluation of performance to the board. Courage, wisdom and independence should be the hallmark of any non-executive director acting in the best interests of the company. The role and function of a non-executive director is increasingly onerous and demanding.
 5. Given the circumstances prevailing at the time, the King Report 1994 determined a more lenient definition of "non-executive" director than that adopted internationally. Corporate South Africa should, however, aim to match international best practice.

6. The law does not recognise the distinction between executive and non-executive director. Every director has a legal duty to act independently, in good faith, with due care and skill, and without fetter or instruction. The labels of executive, non-executive and independent non-executive have evolved in practice. The third label applies to those directors who are not in the employ of the company, do not participate in day-to-day management and are perceived as independent because they do not contract with the company or advise the company professionally. Nor do they represent a dominant shareowner.
7. Accordingly, the following have been re-defined:

7.1. ***Executive director***

An individual involved in the day-to-day management and/or in the full-time salaried employment of the company and/or any of its subsidiaries.

7.2. ***Non-executive director***

An individual not involved in the day to day management and not a full-time salaried employee of the company or of its subsidiaries. An individual in the full-time employment of the holding company or of 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.

7.3. ***Independent director***

Is a non-executive director who:

- is not a representative of a shareowner who has the ability to control or significantly influence management;
- 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;
- 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;
- is not a professional advisor to the company or the group, other than in a director capacity;
- is not a significant supplier to, or customer of the company or group;
- has no significant contractual relationship with the company or group; and
- is free from any business or other relationship that could be seen to materially interfere with the individual's capacity to act in an independent manner.

Companies should categorise their directors in the annual report according to the above criteria.

8. Executive directors should be encouraged to take other non-executive directorships, provided these are not detrimental to their immediate responsibilities as an executive director of the company. On the other hand, non-executive directors should be judicious in the number of directorships they accept, in order to ensure that they do full justice to their onerous and demanding responsibilities. On this point, the IoD is commended for the efforts it has undertaken in director development and education and is urged to engage organised business in extending its programmes, particularly in mentoring inexperienced directors.
9. The practice in the United Kingdom, in particular, of appointing a senior independent or “lead” director should be considered by boards in South Africa. This individual fulfils an important role where any difficulties or conflicts arise between the non-executive component on the board and the executives, as well as in assisting the chairperson in fulfilling his or her tasks when required. This director should have strong leadership qualities, as well as highly developed communication skills. Such an appointment should be considered where the roles of the chairperson and chief executive officer are combined, or even where both the chairperson and deputy chairperson might be executive directors.
10. The appointment of a senior independent non-executive director will also be an effective governance tool, for example, in the following situations:
 - 10.1. during the annual performance evaluation of the chairperson;
 - 10.2. whenever the chairperson is in need of support to ensure the effective functioning of the board;
 - 10.3. when serious disagreements arise between executive and non-executive directors; and
 - 10.4. whenever a serious disagreement arises between the auditors and management, which could not be resolved by the audit committee.
11. After due and careful consideration, it is the view of the King Committee that companies should disclose the earnings, share options, restraint payments and all other benefits of each individual director.
12. Companies should include a “Statement of Remuneration Philosophy” in their annual report and financial statements so that shareowners and stakeholders can comprehend the board’s policy and motivation in setting remuneration for directors in a particular way or mix. The statement should also incorporate the criteria used for remunerating executive directors approaching retirement.
13. Another area where there can be abuse, and which requires full disclosure, relates to severance arrangements where special terms may have been negotiated with executive directors and senior management for special payments often triggered by takeover and merger actions or any other circumstances where such individuals might enjoy a preferential payout for termination (or potential termination) of service. It would be constructive for the shareowners to be aware

of such arrangements, or where such arrangements have come to light in the absence of disclosure in the circumstances mentioned previously.

14. Companies worldwide are moving towards granting shares as part of their remuneration package or share options to non-executive directors. This is based on the premise that entitlement to, or ownership of shares in the company of which the non-executive is a director would positively align the individual with the interests of the shareowners.
15. As executive directors usually receive share options in their capacity as employees of the company, it is recommended that any proposed allocations to non-executive directors individually, should be put to the annual general meeting for approval by shareowners. The allocation of share options to non-executive directors should, accordingly, be left to the shareowners' discretion and approval in strict compliance with sections 222 and 223 of the Companies Act. However, because of the apparent dilution of "independence", in some international markets the view is that non-executive directors should preferably receive shares rather than share options as this is seen to more closely align their interests with shareowners than the allocation of share options.
16. In regard to the allocation of share options, boards should be mindful of the following:
 - 16.1. A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, but should also have regard to the possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing and any perceived impact on their independence.
 - 16.2. Where it is proposed to re-price share options, this should be the subject of prior shareowner approval. Details of the share options of each executive and non-executive director who stands to benefit from any such proposal should be provided and should be subject to shareowner approval individually for each director.
 - 16.3. If share options are to be issued at a discount to the ruling price, shareowners should vote separately on this clause in the trust deed creating the share scheme at its inception. Any subsequent amendments to an existing trust deed that would permit allocations of share options at a discount must be subject to the specific approval of shareowners.
17. Another overseas practice is the purchase by companies of shares on behalf of their non-executive directors out of the proceeds of the fees due to them. However, this is often facilitated by favourable fiscal incentives that are not presently relevant in South Africa.
18. The overriding principle, in regard to directors remuneration, must be full disclosure on an individual basis of all payments, benefits and incentives received from or in respect of:
 - 18.1. the company;
 - 18.2. any subsidiary of the company; and

- 18.3. any company on which the director serves as a representative of the company.

Furthermore, the disclosure should indicate the extent to which remuneration from a subsidiary or as a representative is retained by the individual and how much is paid over to the company of which the person is an executive director.

19. The practice of remuneration committees, now increasingly constituted as a committee considering wider human resources issues, remains an inherent constituent of board governance in relation to the remuneration of executive directors and other senior management. In this regard, too, South African practice should align with international best practice that requires such committees to comprise only independent non-executive directors. Chief executive officers could also sit as members of such committees, or at least be invited to provide input on issues surrounding executive pay and performance, but must be absent from any discussions relating to their own packages.
20. Generally though, while levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, companies are urged to consider structuring a proportion of the executive directors' remuneration in a manner that more directly rewards corporate and individual performance of the executive director. Moreover, while the King Report 1994 previously indicated that an executive director's service contract (if any) should not exceed five years in duration, this is considered excessive in terms of contemporary best practice and that this should desirably not exceed three years without full disclosure and explanation and subjected to the approval of shareowners.

Recommendations

- The board should ensure that there is an appropriate balance of power and authority on the board, such that no one individual or block of individuals can dominate the board's decision taking.
- Non-executive directors should be individuals of calibre and credibility, and have the necessary skill and experience to bring judgment to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standards of conduct, and evaluation of performance.
- In the annual report, the capacity of the director should be categorised as follows:
 - Executive director – an individual that is involved in the day-to-day management and/or is in full time salaried employment of the company and/or any of its subsidiaries.

Recommendations continued

- Non-executive director - an individual not involved in the day to day management and not a full-time salaried employee of the company or its subsidiaries. An individual in the full-time employment of the holding company or of 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.
- Independent director – is a non-executive director who:
 - (i) is not a representative of a shareowner who has the ability to control or significantly influence management;
 - (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;
 - (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;
 - (iv) is not a professional advisor to the company or the group, other than in a director capacity;
 - (v) is not a significant supplier to, or customer of the company or group;
 - (vi) has no significant contractual relationship with the company or group; and
 - (vii) 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.
- A “shadow director” is considered to be a person in accordance with whose directions or instructions (whether they extend over the whole of part of the activities of the company), the directors of the company are accustomed to act. Shadow directors should be discouraged.
- Executive directors should be encouraged to hold other non-executive directorships only to the extent that these do not interfere with their immediate management responsibilities. Non-executive directors should carefully consider limiting the number of appointments they take in that capacity in order to ensure that the companies on which they serve enjoy the full benefit of their expertise, experience and knowledge.

Recommendations continued

- Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board.
- Companies should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company's framework of executive remuneration and to determine specific remuneration packages for each of the executive directors. This is ultimately, the responsibility of the board. This committee must be chaired by an independent non-executive director. In order to obtain input on the remuneration of the other executives the committee should consult the chief executive officer, who may attend meetings by invitation. However, a chief executive should play no part in decisions regarding his/her own remuneration.
- Membership of the remuneration committee or board committee that considers executive remuneration, must be disclosed in the annual report and the chairperson of such committee should attend annual general meetings to answer any questions from shareowners.
- Companies should provide full disclosure of director remuneration on an individual basis, giving details of earnings, share options, restraint payments and all other benefits.
- Performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with the shareowners, and should be designed to provide incentives to perform at the highest operational standards.
- Share options may be granted to non-executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of "independence", in some international markets the view is that non-executive directors should preferably receive shares rather than share options.
- In regard to the allocation of share options, boards should be mindful of the following:
 - A vesting period in relation to the allocation of share options to non-executive directors should be applied to dissuade short-term decision taking, but should also have regard to the possibility or consequences of the removal or resignation of such directors prior to the vesting period maturing and any perceived impact on their independence.

Recommendations continued

- Where it is proposed to re-price share options, this should be the subject of prior shareowner approval. Details of the share options of each executive and non-executive director who stands to benefit from any such proposal should be provided and should be subject to shareowner approval individually in respect of each director.
- If share options are to be issued at a discount to the ruling price, shareowners should vote separately on this clause in the trust deed at its inception. Any subsequent amendment's proposed to an existing trust deed that would permit allocations of these options at a discount must be subject to the specific approval of shareowners.
- The overriding principle of full disclosure by directors, on an individual basis, should apply to all share schemes and any other incentive schemes proposed by management.
- It is not considered appropriate that an executive director's fixed-term service contract, if any, should exceed three years. If so, full disclosure of this fact with reasons should be given, and the consent of shareowners should be sought.
- Companies should establish a formal and transparent procedure for developing a policy on executive remuneration, which should be supported by a Statement of Remuneration Philosophy in the annual report.
- The remuneration or such other similar board committee will play an integral part in succession planning, particularly in respect of the chief executive officer and executive management.
- Every listed company should have a practice prohibiting dealing in its securities by directors, officers and other selected employees for a designated period preceding the announcement of its financial results or in any other period considered sensitive, and have regard to the listings requirements of the JSE in respect of dealings of directors. This should be determined by way of a formal policy established by the board and implemented by the company secretary.

Chapter 5

Director Selection and Development

1. Shareowners are responsible ultimately for electing or removing board members, and it is in their interests that the board is properly constituted. In practice, the board as a whole usually plays a major role in selecting its own members, and should accordingly plan for its own continuity and succession.

2. In order for boards properly to discharge their responsibilities, there should be an effective programme of continuing rotation of appointments in respect of each individual director. Accordingly, all companies should adopt a process of staggered continuity and re-election of their boards to ensure a continuity of experience and knowledge.
3. The board should accordingly select, appoint, induct, develop and remove board members as and when necessary. Incompetent or unsuitable directors (including those who fail to attend meetings without proper explanation) should be removed, taking relevant legal and other matters into consideration, with the chairperson usually leading the process.
4. While the King Committee was previously not disposed towards nomination committees, there is evidence to suggest that, in appropriate circumstances, such a body can provide a useful forum in which to assist the board to identify suitable candidates for consideration. This should be managed by enquiring about the skills needed on the board to add value to the processes of the board in the context of the business of the company. In looking at the skills mix for a board, there are three dimensions of board effectiveness requiring consideration. That is, the knowledge or information required to fill a significant gap on the board, the capacity of an individual to influence preferred outcomes (internally and externally) through their involvement on the board, and the extent to which an individual has the opportunity or availability to meaningfully contribute their time and abilities to the affairs of the board.
5. Such a committee could fulfil some broader functions by maximising the collective wisdom of the non-executive directors serving on the committee (which should comprise a majority of independent non-executive directors). Increasingly, the nominating process for new directors has been incorporated into a board committee dealing with a range of corporate governance issues referred to it by the board, and not covered by other specialist committees such as the audit committee. The name of such a committee could simply be the Corporate Governance Committee.
6. Amongst its other functions, such a committee might annually review the required mix of skills and experience and other qualities required on the board, and oversee a process for assessing the effectiveness of the board as a whole, its committees and the contribution of each individual director. This is dealt with more fully in chapter 6.
7. New directors appointed to the board should be made familiar with the company's operations, senior management and its business environment, be made aware of their fiduciary duties and responsibilities, and of the board's and chairperson's expectations. Since their responsibility carries with it significant personal liability, new directors with no board experience should receive the relevant education and development.
8. An appropriate induction of a director contributes to ensuring that a company should always have a well-informed and competent board. Although this is usually the responsibility of the chairperson, the task should be delegated to the company secretary. The programme should meet the specific needs of both the company and the individual, and should enable any new director to make the maximum contribution as quickly as possible.

9. When a senior manager becomes a director, he or she needs to take a longer and broader view of the company's activities and relationships with external stakeholders. Experienced, independent non-executive directors should guide new executive directors on the importance of independence from their employment, and the need for intellectual honesty and unfettered discretion, in their function as a director.
10. It is important that areas where there is a lack of knowledge be discussed prior to any training or mentoring. All directors should be provided with details of any key roles or functions that are expected of them. Their contribution and reporting to the board will be measured against fiduciary obligations.
11. Mentorship under an experienced director can clarify the dynamics and subtle nuances of the workings of a board.
12. Annual performance appraisals can provide the basis for identifying future training needs and, where necessary, explain why a re-appointment may not be appropriate (see Chapter 6).
13. All directors must keep up to date on industry and legal developments. The company secretary should regularly circulate updates on legal and corporate governance issues to directors, including in the board pack, so that there is an appropriate forum for discussion if required.

Recommendations

- Procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, assisted where appropriate by a nomination committee. This committee should constitute only non-executive directors, of whom the majority should be independent, and be chaired by the board chairperson.
- Board continuity, subject to performance and eligibility for re-election, is imperative, and a programme ensuring a staggered rotation of directors should be put in place by the board to the extent that this is not already regulated.
- The board should establish a formal orientation programme to familiarise incoming directors with the company's operations, senior management and its business environment, and to induct them in their fiduciary duties and responsibilities. Directors should receive further briefings from time to time on relevant new laws and regulations as well as on changing commercial risks.
- New directors with no or limited board experience should receive development and education to inform them of their duties, responsibilities, powers and potential liabilities.
- The company secretary, in consultation with the chairperson, should play a substantial role in the orientation process for directors, and in attending to any educational or development requirements.

Chapter 6**Board and Director Appraisal**

1. Companies must have controls in place to promote their continued survival and profitability. As this is a function of the board, it makes sense for the board to be part of the monitoring and evaluation process.
2. Institutional investors are starting to insist on annual board reviews. According to the Russell Reynolds Association survey (1997) conducted in the United States *“the quality of the company’s board has now become an important evaluation factor for institutional investors”*. While it is difficult to prove a direct link between a board’s effectiveness and the company’s profits, a board that knows it will be regularly monitored is more likely to focus its attention on good corporate governance issues. Once this is entrenched in the company’s culture, it is difficult for a chief executive officer or any director to dominate a board or avoid being held accountable for poor performance.
3. Effective and meaningful evaluation is only possible once the board has determined its own functions and identified the key roles and performance standards for directors. Key roles for executive and non-executive directors would be different.
4. The non-executive director would be expected to contribute to establishing strategic direction, to bring experience and/or specific knowledge to discussions and to influence key decisions. The measurement would be the effectiveness in each role against the importance of that role within the board. The key roles for executive directors are easier to measure.
5. Directors should be assessed both individually, and collectively as a board.
6. Formal evaluations should be conducted by the chairperson and, if peer reviews are in place for executive management, these should be extended to director level. The chairperson should ensure that the directors know that they will be the subject of a review, the criteria used for assessment and the procedure that will be followed. A series of assessment questions should be distributed in time for directors to complete prior to any meeting with the chairperson.
7. Performance evaluations should take place towards the end of the financial year and be reviewed by the nomination committee or such similar committee of the board. This is the most appropriate place, as it forms part of the process of succession planning referred to earlier, but it would be useful for the remuneration committee to be briefed on any issues that may be pertinent to the performance of an executive director.
8. If a deficiency has been identified, a plan should be developed and implemented for the director to acquire the necessary skills or behaviour patterns. It is important that director evaluation be approached in an open, constructive and non-confrontational manner and that this should be a two-way process.
9. The assessment questions should also include evaluation of the chairperson and chief executive officer. The action plan arising out of the assessment should be reported and discussed with the nomination committee. Thereafter, a consolidated summary of the whole process should be reported to the full board.

This will also form the basis for the board to identify key objectives for the effective functioning of the board for the subsequent year.

10. While individual evaluations should be conducted annually, an assessment of the functioning of the board could be undertaken less frequently, particularly if the composition of the board is stable. An appropriate time to conduct a further board assessment would be when there are no major changes to strategy or structure.
11. A typical board self-evaluation is set out in Appendix IV.

Recommendations

- The board, through the nomination committee or similar board committee, should regularly review its required mix of skills and experience and other qualities such as its demographics and diversity in order to assess the effectiveness of the board. This should be by means of a self-evaluation of the board as a whole, its committees and the contribution of each individual director.
- The evaluations should be conducted at least annually.

Chapter 7

Disqualification of Directors

1. Section 421 of the Companies Act requires the Registrar of Companies to keep a register of directors of dissolved companies that were unable to pay their debts, and requires the liquidators of such companies to notify the Registrar of such directors and which of them are considered to have been responsible for the insolvency. However, in practice, the existence of this register is almost unknown.
2. Several grounds for the disqualification of directors, relevant to corporate governance, are contained in section 218 of the Companies Act, and the director or officer of the company who signs the prescribed form giving details of its directors must certify that the directors have not been disqualified. It is doubtful whether those who sign these forms take any steps to check whether a proposed new director is disqualified. Some of the grounds for disqualification are extremely onerous to check while it may be impossible to check others.
3. In terms of section 219 of the Companies Act, the Court is entitled to disqualify persons from acting as a director, unless a State agency were to be mandated and obliged to bring such application before the Courts. In fact, however, very few applications are ever likely to be brought. The criteria in section 219 are also narrower than, for instance, those found in the United Kingdom where broadly subjective grounds, such as misconduct and unfitness, are also included.
4. A duty could be imposed on boards to check whether potential directors are disqualified on the basis of the criteria in section 218 of the Act, and even to investigate the backgrounds of these new directors along the lines of the

requirements of the JSE for directors of listed companies or by legislation for directors of banks.

5. On the issue of qualification to be a director (and this applies equally to executive and non-executive directors), anyone can be appointed as a director of a company that is not a bank, so long as the shareowners think this appointment appropriate and provided that the person is not disqualified from acting as a director.

Recommendations

- Legislative changes are recommended to buttress the existing provisions of the Companies Act regarding directors' disqualification.
- Boards should ascertain whether potential new directors are fit and proper and are not disqualified from being directors. Prior to their appointment, their backgrounds should be investigated along the lines of the approach required for listed companies by the JSE or under the Banks Act, as appropriate. The nomination committee would prove useful for this purpose.

Chapter 8

Board Committees

1. Committees of the board can help to efficiently advance the business of the board. At the same time, committees can demonstrate that directors' responsibilities are being adequately and properly discharged. However, the board is the focal point of the corporate governance system and is ultimately accountable and responsible for the performance and affairs of the company. Delegating authorities to board committees or management does not in any way mitigate or dissipate the discharge by the board and its directors of their duties and responsibilities. Board committees are merely a mechanism to aid and assist the board and its directors in giving detailed attention to specific areas of their duties and responsibilities in a more comprehensive evaluation of specified issues, such as audit, internal control, risk management, remuneration, etc.
2. Some committees are standing committees appointed to perform a continuing function, while others have a specific task, such as investigating an investment opportunity, and are disbanded once that task has been completed. The most common and well established standing committee is the audit committee which, in certain overseas jurisdictions, is mandatory for publicly held companies. Other more common examples of standing committees are those relating to remuneration and nomination.
3. Committees can help share the board's workload. Being smaller, they can go into greater detail and deal with complex issues where the full board might not have had enough time. From a corporate governance perspective, a committee will make sure an issue gets adequate attention and that the board reaches independent, objective decisions.
4. In establishing board committees, the board must determine their terms of reference, life span, role and function. It must create reporting procedures and

proper written mandates or charters for its committees and ways of evaluating them. Time should not be wasted on repeating a committee's deliberations at board level.

5. Board committees should, as far as possible, only comprise members of the board. It may be necessary, where certain board committees fulfil a specialised role, to co-opt specialists as permanent members of such committees but this should be the exception rather than the rule and they should comprise a minority on the committee. Of course, in order to ensure its effective functioning, a committee will of necessity from time to time have to call on specialised skills to assist it with its deliberations and decisions.
6. All companies should have, at a minimum, audit and remuneration committees. Industry specific issues will dictate the requirements for other committees. The overriding principle is that boards must establish committees that are responsive to the nature of business and where direct involvement of directors, particularly non-executives is necessary. Other committees may be: Chairperson's, Executive or Management, Governance, Actuarial, Information Technology, Risk, Environmental, Safety and Health, Nomination, Investment and Employment Equity. It is the responsibility of the board to consider the committees are appropriate for its purposes.
7. A framework of mandates for some of the above committees is included in Appendix V, as a guide. The board committee's terms of reference should be limited to those areas and/or issues that are of specific importance to the board. These committees must enable the board to fulfil its duties to the company.
8. Terms of reference for each committee, as illustrated in Appendix V, should cover the:
 - 8.1. composition;
 - 8.2. objectives, purpose and activities;
 - 8.3. delegated authorities including extent of power to make decisions and/or recommendations (if any);
 - 8.4. tenure; and
 - 8.5. reporting mechanism to the board.
9. Wherever practicable, committee members should be provided with a schedule of meeting dates and venues for the ensuing year and should expect to receive a proper agenda for each meeting.
10. Committees should be free to take independent outside professional advice as and when necessary.
11. A secretary should be appointed for each committee and minutes of each meeting recorded.
12. The committee chairperson should be expected to give, at least, an oral summary of the committee's deliberations at the next board meeting.

13. The chairperson of the board should not be chairperson of the audit committee. With the exception of an operating board committee, all committees should preferably be chaired by an independent non-executive director (whether this be the board chairperson or some other individual as appropriate).
14. Disclosure of committee composition, terms of reference, number of meetings held, etc. should be dealt with in the annual report and the chairpersons of such committees should be in attendance at the company's annual general meeting – certainly those in respect of audit, remuneration and nomination.

Recommendations

- There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation, to enable the board to properly discharge its duties and responsibilities and to effectively fulfil its decision taking process.
- Board committees with formally determined terms of reference, life span, role and function constitute an important element of this process, and should be established with clearly agreed upon reporting procedures and scope of authority.
- As a general principle, there should be transparency and full disclosure from the board committee to the board, except where the committee has been mandated otherwise by the board.
- At a minimum, each board should have an audit and a remuneration committee. Industry and company specific issues will dictate the requirements for other committees.
- Non-executive directors must play an important role in board committees.
- All board committees should preferably be chaired by an independent non-executive director, whether this is the board chairperson or some other appropriate individual. The exception should be a board committee fulfilling an executive function.
- Board committees should be free to take independent outside professional advice as and when necessary.
- Committee composition, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the annual report. The chairpersons of the board committees, particularly those in respect of audit, remuneration and nomination, should attend the company's annual general meeting.
- Board committees should be subject to regular evaluation by the board to ascertain their performance and effectiveness.

2. The chairperson and board will look to the company secretary for guidance on their responsibilities and duties to which they are subject, and how such responsibilities and duties should be properly discharged in the interests of the company.
3. While the role and function of the company secretary will vary from company to company and can be very diverse, the core role concerns three primary areas:

3.1. *The board*

- The company secretary must guide the board, collectively, and each director, individually, as to their duties and responsibilities and make them aware of all legislation and regulations relevant to the company on which board the directors serve.
- The company secretary must ensure that the procedure for the appointment of directors is properly carried out and he/she should assist in the proper induction and orientation of directors, including assessing the specific training needs of directors and executive management in regard to their fiduciary and other responsibilities.
- The company secretary needs also to be available to provide comprehensive practical support and guidance to directors, with particular emphasis on supporting the non-executive directors and chairperson.
- The company secretary should also ensure unhindered access to information by all board and committee members so that they can contribute to board meetings and other discussions.
- The company secretary is responsible for the compilation of board papers and for filtering them to ensure compliance with the required standards of good governance. The company secretary's role should also be to raise matters that may warrant the attention of the board.
- The company secretary's role should also be to raise matters that may warrant the attention of the board.

3.2. *The company*

- The company secretary should ensure compliance with all relevant statutory and regulatory requirements, having due regard for the specific business interests of the company. In particular, the company secretary must also be aware of the duties set out in section 268 G of the Companies Act.
- The company secretary should also help to carry out corporate strategies by ensuring that the board's decisions and instructions are clearly communicated to the relevant persons.

- The company secretary should be available to provide a central source of guidance and advice within the company on matters of ethics and good governance.

3.3. *The shareowner*

- The company secretary needs to communicate with the shareowners as appropriate, and to ensure that due regard is paid to their interests.
- The company secretary also needs to act as the primary point of contact for institutional and other shareowners, especially with regard to matters of corporate governance. It is of particular importance to ensure that all shareowners are treated in a fair and equal manner.

Recommendations

- The board should be cognisant of the duties imposed upon the company secretary and should empower the company secretary accordingly to enable him or her to properly fulfil those duties.
- In addition to extensive statutory duties, the company secretary must provide the board as a whole and directors individually with detailed guidance as to how their responsibilities should be properly discharged in the best interests of the company.
- The company secretary has an important role in the induction of new or inexperienced directors, and in assisting the chairperson and chief executive officer in determining the annual board plan and the administration of other issues of a strategic nature at the board level.
- The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of ethics and good governance.
- The company secretary should be subjected to a fit and proper test in the same manner as is recommended for new director appointments.

SECTION 2 - RISK MANAGEMENT

“The average company today is a complex enterprise engulfed by rapid technological change and fierce global competition. You have to assess exposure to risk on an ever changing landscape.”

Arthur Levitt
Former chairperson of the U.S. Securities Exchange Commission

Chapter 1 Introduction and Definition

1. Enterprise is the undertaking of risk for reward. A thorough understanding of the risks accepted by a company in the pursuance of its objectives, together with the strategies employed to mitigate those risks, is thus essential for a proper appreciation of the company's affairs by the board and stakeholders.
2. Risks are uncertain future events that could influence the achievement of a company's objectives. These could include strategic, operational, financial and compliance objectives. Some risks must be taken in pursuing opportunity, but a company should be protected against avoidable losses.
3. Corporate governance can, in part, be viewed as a company's strategic response to the need to assume prudent risks, appropriately mitigated, in exchange for measurable rewards.
4. Risk management can be defined as the identification and evaluation of actual and potential risk areas as they pertain to the company as a total entity, followed by a process of either termination, transfer, acceptance (tolerance) or mitigation of each risk.
5. The risk management process entails the planning, arranging and controlling of activities and resources to minimise the impacts of all risks to levels that can be tolerated by shareowners and other stakeholders whom the board has identified as relevant to the business of the company.
6. Risk management is thus a process that utilises internal controls as one of the measures to mitigate and control risk. Risks such as political, technological and legislative, that cannot be managed through traditional internal control systems, should be addressed using flexibility, forward planning and similar mechanisms.
7. One of the mechanisms for managing risk is internal control. Internal control should be embedded in the daily activities of the company in the creation of business plans, budgets and other routine operational activities. There are, however, risks that do not make economic sense to control. In other words, the cost of control or mitigation exceeds the benefit thereof. Internal control is aimed at reducing risk to an acceptable level.
8. Internal control is a process designed to provide reasonable assurance regarding the achievement of organisational objectives with respect to:

- the effectiveness and efficiency of operations;
 - the safeguarding of the company's assets (including information);
 - compliance with applicable laws, regulations and supervisory requirements;
 - supporting business sustainability under normal as well as adverse operating conditions;
 - the reliability of reporting; and
 - behaving responsibly towards all stakeholders.
9. The board must decide the company's appetite or tolerance for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives. The board has the responsibility to ensure that the company has implemented an effective ongoing process to identify risk, measure its potential impact against a broad set of assumptions, and then activate what is necessary to proactively manage these risks.
 10. Risk management should be practised throughout the company by all staff in their day-to-day activities.
 11. In evaluating risk to the company, directors should oversee formal reviews of activities associated with the risk management and internal control processes. Sound risk management and internal control frameworks, tailored to the specific circumstances of the company, should be part of the daily operational activities of a company, and should not be viewed independently of normal business activities.
 12. Given the relationship between risk and reward, risk should not only be viewed from a negative perspective. The review process may identify areas of opportunity, such as where effective risk management can be turned to competitive advantage.
 13. Directors have an obligation to demonstrate that they have dealt comprehensively with the issues of risk management and internal control. This requires appropriate disclosure on matters such as risk tolerance and the risk management process in the annual report. This does not mean that companies are expected to disclose risk management information that competitors could exploit, or that could compromise their competitive advantage.

Recommendations

- The board must decide the company's appetite or tolerance for risk – those risks it will take and those it will not take in the pursuit of its goals and objectives. The board has the responsibility to ensure that the company has implemented an effective ongoing process to identify risk, to measure its potential impact against a broad set of assumptions, and then to activate what is necessary to proactively manage these risks.
- Risk management and internal control should be practised throughout the company by all staff, and should be embedded in day-to-day activities.
- The board should make use of generally recognised risk management and internal control models and frameworks in order to maintain a sound system of risk management and internal control to provide reasonable assurance regarding the achievement of organisational objectives with respect to:
 - the effectiveness and efficiency of operations;
 - the safeguarding of the company's assets (including information);
 - compliance with applicable laws, regulations and supervisory requirements;
 - supporting business sustainability under normal as well as adverse operating conditions;
 - the reliability of reporting; and
 - behaving responsibly towards all stakeholders.
- Risk should not only be viewed from a negative perspective. The review process may identify areas of opportunity, such as where effective risk management can be turned to competitive advantage.

Chapter 2

Responsibility for Risk Management

1. The total process of risk management, which includes a related system of internal controls, is the responsibility of the board. Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day-to-day activities of the company. Management is also accountable to the board for providing assurance that it has done so. The internal audit function should be used to provide independent assurance in relation to management's assertions surrounding the effectiveness of risk management and internal control.
2. Although management may appoint a chief risk officer or risk facilitator to assist in the execution of the risk management process, the accountability to the board remains with management and should be the responsibility of every employee.

The risk management process does not, however, reside in any one individual or function but requires an inclusive team-based approach for effective application across the company.

3. To assist it in the discharge of its duties and responsibilities in this regard, the board may appoint a dedicated committee to review the risk management process and the significant risks facing the company. While not recommended, other than for reasons of economy given the nature or size of the company or for other reasons that should be explained to shareowners in the annual report, such responsibilities could also be delegated to the audit committee. Ideally, the audit committee fulfils a separate function in which its assessment of risk management forms only a part.
4. Risk management constitutes an inherent operational function and responsibility. For this reason, a board committee comprising executive directors and members of senior management, who are accountable to the board, is best placed to evaluate risk in the company and to report on it to the board. It nevertheless remains the responsibility of the board, as part of its oversight role, to ensure appropriate disclosure in relation to risk management, including internal control, in the annual report.
5. The risk committee should consider the risk strategy and policy, and should monitor the process at operational level and the reporting thereon. The audit committee, to the extent that it is concerned with risk management, should consider the results of the risk management and internal control processes, and the disclosure thereof. This information will influence the audit committee in deciding the nature and extent of assurance it requires from external and internal audit.
6. Effective, continuous monitoring is an essential part of the risk management process. As the board cannot rely solely on the embedded monitoring processes within the company to discharge its responsibilities, it should, at appropriately considered intervals, receive and review reports on the process that constitutes risk management. In this regard, the board is responsible for ensuring that a systematic, documented assessment of the processes and outcomes surrounding key risks is undertaken at least annually for the purposes of making its public statement on risk management including internal control. This risk assessment should, where possible, include an estimate of the likelihood of occurrence, the quantification of the probable impact, and comparison to available benchmarks. In this statement the board should acknowledge its responsibility for the risk management process and for reviewing its effectiveness.
7. Internal audit should not assume the functions, systems and processes of risk management, but should assist the board and management in the monitoring of the risk management process.
8. If the company has a compliance officer or function, and without detracting from the independence thereof, they should interact regularly with other role-players in the risk management process (Refer to Appendix 7 for more detail).

Recommendations

- The board is responsible for the total process of risk management, as well as for forming its own opinion on the effectiveness of the process. Management is accountable to the board for designing, implementing and monitoring the process of risk management, and integrating it into the day-to-day activities of the company.
- The board should set the risk strategy policies in liaison with the executive directors and senior management. These policies should be clearly communicated to all employees to ensure that the risk strategy is incorporated into the language and culture of the company.
- The board is responsible for ensuring that a systematic, documented assessment of the processes and outcomes surrounding key risks is undertaken at least annually for the purposes of making its public statement on risk management. It should, at appropriately considered intervals, receive and review reports on the risk management process in the company. This risk assessment should address the company's exposure to at least the following:
 - physical and operational risks;
 - human resource risks;
 - technology risks;
 - business continuity and disaster recovery;
 - credit and market risks; and
 - compliance risks.
- A board committee, either a dedicated committee or one with other responsibilities, should be appointed to assist the board in reviewing the risk management process and the significant risks facing the company.
- The board is responsible for disclosures in relation to risk management in the annual report and should acknowledge that it is accountable for the risk management procedures.
- The internal audit function should not assume the functions, systems and processes of risk management, but should be used to provide independent assurance in relation to management's assertions surrounding the effectiveness of risk management and internal control. If a compliance function exists it will provide assurance in relation to compliance with applicable laws, regulations and supervisory requirements.

Chapter 3**Assimilating Risk to the Control Environment**

1. Controls should be established to encompass all management responses to risk. Controls are derived from the way management runs the company and should be integrated into all business processes at every level of the company. There are five essential aspects of control, as follows:

- 1.1. ***Control Environment***

- This sets the tone of the company and in providing the necessary discipline and structure, should be seen as a foundation for all other components of risk management and control.
- The control environment includes factors such as the integrity, ethical values, organisational culture, competence of the company's people, management's philosophy and operating style, the manner the company's management assigns authority and responsibility and the way in which it organises and develops its people, and the attention and direction provided by the board of directors.
- Some common applications include a written code of conduct for all employees, training programmes that address management's expectations and corporate values, incentive programmes, established authorisation protocols, and a largely independent and proactive board of directors.

- 1.2. ***Risk Assessment***

- The risk assessment process should consider risks that are significant to the achievement of the company's objectives. This is a continuous process, requiring regular review, as and when internal and external changes influence the company's strategies and objectives.
- A systematic, documented assessment of the processes and outcomes surrounding key risks should be undertaken at least annually. This risk assessment should, where possible, include an estimate of the likelihood of occurrence, the quantification of the probable impact, and comparison with available benchmarks. Recommendations should also be made as to how each risk should be managed.
- Circumstances demanding close attention would include substantive changes to the operating environment, new personnel, new or revamped information systems, rapid growth, new technology, new products or activities, corporate restructuring, acquisitions and disposals, and changes in foreign operations.

1.3. **Control Activities**

These should be designed to respond to risks throughout the company and its external environment and should include a diverse range of activities aimed at enhancing the control environment, as well as specific matters such as powers reserved for the board, delegation of authority, approvals, authorisations, verifications, operating reviews, reporting, and the segregation of duties.

1.4. **Information and Communication**

- Pertinent information arising from the risk assessment, and relating to control activities, should be identified, captured and communicated in a form and timeframe that enables employees to carry out their responsibilities properly.
- This may include accurate, timely and relevant financial and operational data that is supported by adequate and appropriate systems. Any company or process should have information systems that measure results against objectives.
- These systems should be accompanied by communication practices that ensure that all information, positive and negative, travels up to senior management expeditiously, while also ensuring that best practices are shared across the company and that management's intent is understood by all.

1.5. **Monitoring**

- The monitoring of risks should be linked to key performance indicators linked to organisational objectives, so that the accuracy of the risk assessment and the effectiveness of internal controls can be evaluated objectively.
 - Monitoring helps to assist tracking the change in risks and the effectiveness of the control systems in continuously managing those risks.
 - This may be accomplished through ongoing monitoring activities, separate evaluations or by a combination of the two. The progress of activities aimed at rectifying weaknesses should also be monitored.
2. The system of risk management and internal control should, therefore, be intertwined with the company's operating activities to provide assurance that enterprise-wide policies and procedures are in place to address all forms of risk identified as inherent to the company's activities.
 3. The board must understand and fully appreciate the business risk issues and key performance indicators that could affect the ability of the company to achieve its purpose. Enhancing shareowner value in the long-term, by competing effectively is the primary objective of a company and its board. Hence, business risk and key performance indicators should be benchmarked against industry norms and

best practice so that the company's performance can be evaluated and monitored by the board. Management, in turn, must ensure that it fully and accurately reports on these factors to the satisfaction of the board.

4. An important constituent in this modern era is new technology and IT-based operations, and these should be subjected to the risk-based principles of validation, security, integrity, availability and continuity. This should be applied both to existing systems and to new implementations.
5. The board should regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are always maintained at an optimal level. This in itself necessitates the generation of information about risk and the control environment that is accurate, timely and relevant to good governance principles. The effectiveness of such systems should be communicated to shareowners and relevant stakeholders.
6. Such a system would yield information like, but not limited to, a register of key risks, estimated costs of significant losses, whether risk management and internal control costs are consistent with the risk profile of the business, material losses, reduction in earnings or cash flows caused by unforeseen incidents, material changes to the risk profile, details of risk finance arrangements that could expose the company, the risk-bearing capacity of the business, and due diligence activities. The company's capabilities in the disciplines of disaster recovery, crisis management and business continuity should be commented on in the annual report to the extent that this will assist shareowners and stakeholders to make informed decisions.
7. Any vulnerability in the achievement of the company's objectives, whether caused by internal or external risk factors, should be detected in good time, reported by the systems of control in place and met with appropriate interventions. Not only will this improve its risk profile, thereby enhancing the company's attraction as a worthwhile investment, but it will also enhance the positive influences of risk on the business. However, any such systems cannot be expected to eliminate all losses and deviations from well-considered and established control procedures.
8. In addition to the company's other compliance and enforcement activities, the board should consider the need for a confidential reporting process ("whistleblowing") covering fraud and other risks.

Recommendations

- A comprehensive system of control should be established by the board to ensure that risks are mitigated and that the company's objectives are attained. The control environment should also set the tone of the company and cover ethical values, management's philosophy and the competence of employees.

Recommendations continued

- Risks should be assessed on an on-going basis, and control activities should be designed to respond to risks throughout the company. Pertinent information arising from the risk assessment, and relating to control activities, should be identified, captured and communicated in a form and timeframe that enables employees to carry out their responsibilities properly. These controls should be monitored by both line management and assurance providers.
- Companies should develop a system of risk management and internal control that builds more robust business operations. The systems should demonstrate that the company's key risks are being managed in a way that enhances shareowners' and relevant stakeholders' interests. The system should incorporate mechanisms to deliver:
 - a demonstrable system of dynamic risk identification;
 - a commitment by management to the process;
 - a demonstrable system of risk mitigation activities;
 - a system of documented risk communications;
 - a system of documenting the costs of non-compliance and losses;
 - a documented system of internal control and risk management;
 - an alignment of assurance efforts to the risk profile; and
 - a register of key risks that could affect shareowner and relevant stakeholder interests.
- The board must identify key risk areas and key performance indicators of the company, and monitor these factors as part of a regular review of processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making and the accuracy of its reporting are maintained at a high level at all times.
- In addition to the company's other compliance and enforcement activities, the board should consider the need for a confidential reporting process ("whistleblowing") covering fraud and other risk areas.

Chapter 4

Application of Risk Management

1. The board is accountable for the overall processes of risk management and internal control, for setting the risk tolerance and related strategies and policies. The board is also responsible for reviewing the effectiveness of those processes

on a regular basis in a manner in which its objectives are clearly defined for the benefit of management to guide them in carrying out their responsibilities..

2. When reviewing reports on risk management and internal control in the course of the financial year, the board should:
 - 2.1. consider what the company's significant risks are and how they have been identified, evaluated and controlled;
 - 2.2. assess the effectiveness of the related process of risk management , and particularly any significant failings or weaknesses in the process that have been reported;
 - 2.3. consider if the necessary action is being taken in time to rectify any significant failings or weaknesses; and
 - 2.4. consider whether the results obtained from the review process indicate that more extensive monitoring is required.
3. The reports from management to the board should provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be discussed in the reports, including the impact that they have had, or may have had on the company, and the actions being taken to rectify them. It is essential that management communicates openly with the board on matters relating to risks and controls.
4. The board should consider the changes to the internal and external environment, significant risks and the way they are managed, since the last assessment, as well as:
 - 4.1. the fulfilment of the company's objectives and any specific objectives set for the risk management process;
 - 4.2. the reasons relating to the non-achievement of objectives;
 - 4.3. the company's ability to respond to significant changes in its internal and external business environment;
 - 4.4. the coverage and quality of management's monitoring process in relation to the assessment, identification, evaluation, control and management of risk;
 - 4.5. the structure in place to ensure effective communication of the results of the risk management process – both bottom up and top down;
 - 4.6. the structure in place to rectify identified areas of exposure;
 - 4.7. the effectiveness of the company's reporting process; and
 - 4.8. management's ongoing processes for development, implementation and monitoring of the risk control systems where the board becomes aware at any time of significant failings or weaknesses in such systems.
5. In its statement in the annual report of how the company has dealt with risk and control, the board should:

- 5.1. provide a statement that the board is responsible for risk management and the system of internal control, including the establishment and communication of risk tolerance, and risk and control strategies and policies in the company, and for reviewing the system of risk management and internal control for effectiveness;
- 5.2. report that there is an ongoing process for identifying, evaluating and managing the significant business risks faced by the company, and that it has been in place for the year under review and up to the date of approval of the annual report. This should include a brief description of the following processes:
 - there should be an indication of how a risk management culture is being inculcated and the appropriate infrastructure built within the company. This may require a change in management processes that will include senior management commitment, a common language and process, a change in management process-owner, risk co-ordinators and risk owners, establishing the process or methodology for ongoing risk management, effective communication, learning and education, measurement of the risk profile, reinforcement of the risk management process through human resource mechanisms, and monitoring the risk management process;
 - the level of unacceptable risk, both financially and from a reputation perspective; and
 - the manner and frequency in which significant risks are reported to the board.
- 5.3. The fact that there is an adequate and effective system of internal control in place to mitigate the significant risks faced by the company to an acceptable level, needs to be disclosed. Such a system should be designed to manage, rather than eliminate, the risk of failure to achieve business objectives.
- 5.4. In addition the process as established by the board, to review the system of internal control should be disclosed and should describe:
 - the committees used to assist the board in discharging its responsibilities in this regard;
 - the management processes for reviewing the system of internal control for effectiveness such as supervision, review, segregation of duties and self-assessment techniques, etc.;
 - normal management processes such as monthly management accounts, safety, health and environmental reports and other similar reporting that discusses risk and control issues;
 - assurance gained from various providers such as internal and external audit;

- mechanisms used to report significant control weaknesses and failings and the frequency thereof. This should include a description of exception reporting and regular reporting; and
 - the board's procedures in performing its annual effectiveness review of the risk management process and internal control environment.
- 5.5. Where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these recommendations, this should be disclosed by the board. Alternative sources of assurance regarding the risk management process and internal control should be sought for material joint ventures and associates.
- 5.6. The board may wish to provide additional information in the annual report to assist understanding the company's risk management processes and system of internal control.
- 5.7. The board should state where it cannot make any of the disclosures set out above, and should provide a suitable explanation for the benefit of shareowners and relevant stakeholders.

Recommendations

- Reports from management to the board should provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks. Any significant control failings or weaknesses identified should be covered in the reports, including the impact that they have had, or may have had on the company, and the actions being taken to rectify them.
- The board is responsible for disclosures in relation to risk management and should, at a minimum, disclose:
 - that it is accountable for the process of risk management and the system of internal control, which is regularly reviewed for effectiveness, and for establishing appropriate risk and control policies and communicating these throughout the company;
 - that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company, which has been in place for the year under review and up to the date of approval of the annual report and accounts;
 - that there is an adequate and effective system of internal control in place to mitigate the significant risks faced by the company to an acceptable level. Such a system is designed to manage, rather than eliminate, the risk of failure, or to maximise the opportunity to achieve business objectives. This can only provide reasonable, but not absolute, assurance;

Recommendations continued

- that there is a documented and tested process in place that will allow the company to continue its critical business processes in the event of a disastrous incident impacting on its activities;
- where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying these recommendations. Alternative sources of risk management and internal control assurance applied to these activities should be disclosed, where these exist;
- any additional information in the annual report to assist understanding of the company's risk management processes and system of internal control, as appropriate; and
- where the board cannot make any of the disclosures set out above, it should state this fact and provide a suitable explanation.

- Are the existing management processes adequate to -
 - Identify and monitor the significant risks facing the company?
 - Confirm the effective operation of the established internal control system?
 - Can those who are responsible for managing risks and operating controls take a wholly objective and systematic view of their own performance?
 - Does the board receive the right quality of assurance and information from management and is it reliable?
6. The appointment or dismissal of the head of internal audit should be with the concurrence of the audit committee.

Recommendations

- Companies should have an effective internal audit function that has the respect and co-operation of both the board and management. Where the board, in its discretion, decides not to establish an internal audit function, full reasons must be disclosed in the company's annual report, with an explanation as to how assurance of effective internal controls, processes and systems will be obtained.
- Consistent with the Institute of Internal Auditors' ("IIA") definition of internal auditing in an internal audit charter approved by the board, the purpose, authority and responsibility of the internal audit activity should be formally defined.
- Internal audit should report at a level within the company that allows it fully to accomplish its responsibilities. The head of internal audit should report administratively to the chief executive officer, and should have ready and regular access to the chairperson of the company and the chairperson of the audit committee.
- Internal audit should report at all audit committee meetings.
- The appointment or dismissal of the head of internal audit should be with the concurrence of the audit committee.

Chapter 2

Role and Function of Internal Audit

1. The objective of internal audit is to assist members of executive and senior management in the effective discharge of their duties and responsibilities. To this end, internal audit furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed.

2. The role, function, scope and professional standards of an internal audit function are succinctly documented and codified by the IIA with reference to international best practices.
3. An effective internal audit function should provide:
 - assurance that the management processes are adequate to identify and monitor significant risks;
 - confirmation of the effective operation of the established internal control systems;
 - credible processes for feedback on risk management and assurance; and
 - objective confirmation that the board receives the right quality of assurance and information from management and that this information is reliable.
4. Internal audit is performed in diverse environments and within companies that vary in purpose, size and structure. These differences may affect the practice of internal audit in each environment. The implementation of common standards govern the way in which the internal audit function carries out assigned responsibilities. Compliance with the published standards is essential before the responsibilities of internal auditors can be properly met.
5. Adherence, to the standards of the IIA will, therefore, ensure a common framework and understanding of the requirements for effective internal auditing. This will include clarification of common terms such as “independence” and “standing in the organisation”.

Recommendations

- The IIA has succinctly set out the role and function of internal audit in its *Standards for the Professional Practice of Internal Auditing*, including the code of ethics and the definition of internal audit, which are fully endorsed by the King Committee.
- Internal audit is an independent, objective assurance and consulting activity designed to add value and improve a company's operations. It helps a company accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
- An effective internal audit function should provide:
 - assurance that the management processes are adequate to identify and monitor significant risks;
 - confirmation of the effective operation of the established internal control systems;

Recommendations continued

- credible processes for feedback on risk management and assurance; and
- objective confirmation that the board receives the right quality of assurance and information from management and this information is reliable.

Chapter 3 Scope of Internal Audit

1. In its *Standards for the Professional Practice of Internal Auditing*, the IIA has published a revised definition of internal audit, which broadens the scope of the internal audit function to include contributions by internal audit to risk management and coverage of governance processes in line with current thinking in corporate governance codes and best practice guidelines internationally.
2. Internal audit should consider relevant strategic, business and operational risks and their significance, taking account of the board's, senior management's and its own professional judgment. This process should be co-ordinated with the board's own risk assessment and should result in the identification of high risk activities to be audited. In approving the internal audit work plan, the audit committee should take account of the risk assessment.
3. The scope of internal audit should include the following:

3.1. **Risk management**

The total process of risk management, which includes a related system of internal control, is the responsibility of the board of directors and is dealt with more fully in Section 2. Management is accountable to the board for designing, implementing and monitoring the process of risk management, and for integrating it into the day-to-day activities of the company. The internal audit function should assist the board, directors and management through consultation and facilitation in identifying, evaluating and assessing significant organisational risks to objectives, and by providing independent assurance as to the adequacy and effectiveness of related internal controls and the risk management process.

3.2. **Control**

The internal audit function should assist the directors and management to maintain effective controls by evaluating those controls to determine their efficiency and effectiveness, and by developing recommendations for enhancement or improvement. The controls subject to evaluation should encompass:

- the information systems environment;

- the reliability and integrity of financial and operating information;
- the efficiency and effectiveness of operations;
- the safeguarding of assets; and
- compliance with laws, regulations and controls.

3.3. **Governance**

The internal audit function should assist the directors and management to achieve the goals of the company by evaluating and recommending improvements to the process through which:

- goals and values are established and communicated;
- the accomplishment of goals is monitored;
- accountability is ensured; and
- corporate values are preserved.

4. The standards for professional practice of internal auditing recognise the importance of combined assurance through proper co-ordination between all the assurance providers to the company. The head of internal audit should play a leading role in the co-ordination of planning, activities and assurance from the various parties involved.

Recommendations

- The internal audit plan should be based on risk assessment as well as on issues highlighted by the audit committee and senior management. The risk assessment process should be of a continuous nature so as to identify not only residual or existing but emerging risks and should be conducted formally at least annually, but more often in complex organisations. This risk assessment should be co-ordinated with the board's own assessment of risk.
- The audit committee should approve the internal audit work plan.
- The internal audit function should co-ordinate with other internal and external providers of assurance in order to ensure proper coverage of financial, operational and compliance controls, and to minimise duplication of effort.

SECTION 4 – INTEGRATED SUSTAINABILITY REPORTING

“Corporate citizenship is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.”

*Commonwealth Business Council Working Group on Corporate Citizenship
(adapted from the work of the World Business Council on Sustainable Development)*

***“Umuntu ngumuntu ngabantu”
(I am because you are, you are because we are)
 (“Humanity is interdependent”)***

Chapter 1 Introduction and Scope of Review

1. The concept of “sustainability” is derived from the term “sustainable development”, coined in the Report of the World Commission on Environment and Development, 1987 (The “Brundtland Report”) as meaning *“Development that meets the needs of the present without compromising the ability of future generations to meet their own needs”*.
2. In a corporate context, “sustainability” means that each enterprise must balance the need for long-term viability and prosperity – of the enterprise itself and the societies and environment upon which it relies for its ability to generate economic value – with the requirement for short-term competitiveness and financial gain. Compromising longer-term prospects purely for short-term benefit is counter-productive. A balance must be struck and failure to do so will prove potentially irreparable, and have far-reaching consequences, both for the enterprise and the societies and environment within which it operates. Social, ethical and environmental management practices provide a strong indicator of any company’s intent in this respect.
3. Sustainability can be seen therefore to focus on those non-financial aspects of corporate practice that, in turn, influence the enterprise’s ability to survive and prosper in the communities within which it operates, and so ensure future value creation. This, in turn, represents the essence of corporate social responsibility – or corporate citizenship - which can be defined as *“Business decision-making linked to ethical values, compliance with legal requirements, and respect for people, communities and the environment ... [evidenced by] ... a comprehensive set of policies, practices and programs that are integrated throughout business operations, and decision-making processes that are supported and rewarded by top management”*.²⁰
4. The concept of sustainability has recently been adopted in a business context to mean the achievement of balanced and integrated *economic, social and environmental* performance. This is now universally referred to as the “triple bottom line”, defined as follows by the UK-based organisation SustainAbility: “At

²⁰ Business for Social Responsibility

its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to minimise any harm resulting from their activities and to create economic, social and environmental value. This involves being clear about the company's purpose and taking into consideration the needs of all the company's stakeholders – shareholders, customers, employees, business partners, governments, local communities and the public”.

In other words, non-financial issues – social, ethical and environmental issues - can no longer be regarded as secondary to more conventional business imperatives.

It should also be pointed out that the reference to these issues as “non-financial issues” is for ease of reference. There is no doubt, as is set out below, that these so-called non-financial issues have significant financial implications for a company.

5. The defining characteristics of good corporate citizenship,²¹ as identified by the Commonwealth Business Council Working Group on Corporate Citizenship, are the following:²²
 - 5.1. **Corporate values**
Having clear corporate values, which are stated and enacted.
 - 5.2. **Corporate governance**
Ensuring that the company is governed in a way that is efficient, responsible, accountable, transparent and with probity.
 - 5.3. **Stakeholders**
Recognising the legitimacy of interest of defined key stakeholders and publishing policies governing relationships with them.
 - 5.4. **Shareowners**
Recognising shareowners as a key stakeholder group entitled to expect good return on investment and growth in the medium to longer term.

Understanding the particular position of those with smaller shareholdings.
 - 5.5. **Investing for the long-term**
Engaging in long-term relationships (e.g. in countries, communities and with suppliers and customers).
 - 5.6. **Accountability and responsibility**
Recognising and differentiating accountability linkages (to shareowners and statutes) and responsibility linkages (to other stakeholders).

²¹ Good corporate citizenship has both an internal dimension in relation to intra-organisational ethics and an external dimension relating to issues of social and corporate responsibility

²² These characteristics were culled from the experiences of members of the Commonwealth Business Council (“CBC”) through work on combating corruption; CBC Draft Principles for Best Practice on the Relationship between International Enterprises and Countries to encourage foreign direct investment; CBC survey “A Good Environment for Business Development and Investment”; CACG Guidelines on Corporate Governance; the UN Global Compact; the work of the Prince of Wales Business Leaders’ Forum; and the World Business Council for Sustainable Development

- 5.7. **Transparency**
Being open in structure, process and disclosure. Communicating with key stakeholders and engaging with them.
- 5.8. **Tackling corruption**
Adopting agreed codes and persisting in enforcement.
- 5.9. **Human rights**
Recognising the implications of respect for human rights in the company's operations, having a human rights policy, and acting on it.
- 5.10. **Employee relations**
Respecting the well-being of employees, treating them fairly and with cultural sensitivity, enabling them to develop their potential through skill and technology transfer.
- Sharing the success of the company with the employees. Recognising international agreements and the right to freedom of association and collective bargaining.
- Eliminating all forms of forced labour and dealing with the problem of child labour.
- 5.11. **Environment**
Practising and encouraging greater environmental responsibility. Supporting a precautionary approach to environmental challenges (i.e. applying preventative measures in situations of scientific uncertainty where a course of action may cause harm to the environment).
- 5.12. **Supplier relations**
Treating suppliers fairly, encouraging continued improvement against agreed codes of practice in areas such as health and safety and human rights in the workplace, sharing knowledge, technology and ideas.
- 5.13. **Consumer awareness and product impact**
Avoiding harmful products and processes in full product life cycles, raising awareness of consumers regarding contents, use and disposal of products.
- 5.14. **Engaging with local communities**
Promoting collaborative partnerships with communities through donations, staff involvement and support, recognising the modality and two-way nature of the relationship.
- 5.15. **Building capacity**
Working to build capacity in all dealings with host, local and national communities and respecting the moral and cultural norms and values of others.
- 5.16. **Impact on other species**
Recognising and limiting negative impacts on other species, e.g. product testing on animals, farm conditions, etc.

- 5.17. ***Engaging in dialogue with government***
Engaging in open and constructive dialogue with government to improve the policy and practice environment.
- 5.18. ***Sharing best practice***
Engaging with others active in the field of corporate citizenship in order to improve practice.
6. Closer to home, the notion of sustainability and the characteristics of good corporate citizenship referred to above can be found within the concept of Ubuntu – African humanism, which is generally regarded as the foundation of sound human relations in African societies.²³ Ubuntu means “humanness” or “being human” and includes supportiveness, co-operation and solidarity. *“It is the basis of a social contract that stems from, but transcends, the narrow confines of the nuclear family to the extended kinship network, the community.”*
7. The essence of Ubuntu is that one’s personhood is dependent on one’s relationship with others. The notion of sustainability and the triple bottom line in the corporate world is evolving to an approach that recognises the importance of inter-dependent relationships between an enterprise and the community in which it exists. Ubuntu has formed the basis of relationships in the past and there is no reason why it could not be extended to the corporate world. International experience, which reveals a growing tendency towards an emphasis on non-financial issues, is a wake-up call to Africans not to abandon their cultures when they become part of the business sector, but to import and infuse these practices into the corporate world.
8. It has been noted that *“the Ubuntu philosophy and the community concept of the corporation have significant practical implications for corporate life. Among these are the fact that they provide a cultural hot-bed for such important values as creative co-operation, empathetic communication and team-work. They provide a basis for what should be corporate culture on African soil.”*²⁴ In implementing best practices with regard to the triple bottom line, corporate South Africa would be well-advised to build on the foundation of African values. They can not only form the basis for effective practices in this regard, but also have the potential to set South Africans apart as world leaders in this area.
9. It is interesting to observe that in the May 1999 “Millennium Survey” in which questions relating to corporate social responsibility were directed to citizens in over 20 countries, 49% of the respondents indicated that corporate social responsibility was the item most influencing their impressions of individual companies.²⁵
10. The overriding goal of any company is to consistently generate a competitive return on investment for its shareowners. The hallmark of a successful corporate strategy is the ability to balance the protection and growth of underlying value with competitiveness and profitability.
11. Non-financial accounting and disclosure represent a broad topic that addresses a wide range of issues and interests. International and to an increasing extent,

²³ African humanism (Ubuntu) and service excellence: R J Khoza, 3 December 2000

²⁴ The need for an Afro-centric management approach and within it a South African based management approach, R J Khoza, 20 November 1992

²⁵ *Canadian Democracy & Corporate Accountability – An Overview of Issues*, The Democracy and Corporate Accountability Commission, at page 6

local corporate reporting practice evidences a move away from a focus solely on financial (and therefore primarily historical) reporting. More and more companies, responding to the needs and demands of the capital markets and society-based institutions, are now reporting in greater depth on non-financial issues. These are considered more forward-looking in terms of their benefit and importance to investors and other stakeholder constituencies alike.

12. Non-financial reporting can show what drives underlying or future value creation within the company (e.g. human and other intellectual capital, brand, reputation). This is in contrast to more traditional financial reporting, which is focused on actual realisation of value within the organisation and is therefore historic in nature. Just as financial reporting provides a record of where the company has been, many aspects of non-financial reporting provide an indication of where the enterprise can go and how it will get there. As a guide to the ongoing stewardship of the company's financial and non-financial assets, it is therefore potentially as important to shareowners and investment analysts, as to other stakeholder groups.
13. The concept of sustainability provides the basis for international standards such as the *Global Reporting Initiative's Sustainability Reporting Guidelines* (referred to as the "GRI guidelines") on economic, social and environmental performance launched in June 2000. The GRI guidelines note that "*external non-financial reporting to date has not been guided by a widely accepted, common framework of principles and practices as to what should be reported or how, when and where. Reporting organisations have been at liberty to report what they choose about the economic, environmental and social aspects of their performance.*" This has resulted in a lack of transparency and consistency on non-financial issues, making any meaningful comparison between companies difficult.
14. *Transparency* implies openness in fully explaining the reasons for any decision or course of action adopted by the company. *Accountability* implies acceptance by the company of its responsibility for any decision or course of action adopted by it, the consequences thereof, and a commitment to resolving any issues that arise as a result. Both are fundamental tenets of corporate governance.
15. Many drivers of future value in a business context are non-financial in character. In evaluating a company's worth and potential as an investment vehicle, analysts focus on many such issues, of which the following represent merely a sample:
 - 15.1. market position;
 - 15.2. political situation;
 - 15.3. quality of corporate strategy;
 - 15.4. quality of major business processes;
 - 15.5. understanding of key business risks;
 - 15.6. strength and quality of risk management practices;
 - 15.7. standing, experience and credibility of management;
 - 15.8. the nature and extent of management succession planning;

- 15.9. client base;
- 15.10. brand strength;
- 15.11. employee relations;
- 15.12. ability to attract and retain talented staff;
- 15.13. innovation and research and development capabilities;
- 15.14. intellectual capital;
- 15.15. supply chain quality and reliability;
- 15.16. global reach and capacity; and
- 15.17. level and extent of executive remuneration.

A greater flow of information to the investment community and other stakeholders on issues such as those outlined above is to be encouraged.

- 16. The focus of this section, however, is on those areas relating to the concept of “sustainability”, which merit specific attention in the South African context. Given the evolving nature of reporting requirements, locally and globally, the work carried out by the King Committee can be regarded as part of an evolutionary process that will require regular monitoring, review and updating over time.
- 17. In identifying the headline issues for consideration, the following criteria were used:
 - 17.1. the impact on the business and its sustainability, both economic, but also in terms of the social and environmental context within which any enterprise operates;
 - 17.2. the needs of stakeholders;
 - 17.3. issues that give an indication of material risks to the business; and
 - 17.4. experience and developments internationally.
- 18. These headline issues were then constituted into the following components for consideration:
 - 18.1. Stakeholder relations.
 - 18.2. Ethical practices and organisational integrity.
 - 18.3. Safety, health and the environment (“SHE”).
 - 18.4. Society and transformation, incorporating black economic empowerment, gender and equity issues as matters of continuing strategic significance for South African companies.
 - 18.5. Human capital.

19. Throughout the process of this investigation, sample interviews and consultations took place with representatives of broad stakeholder constituencies.
20. The most significant obstacle to implementing meaningful social, ethical and environmental accounting and reporting lies in the way management thinks within a company. As long as these are perceived as “soft issues”, they are unlikely to receive the focus they also merit from a value-generating, economic point of view. There is also a general lack of awareness or understanding of, and commitment to, the principle of sustainable development.
21. This section deliberately avoids developing a prescriptive list of disclosure requirements. Instead, it provides indicative, aspirational guidelines to South African companies seeking to improve their disclosure practices. What companies choose to disclose, when and how are, for the time being at least, issues probably best left to the discretion of each company, by reference to what is appropriate and relevant in its circumstances.
22. However, as stakeholder and particularly, investor, pressure grows, it is unlikely that many companies will be able to resist the demand for improved disclosure practices. Silence on issues of concern could create negative perceptions, which only increased transparency – even to the extent of reporting that “nothing is being done” – can address.
23. Impetus for change will therefore come from the market and society, which will be the ultimate arbiters of corporate behaviour in this regard. Therefore, companies should engage with both. Identifying expectations informs more meaningful corporate reporting on issues that are pertinent to the sustainability of each company and the communities with which it enjoys the symbiotic relationship on which the viability of both depends.

Chapter 2 Stakeholder Relations

1. “Stakeholders”, can be usefully categorised as follows:
 - 1.1. *Shareowners* as providers of capital.
 - 1.2. *Parties that contract with the enterprise* either as providers of input to its various business processes and activities, or as purchasers of its output. This would include, for example, customers, employees, suppliers, sub-contractors and business partners.
 - 1.3. *Parties that have a non-contractual nexus with the enterprise* but provide it with its licence to operate and thereby exercise an influence on its ability to achieve its objectives. This class could include, for example, civic society in general, local communities, non-governmental organisations (“NGOs”) and other special interest groups whose concerns may be with issues such as market stability, social equity and the environment.
 - 1.4. *The State* as policy maker, legislator and regulator of the economy generally and specific sectors of it. The State’s power, as opposed to mere influence, over the activities of companies sets it apart from other parties with a non-contractual nexus.

In summary, stakeholders can be described as *“those whose relations to the enterprise cannot be completely contracted for, but upon whose co-operation and creativity it depends for its survival and prosperity”*.²⁶

2. The essential principle advanced by the Commonwealth Association for Corporate Governance that *“directors and boards owe their duty to the company and thereby are accountable to shareholders, as owners of the corporation’s capital”* remains paramount.²⁷ However, it must be acknowledged that global awareness is growing that any company’s long-term commercial success is inextricably linked to the sustainable development of the social and economic communities within which it operates.
3. The inclusive approach advocated in this Report, recognises that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers amongst others need to be considered when developing the strategy of a company. The inclusive approach requires that the purpose of the company should be defined, and the values by which the company will carry on its functions should be identified and communicated to all stakeholders. The stakeholders relevant to the company’s business should also be identified. These factors must be integrated into the strategies developed for the company for it to achieve its goals. The relationship between the company and its stakeholders should be mutually beneficial. A wealth of evidence has established that this inclusive approach is the way to create sustained business success and steady, long-term growth in shareowner value.
4. Stakeholders have a direct bearing on ongoing corporate viability and financial performance (for example, employees make products that customers must buy to ensure a return on investment to stakeholders). Stakeholder perception – and thus corporate reputation - is recognised as a significant market value driver, and relationships with stakeholders should be managed accordingly.
5. A company’s vision, mission and core values form the basis for its business goals and conduct. They infuse its activities and represent the cornerstone of relationships and interactions with stakeholders, establishing expectations and providing the terms of reference to assess organisational performance. To be meaningful, they should be embedded in policies, practices and decision-making processes at all levels of the company.
6. Government has a special duty of transparency and accountability in respect of its stewardship of national assets in pursuit of the national interest. However, it is important that government policies for transparency avoid potentially onerous additional requirements for State-owned enterprises that could prejudice their ability to compete effectively with the private sector.
7. Reputation is a function of stakeholder perception of a company’s integrity and efficiency, derived from many sources, such as customer service, employee relations, community relations, ethical conduct, and safety, health and environmental practices. Increasingly, the investment community (although not necessarily directly or quantitatively) builds in an “ethical premium” in its valuation of companies, based on the perceived integrity of an enterprise and its

²⁶ Slinger and Deacon, as quoted in Cook and Deacon – ESRC Centre for Business Research, University of Cambridge, at page 1 (July 1999)

²⁷ CACG *Guidelines – Principles for Corporate Governance in the Commonwealth*, at page 3 (November 1999)

management. Once blemished, this aspect of reputation is often hard to recover, a fact reflected in the share price. In other words, the many non-financial facets of reputation have become important indicators of ongoing economic viability and sustainability of companies. “Non-financial issues” have financial consequences for a business.

8. The private sector has to some extent also become a motivator and generator of equitable and sustainable socio-economic development opportunities. Government’s emphasis is increasingly on facilitating this process. While it is clearly preferable for corporate enterprises to control their destiny through proactive self-regulation, governments around the world have demonstrated that they will introduce legislation where necessary if companies fail to do so. At the same time, society (e.g. through NGOs such as Greenpeace and Friends of the Earth on environmental issues and Amnesty International on human rights issues) has already shifted focus onto the conduct of companies, as much as that of national governments. This is a meaningful indicator of the relative importance of governments and the corporate sector in delivering socio-economic development. As a number of leading multinationals have learned, conduct in developing countries can significantly affect reputation in their home markets. This, in turn, can severely impact financial performance and market valuation.
9. There is growing pressure from society on companies to acknowledge their duty to act as responsible corporate citizens. This has found expression to some extent in the Constitution and recent legislative developments in South Africa. The realisation of greater interdependence is consistent with the notion of Ubuntu, which could be embraced as an example of best practice in the area of corporate governance.
10. The board of directors must ensure that an appropriate balance is maintained between the individual interests of stakeholders and the collective good of the company in which their interests converge. Managing this equilibrium is an integral aspect of good governance and a major challenge for any board. Engaging actively with stakeholders helps inform strategic planning and risk management. Companies mindful of this benefit should adopt a process for the identification and, if necessary, prioritisation of key stakeholders having a legitimate and relevant interest in their operations.
11. The real measure of organisational integrity – and the basis of sound relationships with stakeholders – is in tangible evidence that a company practises what it preaches in all areas of its activities. It must both do, and be seen to be doing, what it says it is doing. Problems arise where perception and reality do not coincide. Accordingly, it is not only useful but important for companies to develop appropriate performance measurement criteria and control processes that can be tangibly applied against stakeholder performance objectives. An increasing number of South African companies are publishing reports describing how their corporate values and business principles have been applied in the interests of their stakeholders. The manner, extent and frequency of disclosure relating to social, ethical and environmental issues and performance is a matter best left to the discretion of the board and management of each company according to what is appropriate to its circumstances and the requirements of its stakeholders.
12. The company should be guided by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability. “Relevance” in this context means that:

- 12.1. technical terms and jargon should be avoided, or if unavoidable, simplified and explained;
 - 12.2. the implications of statistical data should be explained;
 - 12.3. if possible, a comparative analysis or benchmark should be provided on the results furnished; and
 - 12.4. a range of indicators that provide an appropriate evaluation of an organisation's performance in a particular area should be provided.²⁸
13. Criteria and guidelines for materiality in stakeholder reporting should be developed by each company to assist it in reporting consistently. In this respect, regard should also be given to international models and guidelines, as well as national statutory definitions relating to matters falling within the purview of stakeholder reporting.
 14. Effective corporate reporting of necessity requires an integrated approach. This is probably best achieved gradually as the board and company gain a better understanding of the issues identified for stakeholder communication, and more confidence in dealing with these intricate relationships. One approach might be to categorise issues into different levels:
 - 14.1. The first level of disclosure is that relating to acceptance and adoption of business principles and/or codes of practice. Acceptance of a particular principle can be verified by reference to documents, board minutes or established policies and standards.
 - 14.2. The second level could address the implementation of practices in keeping with accepted principles. This will involve a review of whether the company has taken steps to encourage adherence to those principles, as may be evidenced in the form of board directives, designated policies and communiqués, supported by appropriate non-financial accounting mechanisms.
 - 14.3. A further level would involve investigation and demonstration of changes and benefits that have resulted from following stated principles.²⁹
 15. While financial reporting is generally directed at a financially literate audience that understands financial principles, in the case of non-financial reporting an understanding of the issues to be reported on should not be assumed.³⁰ It is important, therefore, for companies to report on stakeholder issues through the most appropriate medium and in the most appropriate manner, so that its achievements are understood by the target stakeholders. Frequency of disclosure is a matter that companies should determine for themselves, though we believe the general principle of disclosure on at least an annual basis is appropriate.
 16. The extent of new legislation promulgated in South Africa since publication of the King Report 1994 should also be noted. Perhaps the most significant would be

²⁸ GRI Guidelines; see appendix XII for detailed description of all the qualitative characteristics for GRI Reporting listed in this paragraph

²⁹ GRI Guidelines

³⁰ GRI Guidelines

the Constitution brought into force on 8 May 1996 and, in particular, the chapter on the Bill of Rights for South Africa, which has led to the promulgation of legislation addressing transparency and public interest issues. More recently, for example, the Promotion of Access to Information Act (No. 2 of 2000) has as one of its objectives the promotion of “*transparency, accountability, and effective governance of all public and private bodies.*” Companies will require to factor these requirements into their stakeholder reporting as well.

17. An important component of non-financial reporting is the benefit to be obtained from independent verification. As with financial reporting, verification serves only to reinforce transparency and so promote stakeholder confidence in a company’s integrity. Such confidence enhances market valuation. This process of verification should not be restricted to auditing in the traditional sense, as different expertise and methodologies may be required.
18. To the extent that reports are subject to verification, the identity of the verifier should be clearly stated, together with the period under review, the focus of the verification exercise and the methodology adopted.
19. Enterprises wanting to develop their stakeholder identification and engagement and non-financial accounting, control and disclosure processes can draw on a growing volume of guidance material, including industry codes of practice, standards, practical method and management tools. Some examples would be:
 - 19.1. the work of the Institute for Social and Ethical Accountability in its *AA1000* framework;
 - 19.2. the GRI guidelines;
 - 19.3. *SA8000* from Social Accountability International;
 - 19.4. *OHSAS 18000* occupational health and safety standards;
 - 19.5. *ISO 9000* quality management and quality assurance standards; and
 - 19.6. *ISO 14000* environmental standards.

The list grows all the time and it is acknowledged that there are many other valid examples.

Chapter 3 Ethical Practices and Organisational Integrity

1. A company’s ethics refer to the principles, norms and standards that it promotes for the guidance and conduct of its activities, internal relations and interactions with external stakeholders, in accordance with established values. Thus, ethical business conduct means that a company’s stakeholders – most notably its staff - adhere to defined standards of behaviour in all their business decisions and actions.
2. Cultural values and norms may differ among individuals, varying from Western notions of individualism to African notions of participation and inclusiveness. Companies should develop a culture of conduct based on generally accepted

behaviour and on their own organisational values, as embedded in their mission and vision statements.

3. The existence of – and demonstrable adherence to – established principles of ethical conduct provide a strong measure of organisational integrity. A company's ethical principles represent a major motivator of stakeholder involvement with it and, as such, should permeate its culture, motivating its strategy, business goals, policies and activities. A company's ethics programme should, therefore, involve both behavioural and structural aspects.
4. To be meaningful, a company's ethical principles should be informed by, and relevant to, the various stakeholder constituencies whose interactions with the company they are designed to cover. Stakeholders should be actively involved in the process of identifying the ethical principles and standards that will guide organisational practice, in terms of behaviour and accountability, in areas such as:
 - 4.1. responsibilities to shareowners and the financial community, including disclosure, accounting practices, insider trading, and conflicts of interest;
 - 4.2. relations with customers and suppliers, including marketing issues, the use of market power, pricing practices, description of goods and services, quality and safety of goods, and recall and related practices;
 - 4.3. employment practices, including equality of opportunity, occupational health and safety, other principles related to employers and employees; and
 - 4.4. responsibility to the community, including support for community activities, social investment, and attention to social and environmental impact.
5. Ethical principles should be codified in a manner whereby they are easily communicable to stakeholders. Codes of ethical practice should be broad and aspirational enough to guide decision-making by employees and other stakeholders in unprecedented situations, but contextualised enough to give practical guidance. They should be made readily available to stakeholders. Key decisions in developing a code of ethics are set out, as guidance, in Appendix VIII.
6. A code of ethics should be formulated and implemented in order to:
 - 6.1. make clear what is acceptable, and unacceptable, practice;
 - 6.2. guide company policy by providing a set of corporate ethical standards;
 - 6.3. encourage ethical behaviour of the board, managers and employees at all levels;
 - 6.4. guide difficult decision-making;
 - 6.5. make ethical infringements easy to identify;
 - 6.6. promote awareness of, and sensitivity to, ethical issues;
 - 6.7. help to resolve conflicts;

- 6.8. specify the enterprise's social responsibility;
 - 6.9. cover relations between stakeholders; and
 - 6.10. enhance the ethical reputation of the organisation.
7. Core ethical principles that all companies should aspire to, and that will demonstrate a commitment to organisational integrity are:
- 7.1. fairness;
 - 7.2. transparency;
 - 7.3. honesty;
 - 7.4. non-discrimination;
 - 7.5. accountability and responsibility; and
 - 7.6. respect for human dignity, human rights and social justice.
8. The formulation and adoption of principles and standards of ethical business conduct are meaningless without demonstrable adherence. Structural measures which can be introduced as part of an ethics programme to support embedded ethical business practices, could include, for example:
- 8.1. regular and formal identification of ethical risk areas;
 - 8.2. development and strengthening of monitoring and compliance policies, procedures and systems;
 - 8.3. establishment of easily accessible safe reporting (e.g. "whistle-blowing") channels;
 - 8.4. alignment of the company's disciplinary code with its code of ethical practice, to reinforce zero-tolerance for unethical behaviour;
 - 8.5. development of performance measurement and remuneration systems that reward ethical behaviour and punish unethical behaviour;
 - 8.6. integrity assessment as part of selection and promotion procedures;
 - 8.7. induction of new appointees;
 - 8.8. training on ethical principles, standards and decision-making;
 - 8.9. regular monitoring of compliance with ethical principles and standards, e.g. using the internal audit function;
 - 8.10. reporting to stakeholders on compliance ; and
 - 8.11. independent verification of conformance to established principles and standards of ethical behaviour.

9. Companies should monitor and evaluate compliance with established ethical principles and standards on a regular basis. They should reconsider the nature and extent of their relationship with any stakeholder (including employees) that does not show an appropriate commitment to such principles and standards.
10. Development and full implementation of an ethics programme may take a considerable amount of time. Regular interim reports on progress should be made available during the implementation process.
11. The following aspirational guidelines can be identified, in terms of responsibilities for establishing and maintaining organisational integrity through demonstrable ethical conduct within a company:

11.1. The **Board of Directors** should:

- establish the values of the company in support of its vision and mission;
- establish principles and standards of ethical business practice for the company in support of such values;
- determine the ethics direction and strategy of the company;
- ensure communication of established principles and standards to affected stakeholders in codified form; and
- assume responsibility and accountability to stakeholders for compliance with such principles and standards (acting through a sub-committee or named individual if appropriate).

11.2. **Management** should:

- support ethical behaviour, both formally and informally, leading by example;
- foster an environment within which ethical business practice is promoted, developed and maintained; and
- ensure compliance with established principles and standards of ethical behaviour and practice.

11.3. **Employees** should be:

- empowered to support the company's ethical principles and comply with established standards in their day-to-day activities;
- held accountable for their ethical conduct; and
- rewarded for complying with established principles and standards of ethical conduct and subjected to appropriate disciplinary measures for failing to do so.

11.4. **Suppliers, consultants and contractors** should be made aware of:

- the ethical principles and standards of the company;
- its expectations of them in this regard; and
- the consequences of non-compliance.

12. Specific laws also address issues that have significance within a business environment from an ethical point of view and they should be respected and complied with by the business community.³¹

13. A compliance system based on legal requirements alone is not enough to curb unethical behaviour within the business community. Measures supplementing this, for example, include the *Federal Sentencing Guidelines* adopted in the United States.

The *Federal Sentencing Guidelines* present the business community with both a “carrot” and a “stick” to foster and promote strong ethical behaviour. Under the *Federal Sentencing Guidelines*, it costs a company under prosecution far more, in terms of heavy fines and rigorous probation conditions, if unethical conduct leads to a lawsuit (the “stick”). However, the *Federal Sentencing Guidelines* also reward companies that have effective ethics and compliance programmes in place, either by not prosecuting them at all, or at least by reducing their fine if they are found guilty (the “carrot”).

In other words, the *Federal Sentencing Guidelines* have sent a very clear message to boards and directors in the US that it is their duty not only to do all they can to uncover, report and punish unethical and illegal conduct, but to prevent such conduct.

14. While the model provided by the *Federal Sentencing Guidelines* might not be entirely appropriate to South Africa, similar parameters might prove constructive in stressing the importance of actively combating unethical behaviour in the workplace. The *Federal Sentencing Guidelines* provide seven basic principles for developing an ethics and compliance programme:

- 14.1. establish compliance standards and procedures;
- 14.2. assign high level individuals to oversee compliance;
- 14.3. exercise due care in delegating discretionary authority;
- 14.4. communicate with and train all employees regarding company values and compliance procedures;

³¹

Examples are:
 Prevention of Organised Crime Act No. 121 of 1998 (anti-corruption measures);
 Insider Trading Act No. 135 of 1998 (conflict of interest, fair business practices, honesty);
 Employment Equity Act No. 55 of 1998 (promotion of development of human capital);
 Labour Relations Act No. 66 of 1995 (employment practices and relationships between employees and employer);
 Promotion of Equality and Prevention of Unfair Discrimination Act No. 4 of 2000 (fair treatment of employees, anti-racism, etc.)

- 14.5. monitor, audit and provide safe reporting systems;
 - 14.6. enforce appropriate discipline with consistency; and
 - 14.7. respond to offences and prevent recurrence.
15. While prescriptive measures are necessary, at least to define desirable and undesirable forms of behaviour, the challenge for companies in South Africa is to take the moral initiative. By its very nature, corporate governance has an ethical dimension that can be viewed as the moral obligation for directors to take care of the interests of investors and other stakeholders. The moral objectives of the company, exemplified by the board collectively and the directors individually, needs to be made visible to both internal and external stakeholders and seen to be integral with other corporate objectives. It is clear that governing the moral performance of a company challenges directors and managers to assume responsibilities that are often new and untested. They must face up to this challenge, however. Failure to do so might discourage investment and will almost certainly damage the company's integrity and the reputation of its board, directors, managers, employees and other internal and external stakeholders closely associated with it.
16. Company standards and procedures usually find expression in a company's specific code of conduct or statement of business principles, or code of ethics or such similar document. Successful codes are those that take into account not just company-specific issues, but recognise industry, national and international best practice. From a South African perspective, the King Report 1994 provided a generic code of aspirational principles that is available from the Institute of Directors in Southern Africa. A national standard, which has been lacking in South Africa, should not prescribe detailed behaviour to individual companies. Rather, it should provide the framework for organisational integrity, referring to the role of international, industry and company standards within this process, and a typical example would be the revised SANCode. The SANCode can be obtained from the Institute of Directors.

Chapter 4 Safety, Health and the Environment (SHE)

- 1. SHE issues should be dealt with in an integrated way where possible. However there may be specific strategic and best practice issues relevant to safety, health and the environment individually. As such this chapter has integrated SHE where possible, but has further highlighted individual issues separately.
- 2. ***Best Practice Principles for SHE***
 - 2.1. Companies should have as an objective the integration of SHE issues into their broader sustainability policies and procedures. This would assist in the achievement of the triple-bottom line goals.
 - 2.2. Companies should integrate SHE issues to reflect regulatory and best practice frameworks, but where necessary, safety, health and environmental issues should be dealt with separately.

2.3. Companies should take cognisance of the financial implications of past SHE issues and their possible impact on the sustainability of the company:

- *The Company*

- SHE issues should be dealt with at board level.
- The board should guide and approve the necessary policy, strategy and structure to manage SHE issues.
- There should be effective and adequate systems of internal control in place to manage SHE risks, including:
 - (i) risk identification and assessments (including legally required environmental impact assessments and major hazard installation risk assessments);
 - (ii) risk management strategies, such as avoidance, elimination, transfer to the extent possible and treatment (tolerance, mitigation). This includes training and emergency response plans;
 - (iii) risk financing; and
 - (iv) being informed of the relevant legal SHE requirements and ensuring compliance therewith.
- The following issues should be reported upon:
 - (i) whether the company and subsidiaries comply with applicable law regarding SHE;
 - (ii) how legal compliance is tested and SHE performance monitored;
 - (iii) any SHE issue which can materially impact on the financial statements of the company;
 - (iv) what benchmarking criteria against industry norms are used;
 - (v) whether the business is sustainable taking into consideration SHE aspects; and
 - (vi) what efforts are made regarding continual improvement in SHE efforts.

- *Directors' responsibilities*

- Directors have individual and collective responsibility for the company's SHE performance and compliance.
- Directors should substantiate management's effective action to address SHE concerns.

- Directors should be aware of the standards applicable to their industry regarding SHE.
- Directors should ensure that they are fully aware of, and understand, chapter 1 of the National Environmental Management Act.
- The company secretary, in discharging his/her obligations to provide directors with guidance as to their responsibilities, should include guidance on SHE issues.

3. **Safety**

- 3.1. Corporate governance practices should reflect a commitment to prevent workplace accidents and fatalities.
- 3.2. South African occupational health and safety legislation, namely the Occupational Health and Safety Act (No. 85 of 1993), and the Mine Health and Safety Act (No. 29 of 1996), requires employers to provide and maintain a safe and healthy risk-free working environment. Directors, and especially the chief executive officer, can incur personal liability for failure to do this. Although mainly applicable to employees of the company, the legislation also provides for the health and safety of non-employees.
- 3.3. The legislation principally requires the employer to identify hazards and risks in the workplace, and to take steps to eliminate them if possible. Alternatively, to mitigate them by implementing the necessary controls. The legislation relies on self-regulation from employers, making corporate governance practices important in this regard. The following factors must be considered:
 - the severity and scope of the hazard or risk concerned;
 - the state of knowledge reasonably available concerning that hazard or risk;
 - the availability and suitability of means to remove or mitigate that hazard or risk; and
 - the costs and the benefits of removing or mitigating that hazard or risk.

4. **Health**

- 4.1. The company should take cognisance of all threats to the health of stakeholders that are material. Corporate governance practices should reflect a commitment to preventing occupational diseases.
- 4.2. Health issues that are critical to a company's success may vary from time to time. However, the HIV/AIDS pandemic is a growing threat in South Africa and as such requires particular attention now. Companies should, however, not disregard other diseases that could pose a significant risk.

- 4.3. It is predicted that HIV/AIDS will have a devastating effect within Southern Africa. Some current indications show that over 20% of South Africa's economically active population will be directly affected within the next five years.
- 4.4. The growing practical impact of the HIV/AIDS pandemic on the South African economy generally – and individual businesses specifically – is therefore potentially huge, in terms of, for example:
- decreased productivity, e.g. through death, sick and compassionate leave;
 - increased overhead costs, e.g. healthcare and insurance;
 - reduction in the available skills base (with attendant indirect recruitment and training costs);
 - a contracting consumer base and changes in consumer spending patterns for some, predominantly retail, industry sectors;
 - reduced profitability; and
 - diminished investor confidence generally.
- 4.5. The South African corporate community has, with some notable exceptions, thus far offered little by way of public accounting and reporting on its strategies and actions for combating the potential social and economic impact of HIV/AIDS on business activities. In other words, there is little evidence of measures taken to promote business sustainability in the face of the HIV/AIDS pandemic.
- 4.6. The board of directors should therefore:
- ensure that it understands the social and economic impact that HIV/AIDS will have on business activities;
 - adopt an appropriate strategy, plan and policies to address and manage the potential impact of HIV/AIDS on business activities;
 - regularly monitor and measure performance using established indicators; and
 - report on all of the above to stakeholders on a regular basis.
- 4.7. Over and above occupational health issues, which may differ from company to company, primary health issues should not be ignored. While primary health issues may not have a direct impact on a company, the impact it could have in the community within which the business operates, may ultimately impact that business. Thus, for example, part of a company's corporate social responsibility programme could be targeted at primary health issues affecting the community.

5. **The Environment**

5.1. Environmental and other legislation imposes duties on companies and their directors personally. Some of the more pertinent requirements are set out below:

- There is a duty on companies and directors:
 - that cause, have caused or may cause significant pollution or degradation of the environment to take reasonable measures to prevent it from occurring, continuing or recurring, and to minimise and rectify pollution or degradation that has already been caused;³²
 - to ensure, as far as is reasonably practicable, that persons other than just those in their employ who may be directly affected by their activities are not exposed to health and safety hazards.³³
- Any person who is, or was, a director of a company, at the time of the commission by that company of a “scheduled” environmental offence will be:
 - guilty in their personal capacity of such offence; and
 - liable on conviction to the penalties imposed, if it is found that the offence in question resulted from the failure of the director to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence by that company.³⁴

5.2. The above requirements are consistent with contemporary international legal practice. The promulgation of further legislation will be a major development that should be anticipated by all companies, in their policies and planning. Companies may not in themselves constitute a “high risk” for pollution liability, through environmental damage, in terms of new and planned legislation in South Africa. However, association with or financing of environment unfriendly companies could have a detrimental impact, as many companies have learned. Whilst a number of companies refer to environmental issues in their annual reports, only a small percentage of South African companies report comprehensively on environmental issues, either in a separate report dealing exclusively with environmental issues, or in terms of an integrated report covering environmental issues as an inherent part of its reporting practices.

5.3. Current South African reporting requirements or guidelines for environmental disclosure, could be construed to include:

³² Section 28(1) of the National Environmental Management Act No. 107 of 1998

³³ Section 9 of the Occupational Health and Safety Act No. 85 of 1993

³⁴ Section 34(7) of the National Environmental Management Act No. 107 of 1998

- The *Companies Act* (No. 61 of 1973), under which directors are required to report on the state of affairs by specifically dealing with matters that are material for the business and profits of the company. “Material” is defined in Schedule 4 as “*anything that is significant in relation to the circumstances applicable to each company*”. The Board should establish an appropriate definition of “materiality” for the company in this regard.
- *JSE listings requirements*, which identify further issues regarding or connected with the supply of information, performance factors including the company’s performance and obligations with respect to the environment, and continuing obligations.
- *International Auditing Practice Statement 1010* (or SAAS 2501 in South Africa), which deals with the consideration of environmental matters in the audit of financial statements, as follows:
 - The objective of a financial audit is to enable an auditor to express an opinion as to whether or not the financial statements fairly represent the true position, in all material respects, in accordance with an identified financial reporting framework (SAAS 200).
 - Environmental matters that may, in certain circumstances, have a material impact on the company’s financial statements.
 - Management’s responsibility is to recognise, measure and disclose environmental issues, and to do so in the context of the financial statements.
 - Where environmental issues are significant, there may be a risk of material misstatement (including inadequate disclosure) in the financial statements and reports arising from such matters. In these circumstances, the auditor needs to give consideration to environmental matters in the audit. SAAS 2501 provides a framework that could assist in considering environmental matters in the audit of financial statements.

5.4. International reporting trends suggest that:

- environmental reporting remains general and unsystematic; and
- environmental reporting is still giving low target information and has a low percentage of external verification.³⁵

5.5. To make environmental corporate governance principles effective, they should be integrated with the financial components and other aspects of the business. This gives the board a reason to take cognisance of the

³⁵

According to an article entitled “*South African Environmental Reporting: What is it, what it should be*” – Charl De Villiers, University of Pretoria

environment, and enables the directors to justify any related expenditure to shareholders:

- The financial issues to be considered include:
 - placing a realistic price on natural resources such as water and energy;
 - the implications of the environmental performance and management as a trade barrier, whether real or artificial, where foreign trading partners may demand that the company has implemented certain environmental monitoring standards, before trading with it, or allowing it to do business;
 - the benefit of the development and active participation in environmental financial indices, such as the Dow Jones Sustainability Index or local equivalent green funds; and
 - competitiveness issues, such as introducing cleaner technology and reducing reliance on non-renewable resources.
- Moreover, environmental management systems, whether formal or informal, and whether certified or not, are becoming the benchmark by which companies are being measured, to determine whether they have adequately dealt with environmental concerns.
- Formal certification, arguably gives the company a competitive advantage – whether real or perceived.

5.6. The following principles of best practice are recommended:

- Viewed from a holistic perspective, the environment should be clarified as a stakeholder in its own right within the category of stakeholders that have a non-contractual nexus with the company, i.e. society at large. Placing emphasis on the environment as a stakeholder in its own right should encourage conduct to preserve all life.
- Where a company has operations in a foreign jurisdiction, the higher legislative standard between South Africa and that country's standard should be the benchmark. The aspiration should be to achieve best practice.

5.7. The “reasonable measures” or environmental due diligence standards for which boards collectively, and directors in their personal capacities, must strive should be determined by the nature of the company, its products, processes and other activities:

- The “Best Practicable Environmental Option” is defined as that option that has most benefit, or causes the least damage, to the environment at a cost acceptable to society. This standard should

be applied to all decisions taken by the company which could impact the environment.

- “Reasonable measures” include the following:
 - all relevant environmental risks should be identified and prioritised;
 - environmental legal compliance requirements should be determined, together with a strategy to ensure that compliance is attained and maintained;
 - environmental issues should be dealt with promptly;
 - environmental emergency response plans should be in place and distributed to all affected parties;
 - environmental training and development programmes should be implemented based on identified needs;
 - environmental issues should be addressed at board level;
 - companies should make open and transparent disclosure on environmental issues to shareowners and relevant stakeholders, which should allow them to:
 - (i) determine whether fines, clean-ups or damages will result in significant losses to the company;
 - (ii) identify whether the level of environmental compliance in the company suggests any potential for unforeseen or undisclosed environmental problems in the future;
 - (iii) consider and evaluate company performance on issues such as waste prevention or minimisation
 - enterprises should disclose the nature of their environmental policies, ethos, and values.

6. It has been argued that there is no financial incentive for companies to expend capital on improving environmental performance, save for the potential avoidance of the costs of fines and rehabilitation and implications for reputational damage. It is recommended, that companies be given legislative incentives to improve performance, encourage best practice and promote compliance with environmental corporate governance. An incentive in the form of tax relief already exists for mining operations under section 10(1)(cH)(i) of the Income Tax Act (No. 58 of 1962), which could be extended to certain other sectors of industry beyond the mining sector.

Chapter 5 **Social and Transformation Issues (including Black Economic Empowerment)**

1. In South Africa, where social imbalances have existed for many decades, the need for reform, the need for “ploughing back” and the need for a greater social and ethical conscience of companies are crucial to their long-term survival. Such actions would also promote the greater well-being of society generally. Increasingly, South African companies are seen as agents of change not only for their own benefit but also for the benefit of their stakeholders.
2. The concept of Ubuntu has already been highlighted as an aspect of the African value system that can contribute towards sustainability, even in the corporate world.³⁶ It is even more valuable in the context of the transformation that needs to occur in South Africa. That transformation process should also be underpinned by “supportiveness”, co-operation and solidarity.
3. Transformation is an essential ingredient of this process in addressing a legacy of inequality. It also makes good business sense. The fact that something needs to be done is accepted and requires no further motivation. The challenge is how to do it in the most effective manner.
4. Success depends upon a partnership between government, business, labour and society at large.
5. The contribution from government has been to shape the legislative framework to encourage the achievement of certain objectives. The following legislation has been instrumental in encouraging the required behaviour:
 - 5.1. the Employment Equity Act (No. 55 of 1998), which obliges companies to develop an Employment Equity Plan and to report on progress in achievement of the objectives set out in their plans;
 - 5.2. the Skills Development Act (No. 97 of 1998) and Skills Development Levies Act (No. 9 of 1999), which govern the provision of resources for skills development and training by companies;
 - 5.3. the Promotion of Access to Information Act (No. 2 of 2000), which provides for access to information held by companies to encourage better transparency.

These laws have helped effect change. No further legislative intervention is necessary at this stage.
6. The onus on the business sector is to uphold the law in a manner that goes beyond a mere “tickbox” approach to compliance, towards a commitment to the underlying objectives.
7. Stakeholders should be told how a company is meeting these legal requirements. At a bare minimum, reporting required by statute to the respective government department or other supervisory body could be made available to a wider range of stakeholders. A summary of detected violations of the legislation could also be

³⁶ See paragraph 6, chapter 1

disclosed. It should also be pointed out that if the corporate world does not rise to the challenge of facilitating transformation in an effective manner, further obligations may be imposed through legislation. Clearly, this is not the ideal solution and should be avoided to the extent possible.

8. Stakeholders should be informed about:

8.1. **Employment equity**

- *Underlying Principle*

Employment equity is about rectifying the social and economic effects of past discrimination that resulted in the underdevelopment and underutilisation of a section of the population. Hence, the empowerment and advancement of previously disadvantaged individuals, and in particular, women should be based on the premise that they are equal partners in the corporate sphere, and that their contribution can be a valuable one.

- *Women*

The problem is more acute in the South African business environment with regard to women, who are to a large extent excluded from leadership positions. Also, within companies in general the glass ceiling is still pervasive, and company culture tends not to support the growth and development of women. As such, special measures are required to ensure good corporate governance practices in this regard.

Certain issues pertinent to the empowerment of women require specific mention:

- At the level of organisational culture, care should be taken to curb aspects of managerial behaviour which has the effect of undermining the performance of women. An example here would be the need to ensure that managerial decisions are taken through formal governance processes and not through informal network arrangements from which women may be excluded.
- Due consideration should be given to the particular parental responsibilities women shoulder. Governance arrangements should therefore be sufficiently flexible to allow for the full participation of such women at all levels, from leadership to the shop-floor.
- Companies should strive for adequate representation of women at top management and board levels.
- The long-term success of the South African economy is dependent on a wide and diverse pool of skill contributing to, and participating in, the most meaningful way. Given this, women need to play a bigger role in larger numbers in business at all levels. To drive this process, focused initiatives should be put in place to make these jobs more accessible to women. These

objectives will not be met unless they are quantified and translated into performance measures for executives.

- Organisations should be encouraged to report on the steps they have taken to create conditions and opportunities to reach the executive level and realise their full potential.

- *Disclosure*

Enterprises should disclose the nature of policies and practices in place to specifically address the kinds of issues that create the conditions and opportunities for previously disadvantaged individuals, in particular women to have an equal opportunity to reach executive levels in the company and to realise their full potential.

8.2. **Diversity Management**

- Diversity management is an important constituent of transformation, particularly in relation to employment equity, namely in:
 - Addressing issues such as discrimination, cross-cultural issues (e.g. racial conflict, stereo-typing, cultural assumptions), attitudinal issues (e.g., resistance, trust, respect, expectations), inter-personal issues, and potential hidden organisation cultural issues (e.g., the 'old-school-boy' culture, the 'similar-to-me' bias in employment practices; the view that 'others' need to fit into the existing culture or the persisting deficit view of blacks/women).
 - Changing organisations need new ideas and values to succeed in a new South Africa and the changing business world. A diverse workforce will help generate these new ideas and values by leveraging the contribution and potential of all employees. A diverse workforce will enhance organisational creativity and problem solving, resulting in more innovative solutions to organisational challenges.
- Fundamentally, diversity should be characterised by two values - an acceptance that diversity of all kinds will be viewed in a positive light and respect for all employees whatever their level, race and gender. These values should manifest themselves in day-to-day management and employment practices, so as to take full advantage of the multicultural aspects of South Africa.
- Companies should value diversity of approach, values and contribution which women and black people bring to the table, and should develop mechanisms to positively reinforce the richness of diversity.

8.3. ***Black Economic Empowerment (including Women Equity)***

- Over and above measures to facilitate empowerment through employment practices, companies can make a significant contribution in this regard that go beyond their employment practices, through for example, procurement and investment policies.
- Black economic empowerment should be aimed at redressing the continued unequal distribution of ownership, management and control of South Africa's financial and economic resources. It will achieve this by ensuring broader participation of black people in the formal economy in order to achieve sustainable development and prosperity, both at the corporate level and in the national interest.
- At the heart of black economic empowerment should be initiatives that will advance black people economically on a large scale (including job creation, rural development, poverty alleviation, and access to finance for the purpose of conducting business), rather than the enrichment of a few. Progress towards particular targets should be disclosed.
- Social investment prioritisation and spending, as well as procurement practices, should take due cognisance of the need to empower women in particular.

8.4. ***Social Investment***

- As has been observed earlier in the Report, an important development in stakeholder engagement and reporting has been the increased focus on socially responsible investment. In some countries, such as the United Kingdom, Canada, Australia and the USA, this development has been stimulated by legislation prescribing disclosure by pension funds on the extent to which social investment considerations are taken into account in their investment guidelines.
- In the United States alone, social investing has escalated from US\$40 billion in 1984 to an estimated US\$ 2,1 trillion by 1999.³⁷
- The Canadian Social Investment Organisation has published the first comprehensive survey results of a study conducted on assets managed according to social responsibility guidelines in Canada. It distinguishes three categories of socially responsible investment:
 - *Positive and negative screening*

Negative screens are criteria that exclude companies from investment portfolios based on issues considered socially undesirable. Positive screens identify companies making a

contribution to social, economic or environmental sustainability or industries with exemplary employee practices.

➤ *Community investment*

This is the investment of money into community development or micro-enterprise initiatives that contribute to the growth and well-being of particular communities. The idea is to reverse the drain of capital and income that debilitate low-income communities.

➤ Shareowner advocacy and corporate engagement

This is the process of using shareowner influence to help bring about corporate social and environmental change. This can include proxy voting (establishing policies for voting shares on social and environmental issues), corporate engagement (communicating with management on particular issues), shareowner resolutions (filing or supporting shareowner proposals on social and environmental issues) and divestment (selling of shares).

- Social investment prioritisation and spending, as well as procurement practices, should take due cognisance of the need to empower women in particular.
- Boards should become familiar with the criteria in regard to socially responsible investment used by investment managers responsible for investment of corporate and pension funds on its behalf. The company's policy on investment of corporate funds should be disclosed. In particular, pension funds, both in the private and public sectors, should indicate in a Statement of Investment Principles and Policies or an equivalent document whether or not they take into account socially responsible investment criteria when making investment decisions.

Chapter 6 Human Capital

1. Any fair valuation of a company depends both on an assessment of what will drive future value and on an evaluation of management's ability to unlock, protect and develop it. Much of this value is inherent in the company's intangible assets, such as its accumulated knowledge, intellectual property, customer relations, innovative ability, operational process efficiency and IT, all of which are reflected in the strength of its brand, image and broader reputation. At the core of any such intangible assets are, however, the extent and quality of its human capital.
2. Human capital denotes the latent, or potential, value that employees at all levels – individually and collectively – represent for a company. This is a function of their knowledge, learning, intuition, skill, expertise and experience, both existing and, importantly, latent. Nurturing, protecting, capturing, retaining and developing human capital can therefore be seen as a vital ingredient for the

sustainable economic performance of any company. It forms the basis for future strategic advantage and economic value creation. A focus on developing human capital represents a focus on breathing life into the oft-quoted statement that “our people are our most important asset”.

3. The ongoing challenge is for the company to benefit from staff members’ latent potential. This can be achieved by effective training and knowledge management processes, and reflected in good management practice, such as effective succession planning.
4. Though clearly related, “human capital” represents a concept distinguishable from that of “human resource”, which is closely aligned to the need to apply employees to requisite functions (operational and management). Human resource policies can be said to focus on attracting and retaining an appropriate mix of skills and experience.
5. Policies for the development of human capital ensure that such skills and experience are developed, consistently and methodically retained (or “capitalised”) and enhanced to create value for the company. In other words, the development of human capital focuses on the conversion of “raw”, latent human potential into tangible, retained value for the company (e.g. in the form of innovative product designs and patents, developed systems, methodology, procedures etc.).
6. By capitalising individual skills and experience, companies can reduce any dependence on what is locked “inside people’s heads” and instead transfer such knowledge into the organisational domain. The value this represents for the company will extend potentially far beyond the term of each individual’s involvement with it.
7. Development of human capital serves not only the economic interests of the company itself, but also the broader requirements of the society within which the company operates. This is of particular significance in South Africa. It means ensuring not only that the staff has skills to deliver on strategy, but also that statutory and social obligations in relation to issues such as racial, gender and disability demographics are met.
8. The Employment Equity Act has provided a basis for the development of equity plans and reporting on progress towards targets. It aims to make companies demographically representative of society. The focus for now, is on the number of previously disadvantaged people who are employed or promoted within a company.
9. Employment equity also means that skills, expertise and human capital should be consistent with demographic representation over time. In other words, if 50% of a company’s employees are from the previously disadvantaged categories, the next measure should be what contribution this 50% make to the true value of the company. The focus should therefore be on the extent to which previously disadvantaged people have been brought in to areas of core skills within a company at a management, technical and operational level.
10. In the short-term, companies must strive for an employee roster that shows an appropriate mix of staff, meeting legislative requirements in purely numerical terms, so addressing the short-term demands for affirmative action. This mix should, however, be adequately reflected through the development of core skills

and competencies across all disciplines (e.g. management, technical, professional, manual) over the longer-term, thereby addressing the longer-term requirement for employment equity.

11. Management should have ways of meeting and monitoring progress towards human capital developmental objectives. Performance should be measured and rewarded accordingly at both enterprise and individual level.
12. An ongoing process of measurement, monitoring and review in relation to human capital development represents good management practice. Areas in which management accounting practices can reflect the requirements of human capital development could include:
 - 12.1. number of staff (with particular focus on demographics, gender, disabilities and age);
 - 12.2. training (including attendance, development and financial investment);
 - 12.3. international transfers inwards and outwards (for companies with an international presence);
 - 12.4. employee retention, satisfaction and succession planning;
 - 12.5. development of knowledge management infrastructure, information sharing, database development and IT capability; and
 - 12.6. employee health and safety and the impact of HIV/AIDS programmes.
13. Reporting on the development of human capital provides both a public account of past performance and, more importantly, an indication of future prospects. It is likely to be targeted at a range of stakeholder constituencies (e.g. employees themselves and their representatives, such as trades unions, society at large and existing and potential shareowners). While the respective short-term interests of such stakeholder constituencies might diverge, their longer-term interests will converge in the prosperity, viability and therefore the sustainability of the company. They all want the company to survive and prosper.
14. Companies should consider disclosing information on the underlying principles, standards and goals adopted for the development of human capital, how accounting policies will support them and how their performance rates by comparison. Independent external verification of performance can only add strength to such public accounts.

Recommendations

• Sustainability Reporting

- Every company should report at least annually, on the nature and the extent of its social, transformation, ethical, safety, health and environmental management policies and practices. The board of directors should, in determining what is relevant for disclosure, take into account the environment in which the company operates. For South Africa, the board should disclose:
 - (i) whether it has adopted an appropriate HIV/AIDS strategy plan and policies to address and manage the potential impact of HIV/AIDS on the company;
 - (ii) whether it has developed formal procurement policies that take into account black economic empowerment;
 - (iii) whether it has developed and implemented a definitive set of standards and practices in the company based on a clearly articulated code of ethics.
- In disclosure there should be clarity on:
 - (i) the nature of the disclosing entity (e.g. a group of companies, or one business unit only);
 - (ii) the scope of issues subject to disclosure;
 - (iii) the period under review;
 - (iv) the performance expectations (i.e. as an integral aspect of the “going concern” concept); and
 - (v) the extent to which items disclosed are directly attributable to the disclosing entity’s own action or inaction.
- Public disclosure of non-financial information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability in line with the Global Reporting Initiative Sustainable Reporting Guidelines on economic, environmental and social performance.
- Criteria and guidelines for materiality should be developed by each company to assist in reporting consistently. In this respect, regard should be given to international models and guidelines, as well as national statutory definitions.

Recommendations continued

- Companies should make available to a wider range of stakeholders such reports as are made to respective government departments or other supervisory bodies as required by legislation, to the extent that such stakeholders have a legitimate interest in the information contained therein.

- **Organisational Integrity / Code of Ethics**

- Every company should engage its stakeholders in determining the company's standards of ethical behaviour. It should demonstrate its commitment to organisational integrity by codifying its standards in a code of ethics.
- Each company should demonstrate its commitment to its code of ethics by:
 - (i) creating systems and procedures to introduce, monitor and enforce its ethical code;
 - (ii) assigning high level individuals to oversee compliance to the ethical code;
 - (iii) assessing the integrity of new appointees in the selection and promotion procedures;
 - (iv) exercising due care in delegating discretionary authority;
 - (v) communicating with, and training, all employees regarding enterprise values, standards and compliance procedures;
 - (vi) providing, monitoring and auditing safe systems for reporting of unethical or risky behaviour;
 - (vii) enforcing appropriate discipline with consistency; and
 - (viii) responding to offences and preventing re-occurrence.
- Disclosure should be made of adherence to the company's code of ethics against the above criteria. The disclosure should include a statement as to the extent the directors believe the ethical standards and the above criteria are being met. If this is considered inadequate there should be further disclosure of how the desired end-state will be achieved.
- Companies should strongly consider their dealings with individuals or entities not demonstrating its same level of commitment to organisational integrity.

Recommendations continued**• Safety, Health and Environment**

- Business processes and safety, health, and environmental management principles should be integrated.
- Environmental corporate governance must reflect current South African law by the application of “Best Practicable Environmental Option” standard (defined as that option that has most benefit, or causes the least damage to the environment at a cost acceptable to society).
- Corporate governance should reflect a committed effort to reduce workplace accidents, fatalities and occupational health and safety related incidents. There should also be regular measurement against an ongoing improvement objective, which should be disclosed to stakeholders.

• Social Transformation

- Companies should value diversity of approach, values and contribution which women and black people bring to the table, and should develop mechanisms to positively reinforce the richness of diversity.
- Social investment prioritisation and spending, as well as procurement practices, should take due cognisance of the need for black economic empowerment and, in particular, the need to empower women.
- Companies should disclose the nature of policies and practices in place to promote equal opportunities for the previously disadvantaged (notably black people, women and the disabled), in terms of realising their full potential and reaching executive levels in the company.
- The company’s policy on investment of corporate funds should be disclosed. In particular, pension funds, and institutional investors both in the private and public sectors, should indicate in a Statement of Investment Principles and Policies or equivalent document the extent to which they take into account socially responsible investment criteria in their investment decisions.

Recommendations continued

- **Human Capital**

- Companies should disclose the criteria by which they propose to measure human capital development, and report accordingly on their performance in terms of such criteria.
- Business practice should reflect requirements of human capital development in areas such as the number of staff, with a particular focus on demographics (race, gender, people with disabilities), age, corporate training initiatives, employee development and financial investment committed.

SECTION 5 – ACCOUNTING AND AUDITING

“If you are looking for signs that governance is working, look for clear purpose, inspiring vision, shared values, robust relationships, reciprocal accountability and balanced measurement.”

*The Corporate Reporting Jigsaw
Centre for Tomorrow's Company*

Chapter 1

Auditing

1. **External Audit**

- 1.1. The external audit provides an independent and objective check on the way in which the financial statements have been prepared and presented by the directors when exercising their stewardship to the stakeholders. An annual audit is an essential part of the checks and balances required, and is one of the cornerstones of corporate governance.
- 1.2. While external auditors have to work with management, they must be objective and consciously aware of their accountability to the shareowners. An audit committee, comprising a majority of non-executive directors with an independent non-executive director chairperson, can maintain the objectivity between the auditors and management. Differences of opinion between the two can be aired, discussed and overcome in that committee. The auditors should also be able to turn to the non-executive directors in regard to any concerns they may have about the company or its business.
- 1.3. Auditors, through their audit activities, have an important impact on the quality of the internal control system, including holding discussions with management, the board of directors, the internal auditors and the audit committee. They may recommend improving internal controls.
- 1.4. Since the proper functioning of the external auditors depends on their independence, the following should be borne in mind:
 - Audit fees should be set in a manner that enables an effective external audit on behalf of shareowners. Targeting audit fees as a means of cost savings to the company should be discouraged.
 - Auditors compete with each other for the performance of other functions, such as management consultancy and corporate finance. This should not have the unfortunate by-product of impairing their effectiveness in the performance of their audit functions.
- 1.5. Auditors should observe the highest standards of business and professional ethics.

- 1.6. Directors or officers may have by their acts of commission or omission, contributed to a company's failure and should be held liable for any such conduct. Damages against auditors for company failures are becoming a matter of concern. Directors and auditors should be held liable for damages in proportion to their contribution to the failure.

Recommendation

Directors or officers may have by their acts of commission or omission, contributed to a company's failure and should be held liable for any such conduct. Damages against auditors for company failures are becoming a matter of grave concern. Directors and auditors should be held liable for damages in proportion to their contribution to the failure.

2. *Review of Interim Results*

- 2.1. The King Report 1994 recommended that interim reports should be subject to an independent review by the auditors. However, this was not supported by the JSE Securities Exchange at the time, except in certain circumstances, i.e. where a modified auditors' report had been issued on the previous year's annual financial statements.
- 2.2. At present, independent reviews of interim reports are not mandatory requirements of either the Securities Exchange Commission in the United States or the London Stock Exchange. Until this becomes a global requirement, it should be the responsibility of the audit committee to consider whether a voluntary independent review of the interim report is in the best interests of the company. As the scope of this report is wider than those of companies listed on the JSE Securities Exchange, it is recommended that, at a minimum, the audit committees should request that an independent review of the interim report is performed if the auditors have qualified or disclaimed their opinion, or produced an adverse opinion, on the latest annual financial statements.
- 2.3. Where an independent review was conducted, the audit committee's report commenting on the interim report, together with the auditors' review report, should be tabled at the board meeting to adopt the interim report.
- 2.4. Where an independent review was not conducted, a comprehensive statement of the reasons why the audit committee concluded a review was not required should be tabled at the board meeting. Where an independent review was not conducted, any publication of the interim results should then be labelled "unaudited".

Recommendations

- The audit committee should consider whether or not an interim report should be subject to an independent review by the auditor.
- In the case of an independent review the audit committee's report commenting on the interim report and the auditors' review report, should be tabled at the board meeting held to adopt the interim report.
- Where an independent review was not conducted, the audit committee should table reasons at the board meeting.

3. Going Concern

- 3.1. South African Statements of Generally Accepted Accounting Practice ("GAAP") state that, when preparing financial statements, management should make an assessment of the company's ability to continue as a going concern. Financial statements should be prepared on a going concern basis, unless management either intends to liquidate the company or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast doubt upon the company's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the company is not considered to be a going concern.
- 3.2. In addition, these Statements of GAAP require that, in assessing going concern, management should take into consideration all available information for the foreseeable future. This should be at least, but is not limited to, 12 months from the balance sheet date.
- 3.3. There is ample support for the recommendation made in the King Report 1994 that directors should be required to state in the annual report that there is no reason to believe that the business will not be a going concern in the year ahead, or to explain any reasons otherwise.
- 3.4. Although directors cannot be expected to consider going concern as fully for interim reporting, as they would for final reporting purposes, they should nevertheless review the previous work. Directors should consider the position at the previous year end, and determine whether any of the significant factors identified at that time have changed in a way that affects the going concern assumption at the interim reporting stage.

Recommendations

- The board should minute facts and assumptions used in the assessment of the going concern status of the company at the year end.
- At the interim reporting stage, the directors should consider their assessment at the previous year end of the company's ability to continue as a going concern, and whether there have been changes that affect that conclusion.
- The board should minute the conclusion reached by the directors at the interim reporting stage.

4. Relationship Between External and Internal Auditors

- 4.1. The roles and responsibilities of external and internal auditors are different. External auditors have a statutory duty to report their independent opinion to the shareowners, on the company's financial statements, and to consider statutory requirements and standards for financial reporting, as well as auditing. This contrasts with the internal audit, which is a service to the company focusing on the system of internal control and which reports to the executive management and the audit committee. These are the individuals that determine the scope of internal audit, which varies depending on the size and structure of the company. Internal auditors also have to adhere to professional standards relevant to the conduct of their work.
- 4.2. Since some of the means of achieving the respective objectives of external and internal audit are often similar, some of the work of internal audit may be useful for determining the nature, timing and extent of external audit procedures.
- 4.3. The degree of reliance that the external auditors may wish to place upon an internal audit function should be maximised by dialogue and co-ordination. These matters could be formalised by an audit "partnership". If an audit "partnership" is in place, the matters that should be considered within this "partnership" could include the following:
 - a good understanding of the audit approach by each party, and a co-ordinated approach (including assistance to either party where appropriate) to ensure consistent risk assessment and to avoid unnecessary duplication of work. Special emphasis should be placed on this understanding at the planning stages, when information could be shared on risk assessments and materiality levels;
 - a continuing dialogue on problems and issues found by the internal and external auditors that they may, or may not, include in their management letters. In addition to the normal control weaknesses and audit adjustments, issues may include illegal acts, problems in conducting their audit work, disagreements with management,

matters that need follow-up by internal audit, and suspicions related to potential fraud;

- access to each other's audit programmes and working papers, as well as a sharing of each other's reports; and
- a formal annual review of the working arrangements in the audit "partnership".

4.4. It is important that the external auditors are able to express their views on the quality of the internal auditors' work, even where the internal audit function is outsourced to the accounting firm performing the external audit.

Recommendations

- Companies should aim for efficient audit processes using external auditors in combination with the internal audit function.
- Management should encourage consultation between internal and external auditors. Co-ordination of efforts involves periodic meetings to discuss matters of mutual interest; the exchange of working papers, management letters and reports; and a common understanding of audit techniques, methods and terminology.

5. Audit Committees

- 5.1. The role, objective and responsibility of the audit committee were dealt with in the King Report 1994. However, salient points are included here for completeness.
- 5.2. The appointment of an audit committee gives the board a means to monitor an effective internal control system. In addition, the audit committee reinforces both the internal control system and the internal audit function.
- 5.3. The audit committee is normally regarded as a committee of the board, comprising a majority of independent non-executive directors. The majority of the members of the audit committee should be financially literate.
- 5.4. The chairperson of the committee should be knowledgeable about the status of the position, have the requisite business, financial and leadership skills and be a good communicator. The chairperson should be an independent non-executive director and should not be the chairperson of the board. In addition, the better view is that the board chairperson should not be a member of the audit committee at all. Of course, the attendance of the board chairperson at meetings of the audit committee may at times be necessary or appropriate, in which case he or she could be invited at the discretion of the chairperson of the audit committee. The board should consider whether or not it is desirable for the chief executive officer to be a member of the audit committee, or to attend only by invitation.

- 5.5. The audit committee should have written terms of reference dealing adequately with its membership, authority and duties. The terms of reference of the audit committee should be confirmed by the board and reviewed every year.
- 5.6. Shareowners, on request, should be able to obtain a copy of the current terms of reference of the audit committee at the registered office of the company.
- 5.7. The audit committee should review:
 - the functioning of the internal control system;
 - the functioning of the internal audit department;
 - the risk areas of the company's operations to be covered in the scope of the internal and external audits;
 - the reliability and accuracy of the financial information provided to management and other users of financial information, and whether the company should continue to use the services of the current external and internal auditors;
 - any accounting or auditing concerns identified as a result of the internal or external audits; and
 - the company's compliance with legal and regulatory provisions, its articles of association, code of conduct, by-laws and the rules established by the board.
- 5.8. The audit committee should encourage communication between members of the board, senior executive management, the internal audit department and the external auditors.
- 5.9. The audit committee should confirm the internal audit department's charter and the internal audit plan, as well as the resources required. It should receive the activity reports and a summary of the department's main recommendations and management's plans for their implementation.
- 5.10. The audit committee should expect the external auditors, as experts in accounting and financial reporting, to express an independent judgment on the appropriateness, not just acceptability, of the accounting policies and practices and on the clarity of the financial disclosure practices used or proposed by the company.
- 5.11. The audit committee and the external auditors should develop a direct, strong and candid relationship. Lines of communication and reporting should facilitate independence from management and encourage the external auditors to speak freely, regularly and confidentially with the audit committee.

- 5.12. The audit committee should, without the presence of executive directors, have a discussion with the external auditors at least once a year to ensure that there are no unresolved issues of concern.
- 5.13. The duties of the audit committee include reviewing the scope and results of the external audit and its cost effectiveness, as well as the independence and objectivity of the external auditors. Where the auditors supply non-audit services to the company, the audit committee should review the nature and extent of such services, seeking to balance the maintenance of objectivity and value for money.
- 5.14. The minutes of the meeting of the audit committee must be placed before the board at its next meeting which follows that of the audit committee. This will ensure that the board will not only receive the verbal report of the audit committee chairperson, but they shall also have the opportunity to consider any other issues that may be contained in the minutes which may warrant consideration in addition to matters highlighted by the audit committee chairperson.
- 5.15. The audit committee should consider the rotation policy adopted by the external auditors, and whether there is any need to recommend that the audit partner or senior staff be changed because of the extent of time served on the audit engagement.
- 5.16. Companies should avoid opinion shopping in regard to audit and accounting matters. The audit committee can prevent this by acting as arbiter between management and the external auditors when there is a disagreement over accounting policies or disclosure in the financial statements. The audit committee should enquire whether or not opinion shopping has occurred on issues within the scope of their activities. Where this has indeed occurred, the reasoning for the opinion adopted should be obtained.
- 5.17. The audit committee should draw up a recommendation to the board for the appointment and removal of the external auditors.
- 5.18. The audit committee should have explicit authority to investigate any matters within its terms of reference. It must be provided with the required resources that have full access to information. The audit committee should be able to obtain outside professional advice and, if necessary, to invite outsiders with relevant experience to attend meetings. The audit committee must safeguard all the information supplied to it as specified by law.
- 5.19. The audit committee's activities and effectiveness should be assessed periodically and reviewed by the board.
- 5.20. Companies should, in their annual report, disclose whether or not the audit committee has adopted formal terms of reference and, if so, whether or not the committee satisfied its responsibilities for the year in compliance with its terms of reference.
- 5.21. Membership of the audit committee should be disclosed in the annual report, and the chairperson of the committee should be available to answer questions about its work at the annual general meeting.

Recommendations

- The board should appoint an audit committee that has a majority of independent non-executive directors. The majority of the members of the audit committee should be financially literate.
- The audit committee should select a chairperson that is an independent non-executive director. The chairperson of the audit committee should be selected without cronyism or tokenism, be knowledgeable of the status of the position, have the requisite business, financial and leadership skills, and be a good communicator.
- The board chairperson should not chair the audit committee. In addition, the better view is that the board chairperson should not be a member of the audit committee at all, but could be invited to attend meetings as necessary by the chairperson of that committee. The board should consider whether or not it is desirable for the chief executive officer to a member of the audit committee, or to attend only by invitation.
- The audit committee should have written terms of reference, dealing adequately with its membership, authority and duties. The terms should be confirmed by the board and shareowners should, on request, be able to obtain a copy of the current terms of reference of the audit committee at the company's registered office.
- The audit committee should review:
 - the functioning of the internal control system;
 - the functioning of the internal audit department;
 - the risk areas of the company's operations to be covered in the scope of the internal and external audits;
 - the reliability and accuracy of the financial information provided to management and other users of financial information;
 - any accounting or auditing concerns identified as a result of the internal or external audits; and
 - the company's compliance with legal and regulatory provisions, its articles of association, code of conduct, by-laws and the rules established by the board.
- The duties of the audit committee include reviewing the scope and results of the external audit and its cost effectiveness, as well as the independence and objectivity of the external auditors. Where the auditors supply non-audit services to the company, the audit committee should review the nature and extent of such services, seeking to balance the maintenance of objectivity and value for money.

Recommendations continued

- Companies should avoid opinion shopping in regard to audit opinions. The audit committee can prevent opinion shopping by acting as arbiter between management and the external auditors when there is a disagreement over accounting policies or disclosure in the financial statements. The audit committee should enquire whether or not opinion shopping has occurred on issues within the scope of its activities. Where opinion shopping has occurred, the reasoning for the opinion adopted should be obtained.
- The audit committee should draw up a recommendation to the board for consideration and acceptance by the shareowners for the appointment of the external auditors.
- Companies should, in their annual report, disclose whether or not the audit committee has adopted formal terms of reference and, if so, whether or not the committee satisfied its responsibilities for the year in compliance with those terms.
- Membership of the audit committee should be disclosed in the annual report. The chairperson of the committee should be available at the annual general meeting to answer questions about its work.
- The audit committee's activities and effectiveness should be assessed periodically and reviewed with the board.

Chapter 2

Non-audit Services

1. The importance of external auditor independence is a vital pre-condition to the workings of efficient capital markets. Accounting firms and the public benefit when firms have effective quality controls that ensure the independence of external auditors. These controls protect the public and the accounting firms on whose audit the public relies. Public companies benefit as well, since they are able to access capital at a lower cost through the capital markets.
2. A critical unbiased eye gives investors and other users of financial information comfort and faith in the numbers and disclosures presented. In recent years, whole economies around the world have faltered because of lax standards of financial reporting.
3. More than anyone else, it is the external auditors that guard the public interest. It is their duty and unique franchise to protect and honour that interest.
4. Accounting firms have provided non-audit services throughout the history of the profession. These services, by and large, have grown as logical extensions to the performance of audits.

5. Audit and consultancy services can be construed as contradictory, as one demands objectivity and independence, and the other a direct interest in a client's success.
6. An option considered internationally was to prohibit accounting firms from providing certain identified non-audit services to their audit clients. However, firms could provide those services to non-audit clients.
7. The effect of prohibiting accounting firms from providing certain types of non-audit service to their audit clients would be to inhibit their ability to innovate types of service and grow them in a way that makes our economy more efficient. In addition, audit-dominated accounting firms would be unable to attract and retain the specialists necessary to assist and support the audit function of the firm.
8. In considering the external auditor's independence, the board should consider how the accounting firm is structured to ensure independence, the ownership of the accounting firm and whether the accounting firm has formed alliances with entities that provide clients with the sort of services the accounting firm would not be allowed to provide.
9. Audit committees should have the business acumen to address external auditor independence issues on a case-by-case basis, thereby preserving a company's ability to select its external auditor for non-audit services, if, in the circumstances, that is the best choice for the company and the investors
10. The audit committee should set the principles for using the external audit firm to provide non-audit services.
11. In accordance with the Companies Act requirement, there should be separate disclosure of the amount paid for non-audit services as opposed to audit services.
12. Information relating to the use of non-audit services from the external auditors of the company should comprise detailed disclosure in the notes to the annual financial statements, providing a detailed description of the nature of those services together with an indication of the amounts paid in respect of each of those services rendered. It might be useful, where appropriate, for the annual corporate governance statement contained in a company's annual report to provide additional explanation or justification for the approach taken by the company in this regard and would probably be best dealt with in the section dealing with the audit committee, internal controls and/or risk management. This should provide a basis for the audit committee's recommendation supporting such an approach and confirmation of the board's reasons for implementing such recommendation.

Recommendations

- The audit committee should set the principles for using the accounting firm of the external auditors for non-audit services.
- In accordance with the related Companies Act requirement, there should be separate disclosure of the amount paid for non-audit services as opposed to audit services.
- A detailed description of non-audit services rendered by the external auditor and the nature thereof should be provided in the annual financial statements of the company, together with particulars of the amounts paid for each of the services described. Where appropriate, it might be useful for the annual corporate governance statement to provide for additional explanation or justification for these services.

Chapter 3

Legal Backing for, and the Monitoring of, Compliance with Accounting Standards

1. The Companies Act requires that financial statements of companies, “in conformity with generally accepted accounting practice, fairly present the state of affairs of the company and the results of its operations. Legal opinions obtained in 1977 and 1987 confirmed that the South African Statements of Generally Accepted Accounting Practice (“Statements of GAAP”) approved by the Accounting Practices Board (“APB”) do constitute generally accepted accounting practice. However, other practices not codified in Statements of GAAP may also constitute generally accepted accounting practice, as the concept of generally accepted accounting practice allows for this flexibility.
2. This dichotomy can result in unsound accounting practices being sanctioned purely because several companies adopt them. This situation can prejudice users of financial statements, as accounting practices may be adopted to reflect management’s and the company’s performance in a favourable light rather than to give an objective view to users. In addition, there is little or no certainty that like transactions and events will be accounted for in a like manner.
3. In 1999, a legal opinion was obtained on the interpretation of paragraph 5 of Schedule 4 of the Companies Act. According to this opinion, in order for directors to meet the requirements of the Companies Act, the financial statements should be prepared in conformity with generally accepted accounting practice. However, if they depart materially from Statements of GAAP, the financial statements should provide disclosure of the departure, the particulars thereof, the reasons therefore and the effect of such departure on the financial statements.
4. Based on this legal opinion, SAICA issued Circular 8/99 providing guidance to directors and external auditors on compliance with paragraph 5 of Schedule 4. Although this move improved compliance with Statements of GAAP, the fact that the guidance is based on a legal opinion is questioned by some who

prepare and audit financial statements. They believe that the requirement to prepare financial statements in conformity with Statements of GAAP should be apparent from a plain reading of the Companies Act.

5. In light of the above, the Accounting Practices Board (“APB”) and SAICA, in consultation with interested parties, is proposing that the Companies Act should be amended to provide for:
 - 5.1. companies to prepare financial statements in conformity with general purpose financial reporting standards laid down by a proposed Financial Reporting Standards Council; and
 - 5.2. private companies, under specified circumstances, to prepare financial statements in conformity with limited purpose financial reporting standards laid down by a proposed Financial Reporting Standards Council.
6. It is acknowledged that it is neither reasonable nor practicable to require small enterprises to comply with accounting standards that are based on international accounting standards. Therefore, it is proposed that the Companies Act should provide for private companies, under specified circumstances, to prepare their annual financial statements in conformity with limited purpose financial reporting standards approved by the Financial Reporting Standards Council.
7. As financial reporting is not limited to companies, it is proposed that a new Act, i.e. the Financial Reporting Act, provides for:
 - 7.1. the laying down of general and limited purpose financial reporting standards;
 - 7.2. the establishment and functions of a Financial Reporting Standards Council; and
 - 7.3. supervision of compliance, and penalties for non-compliance, with the financial reporting standards.
8. It is proposed that the proposed Financial Reporting Act is administered by National Treasury and that the accounting standard setting and monitoring and enforcement processes are housed in a separate directorate within the Financial Services Board (“FSB”) – possibly for a limited period of time, after which it could become an independent private sector body. The proposed processes are new and complex with new ground to be broken. The FSB has been involved in establishing similar processes in the past and can contribute a wide range of experience, expertise, infrastructure and other resources. Accounting standard setting and monitoring and enforcement of compliance are of interest to government, making the FSB the ideal body to assist in the establishment of these processes.
9. As the new standard setting and monitoring and enforcement processes would be of direct benefit to the companies and their many and varied stakeholders, it is proposed that the processes should be funded by a levy to be charged to and collected from companies by the Registrar of Companies on behalf of the proposed new FSB directorate.
10. Annual financial statements should be meaningful, relevant and reliable for investors. Therefore, if the Companies Act is amended to provide for compliance

with accounting standards, which are in line with international accounting standards, both local and foreign investors will be able to rely on the information contained in a company's financial statements.

Recommendations

- There should be legal backing for accounting standards approved by the proposed Financial Reporting Standards Council.
- In addition to the above, provision should be made for:
 - the laying down of general and limited purpose financial reporting standards;
 - the establishment and functions of a Financial Reporting Standards Council; and
 - supervision of compliance, and penalties for non-compliance, with the financial reporting standards.
- The accounting standard setting and monitoring and enforcement process initially should be housed in a separate directorate within the FSB. These processes should be funded by a levy to be charged to and collected from companies.

Chapter 4 Information Technology

1. The King Report 1994, and most writings on corporate governance since then, has been relatively silent on the role of information technology (IT). However, there have been significant changes in this area and IT is now seen as being an integral part of enterprise strategy rather than a mere enabler within organisations. While technology developments can help improve governance, they have also brought increased risks and challenges that need to be addressed so that management can discharge its governance responsibilities.
2. IT has had a major impact on the way business is conducted and how businesses are assessed. Organisational boundaries have become blurred with e-businesses increasing the degree of integration along the supply chain. This has resulted in governance challenges, since responsibility is no longer confined to a single organisation. The rate of technological advancement and limited understanding of it among stakeholders has provided further challenges.
3. Legislation is not able fully to accommodate all the regulatory issues that are required in an e-commerce environment. A recent green paper on e-commerce has identified some of these issues and provides a useful platform for further legislation. In the interim, self regulation is even more important.
4. Areas in which IT has a significant impact on corporate governance include:

4.1. **Internal control system**

- The directors have a responsibility to ensure that an effective internal control system is being maintained.
- Modern enterprise resource planning systems are an integral part of many organisations. The introduction of these systems has had far-reaching implications for management and auditors alike. Pre- and post-implementation reviews have become a key part of successful implementation strategies.
- Auditing around the computer is no longer an option for the auditors, the controls and processes incorporated in modern systems have to be evaluated and tested. In many instances, internal control systems are altered to bring them in line with best practices included with the basic functionality of many of these systems.
- Employees across the organisation have been empowered with a greater degree of responsibility. Some important controls occur at transaction level rather than in a central accounting area.
- All of these changes have had fundamental implications for management in discharging its responsibility for maintaining a sound control environment. Responsible management needs to demonstrate adequate knowledge of modern IT-enabled systems as well as an appreciation of the related changes in the organisation's internal control system.

4.2. **Reporting**

- IT is a potentially powerful enabler for making information available to stakeholders. Many organisations publish financial and other relevant information on web sites, while e-mail is a highly effective means of sharing information.
- There have been recommendations and debate around IT issues such as interim reporting, preliminary announcements, press releases and the scope and content of annual reports. Issues that have to be considered in this regard include:
 - the possibility of these forms of communication replacing the current dissemination of information;
 - implications for audit and information integrity;
 - access of all stakeholders to electronic information; and
 - IT systems providing the potential for more frequent reporting.

4.3. ***Fiduciary implications***

- The laws and regulations affecting IT are broader in scope than those associated with other business operations, and typically include a greater emphasis on intellectual property rights. Accordingly, the organisation needs to be sensitive to its exposure in these areas.
- Blurred organisational boundaries that arise as a result of e-business initiatives also have an affect on statutory compliance.
- Legislators are acutely aware of the shortcomings of existing statute in addressing many of the challenges created in e-business. These include:
 - the application to electronic communications of statutory provisions that mandate paper or paper-based concepts such as original writing and signature;
 - electronic formation of contracts;
 - taxation – direct and indirect;
 - admissibility of electronic evidence;
 - authenticity and integrity of electronic communications;
 - verification of dispatch;
 - acknowledgement of receipt;
 - management and retention of records; and
 - protection of the consumer.
- A green paper on e-commerce dealing with many of these and other issues relating to ecommerce, was issued by the government for comment by 31 March 2001. With such a wide range of uncharted territory, sound principles of corporate governance are vital for achieving self-regulation.

4.4. ***Business***

The introduction of ebusiness initiatives has resulted in a fundamental change in the way that business is conducted, with a greater degree of integration of processes in the supply chain than traditional systems ever allowed. This change has implications for internal control systems, as well as statutory compliance with legislation, for example the Competition Act.

4.5. ***Technology***

- Technology has had a fundamental impact on the way in which business is conducted and businesses are measured. All of the

responsibilities to stakeholders that are part of good governance have a pronounced role in IT companies.

- Typically these organisations have traded at a significant earnings multiple because of their perceived growth potential. Employees are often attracted to these businesses with comparatively low fixed income because of the same growth expectations. Many stakeholders in these organisations do not have a full understanding of the true opportunities and threats facing the organisation. Consequently, the importance of the basic tenets of good governance is particularly significant.
- Management needs to be completely honest and transparent in reporting on organisational results and prospects.

4.6. *Cost/value relationship*

- With shareowners widely viewed as the most important stakeholder group, management has to give due consideration to the cost/value relationship in considering IT strategy. While this is true for all business expenditure, the high rate of development and obsolescence in IT makes decisions on IT expenditure particularly important.
- IT is also an area where management is not traditionally able to apply cost/value principles as easily as in other areas of business. There is often a perception that IT expenditure is motivated by strategic instinct more than sound commercial principles. The challenge of rigorously applying basic economic evaluation criteria has to be embraced if the company is to discharge its performance obligation to stakeholders.

Recommendations

- Information technology has had a profound effect on processes within organisations. Accordingly, boards need to ensure that the necessary skills are in place to ensure that their responsibilities in respect of internal control systems are adequately discharged.
- Potential benefits that result from using technology to improve reporting and transparency should be embraced.
- Directors need to be mindful of the implications of blurred organisational barriers that arise as a consequence of ebusiness, to the extent that these result in their governance responsibilities extending beyond the traditional corporate boundaries. They need to ensure that the same levels of governance are applied in the companies with which they integrate along the supply chain.

Chapter 5**Accessibility of Financial Information****1. Accessibility**

- 1.1. Traditionally, the major channel of communication with the broad stakeholder and investor community has been the annual report, incorporating the financial statements. This is supported by other channels of communication.
- 1.2. Given the impact of technology on communication, there will be increased pressure to make information available electronically. While this represents an opportunity to communicate in good time with stakeholders and the broader investor community, an important aspect will be to ensure the security of the data and/or information communicated by electronic means so that its integrity is not compromised through unauthorised means.
- 1.3. A clear distinction should be made between audited and unaudited financial information, as well as other non-financial information that has been externally validated. This would apply particularly to information that is released via websites.

Recommendation

Companies should make every effort to ensure that information is distributed via a broad range of communication channels, including the Internet; having regard for its security and integrity while bearing in mind the need that critical financial information reaches all shareowners simultaneously.

2. Summarised Financial Statements

- 2.1. Due to the cost involved in printing and distributing the annual financial statements to all shareowners, consideration should be given to amending section 302 of the Companies Act to provide for the (electronic) distribution of summarised or abbreviated annual financial statements to all shareowners. The full set of financial statements would be retained and distributed on request.
- 2.2. SAICA should draft guidance on the content of summarised or abbreviated annual financial statements and make representations to the Standing Advisory Committee on Company Law ("SAC") to amend the Companies Act accordingly.

Recommendation

Subject to requisite changes to the Companies Act, companies may distribute summarised or abbreviated annual financial statements to all shareowners. This may be either in printed or electronic form. These statements should include a clear indication as to how and where the full set of annual financial statements can be obtained.

SECTION 6 - COMPLIANCE AND ENFORCEMENT

“...the substance of good corporate governance is more important than its form; adoption of a set of rules or principles or of any particular practice or policy is not a substitute for, and does not itself assure, good corporate governance.”

The Business Roundtable, USA

Chapter 1 Introduction

1. All the principles embodied in a code on corporate governance are effective only if adequate remedies and sanctions exist to enforce compliance with those principles. Thus it is vital to ensure that the preceding chapters do not amount to yet another compilation of well-meaning principles that will be consigned to an illustrious place on bookshelves and in libraries without making any realistic impact on the operations of corporate business in the economy.
2. In order to make a meaningful contribution to the future application of the code, this committee has based its report on the following:

2.1. ***Delineation between law and governance***

In evaluating appropriate legal remedies and sanctions to ensure compliance with the principles and recommendations contained in the accompanying Code of Corporate Practices and Conduct, it is important to distinguish between those for which a legal remedy already exists and others.

2.2. ***Placing reliance on existing legal remedies as a means of enforcement, with a view to determining why these are currently not being used***

Having identified that category of principles for which legal enforcement remedies already exist, it is necessary to determine why those remedies are not being used in practice. Then we need practical methods to eliminate the deficiencies in the enforcement of existing remedies. Where there is no existing remedy, it is necessary to determine whether legal remedies and sanctions are necessary and, if so, to suggest remedies. It is preferable if the remedies and sanctions recommended will not require any further legislation. This expedites enforcement. Cadbury³⁸ stated that:

“The codes that have appeared so far have no statutory backing, although the majority require companies to state how far they comply with them and to explain areas of non-compliance. Compliance itself is left as a matter between boards and their shareowners. Equally, they are non-prescriptive, respecting the differences between individual companies and boards, which are often as great within countries as between them”.

³⁸ Sir Adrian Cadbury, “*The Corporate Governance Agenda*” Corporate Governance - An International Review, volume 8 number 1 January 2000 at page 9

statutory and common law principles. The provisions in the Companies Act for sanctions are too numerous to be mentioned individually.⁴¹ One such example, however, is section 424 of the Companies Act. This section relates to the liability of directors and others for the fraudulent conduct of business and provides, *inter alia*, that if it appears that any business of a company is carried on recklessly or with intent to defraud creditors or for any fraudulent purpose, the Court may (on application of various stipulated categories of people) declare that any person, who was knowingly a party to the carrying on of the business in this manner, personally responsible for any or all of the debts of the company. Unfortunately, the section has been criticised for being both difficult and expensive to implement.⁴²

3. One can also look to the amended JSE Securities Exchange Listings Requirements to observe a further sanction. In an attempt to regulate the directors of listed companies, the JSE has introduced Schedule 21 – a declaration required to be completed by all new directors of listed companies so that the regulator can compile a database of directors. It is not known if this list will be available to the public but it will presently be used for the JSE’s purposes.
4. Thus, to the extent that principles of corporate governance co-exist with established legal principles as set out above, it is not recommended that any new sanctions and remedies be adopted. However, where appropriate, these sanctions can and must be improved. It is somewhat unnecessary to introduce new remedies for so long as existing remedies are not enforced.

Chapter 3 Enforcement of Existing Remedies

1. There is an apparent lack of enforcement of existing remedies for breaches of statutory and common law principles by delinquent directors and officers. The question is why. In this regard, the role of the State must be emphasised.
2. ***Resources and the Criminal Justice System***
 - 2.1. It appears that the criminal justice system of the country is under-resourced. In areas where the resources are sufficient, they are often mismanaged or incorrectly allocated.
 - 2.2. It is suggested that urgent and ongoing liaison take place between the leadership of the business community and the National Director of Public Prosecutions (“NDPP”) and the Department of Justice to determine how the business community can help the State to enforce breaches of criminal law by delinquent directors and officers.
 - 2.3. The office of the Registrar of Companies needs sufficient resources to regulate compliance with the Companies Act.
 - 2.4. Before issues can be reported, they need to be detected. This means that the resources of the South African Police Service (“SAPS”) also need to be

⁴¹ See Appendix III to this report which lists some of the relevant provisions. Other sections to take note of are sections 37, 86, 218 and 219 of the Companies Act

⁴² See “The First Report of the Commission of Inquiry into the affairs of the Masterbond Group and Investor Protection in South Africa” (referred to as the Nel Commission) pages 127-131

enhanced, so that complaints can be adequately investigated. At present, investigators do not always have the expertise to investigate commercial crime and hence there is a backlog of cases. The recent work of the specialised “Scorpions” unit must, however, be commended.

2.5. Prosecutors are not trained⁴³ in the prosecution of commercial cases so leading to low levels of conviction.

2.6. The State must address these issues urgently.

3. ***Business Against Crime (“BAC”)***

To counter these inefficiencies, the initiatives of organisations like BAC should be encouraged. The Arbitration Foundation of Southern Africa and the BAC are currently involved in the “Specialised Commercial Court Pilot Project”, which aims to improve the investigation, prosecution and adjudication of commercial crime. Funding for the project is provided by the business sector.

4. ***Civil Remedies***

Civil remedies are available to shareowners in that contraventions of the provisions often give rise to a delictual action and even personal liability. The exposure of directors and managers to such civil liability is an important regulatory and enforcement tool. Unfortunately, this liability is seldom enforced. The main reason appears to be a lack of access to the law on the part of the victims, who are often holders of very small parcels of shares in the relevant company. There is no incentive for these small shareowners to resort to expensive litigation. This deficiency should be cured by the following measures:

4.1. the establishment in practice of a more liberal use of class actions, but with appropriate provisions to prevent abuse; and

4.2. the use of a contingency fee mechanism by legal practitioners.

The use of class actions and contingency fees have important advantages because they are important tools in giving minority shareowners access to the courts. It is appropriate for the South African Law Commission or the Standing Advisory Committee on Company Law to address these issues, which are discussed in more detail below.

5. ***Class Actions***

5.1. A class action enables a large number of claimants, whose claims are based on a well-defined common question of fact or law, to have their matters heard in one proceeding. It ensures economic and efficient litigation by avoiding duplication. In the United States, class actions are a common form of litigation. Before the Court will “certify a class”, it must be satisfied that there is a sufficient number of claimants to render the joinder of individual actions both impractical and unfair (on the basis that individual actions may lead to inconsistent results). Once a class has been certified, the named class plaintiffs and the attorneys assume fiduciary responsibility to protect the interests of those “absent” class members who, although not named, are bound by the outcome of the action. The class action

⁴³ The Justice College has not been offering relevant courses for some time due to a lack of expertise

procedure represents an exception to the general rule that one cannot be bound to a judgment rendered in a proceeding wherein one was not joined as a party.⁴⁴

- 5.2. Class action litigation has not been without its problems and in the United States, the Private Securities Litigation Reform Act of 1995 became effective on 22 December 1995 to avoid spurious claims relating to class action securities fraud litigation.⁴⁵
- 5.3. Notwithstanding the concerns, class action lawsuits protect defendants from inconsistent obligations that may arise in multiple suits managed individually. Remedies for a group of people may be achieved using class action when they may otherwise never have their day in Court. Class action litigation may also be used to help settle many claims among class members spread over a large geographic area. The liberal use of class actions can in itself be a useful tool for providing better access to the law, particularly in the context of shareowners who are the victims of management delinquency. Provision already exists in the Constitution for class actions. It may be that the most appropriate method of advancing the use of class action in the context of management abuse is to approach the Judges President of the various Provinces with a request to formulate rules of Court for the purposes of permitting these types of class action.
- 5.4. Although the Constitution provides for class actions, the rules of Court still need to be amended. In this regard, the Law Societies of the various provinces should be encouraged to formulate a proposal to the Rules Board for the Courts of Law to recommend adopting changed rules to the Minister of Justice. However, this may not be all that is required and legislation may still be needed.

6. **Contingency Fees**

- 6.1. The use of contingency fees in the context of delinquency in the management of a company is another mechanism for promoting easier access to the law. This view is enunciated by Lord Denning, Master of the Rolls, in *Wallersteiner v Moir*.⁴⁶ An approach should be made in this regard to the General Council of the Bar and to the Law Society of South Africa.
- 6.2. A contingency fee is an agreement between a legal practitioner and a client to the effect that no fees will be charged if the case is conducted unsuccessfully. It had not been introduced in South Africa owing to common law restraints. In March 1996, the South African Law Commission ("SALC") published a working paper on speculative and contingency fees. The SALC proposed that contingency fee agreements be allowed with

⁴⁴ *Hansberry v Lee*, 311 U.S. 32, 61 S.Ct 115, 85 L.Ed.2d 22[1940]. In the United States, class actions involve both the United States Constitution (as to concepts of due process, notice and jurisdiction), Rule 23 of the Federal Rules of Civil Procedure (as to the procedural mechanism that governs class actions) and applicable local rules of practice. District Courts promulgate their own local rules of practice

⁴⁵ e.g. the Act increases the standards for pleading to make it more difficult for plaintiffs to file allegations of securities fraud without having substantial information on which to base such a claim. To address concerns about the influence of "professional plaintiffs" and class action attorneys, the Act contains a "lead plaintiff" provision and class notification process aimed at giving the plaintiffs with the largest financial interest at stake (presumably institutional investors) the right to control the course of the litigation and to select lead counsel for the class, subject to Court approval

⁴⁶ [1974] 3 All ER

limitations on the fee relating to the prospects of success. This paper led to the Contingency Fees Act (No. 66 of 1997), which allows for contingency fee agreements (the Act stipulates the content of such agreements). Criminal or family law matters are, however, excluded from the provisions of the Act.

6.3. The SALC is of the opinion that introduction of the aforementioned will require an amendment to existing law.⁴⁷

7. **Register of Delinquent Directors**

7.1. A further aspect that will necessitate amendments to the Companies Act to operate effectively, is the disqualification of those persons who have been delinquent in the management of a company from being appointed as directors.

7.2. Consideration should be given to the formation of a register of directors that are disqualified in any way from acting in that capacity (to be maintained by the office of the Registrar of Companies and disclosed on its website).⁴⁸ This has been successfully applied in Malaysia.

7.3. It is further recommended that organised business plays a more active role in ensuring that persons who have proved themselves unsuitable to manage companies are disqualified under section 219 of the Companies Act.⁴⁹ Provision should be made in the Companies Act for notification to the Registrar to ensure effective maintenance of the list.

Chapter 4 Principles of Disclosure

1. Regulation by adoption of the philosophy of disclosure has a number of beneficial effects.
2. In the first place, disclosure has a shrinking effect. When certain conduct, including the receipt of benefits, is required to be disclosed it often has the effect of deterring the adoption of any such conduct or the receipt of any such benefit. In this sense it deters the incidence of malpractice and excessive executive rewards.⁵⁰
3. The second benefit of disclosure is that it highlights misconduct and non-performance, thereby enabling the victims of delinquent misconduct to be aware of the delinquency so that appropriate remedial action can be taken. In the United States, the Securities and Exchange Commission ("SEC") was formed to create public disclosure and enforcement mechanisms to protect investors and promote the dissemination of reliable corporate information in the marketplace. The SEC regulates and promulgates rules governing shareholder resolutions.

⁴⁷ See SALC Working Paper "The recognition of a class action in South African Law" and the 1998 report titled "The recognition of a class action and public interest actions in South African Law"

⁴⁸ Section 422 of the Companies Act provides for the keeping of register, but this is only in the case of insolvency

⁴⁹ This section provides that a Court may, on application, make an order preventing any person from acting as a director for a specified period

⁵⁰ UK: *The Combined Code* led to the changes in the listings requirements and the obligatory disclosure of detailed individual directors' emoluments

4. The benefits of disclosure were well summarised by Justice Louis Brandeis in *Other People's Money* (1916) where the learned Judge states "*Sunlight is justly commended as the best disinfectant, electric light as the best policeman*". Stanford Law School has set up the Stanford Clearinghouse that assist investors, the judiciary, policymakers, and the media in regard to class action litigation. Based on the statement by Justice Brandeis, the website⁵¹ established by the school states that "*if there are problems with the incidence of securities fraud, or with the conduct of class action litigation, the "sunlight" provided by this Internet disclosure facility may prove beneficial for all involved.*"⁵² The project also depends on the SEC providing information dissemination services.
5. Increased disclosure levels should be encouraged in South Africa. The JSE listings rules now provide for the disclosure of directors' emoluments beyond that required by the Companies Act. Other regulators should be encouraged to increase disclosure levels to an extent greater than required by the statutes.
6. Regulatory bodies, like the JSE⁵³ and Financial Services Board ("FSB"), should be encouraged to enforce the strictest of sanctions on companies to avoid the *laissez faire* attitude that has crept into society with regard to law enforcement (which attitude extends to commercial law and regulations). Regulatory bodies are responsible for ensuring that delinquent directors are dealt with more severely.
7. All boards should apply their minds to any incidents of misconduct by directors, and should censure guilty directors. In addition, boards should report their findings and actions to shareowners.
8. Transparency should be increased by private companies disclosing financial information. Standards of governance should protect all stakeholders, and private companies should be obliged to disclose financial information. Where people transact with the public, there is a duty to exercise good governance. In the context of a limited liability entity, disclosure is essential. The exemption available to private companies whereby they do not have to file their financial information with the Registrar of Companies should be removed.⁵⁴ Only once proper information is freely available will parties be able to seek the necessary protection for themselves.

⁵¹ <http://securities.stanford.research.html>

⁵² In the United States, the District Court for the Northern District of California approved Local Rule 23-2, the first local rule of Court in the US that requires Internet posting of major securities fraud class action litigation filings

⁵³ The continued listing of a company on the JSE is effectively dependent on a company complying with its continuing obligations. A company is required to provide a certificate on an annual basis indicating its compliance. Where there is non-compliance with any listings requirements, the JSE Listings Committee may censure an issuer or suspend or terminate a listing. The censure can be private or public and it may impose a penalty. Further, if it finds that the contravention is due to a failure by all or any of the issuer's directors to discharge their responsibilities under the Listings Requirements, it may censure the relevant director and publish such censure. In the case of wilful or persistent misrepresentation and or refusal by a director to discharge his responsibilities following such censure, the Committee may state publicly that retaining the office is prejudicial to the interest of investors and if the director remains in office thereafter, the Committee may suspend or terminate the listing of the issuer's securities. The Committee is urged to use these provisions

⁵⁴ See section 302 of the Companies Act

other shareowner activists in both the United Kingdom⁵⁸ and in the United States⁵⁹ have had an impact on the behaviour of companies and other bodies. Similar bodies should be funded and established (together with relevant education) in South Africa. It is essential that support be given to the development of these bodies, as they will ensure the critical governance levels that are necessary to attract international capital.

2. Although business representative bodies should try to educate investors on a large scale, the residual benefit of such an undertaking does warrant careful consideration. When one considers the make-up of shareowners in South Africa (the majority of whom are institutional investors), focus should rather be placed on the actions of institutional shareowners. To this end, corporate rating analysts should be encouraged to report on the qualitative aspects of companies. Financial ratios are driven by a number of factors, including business risk, and this includes corporate governance.⁶⁰ It is not impossible to quantify such issues.
3. In Germany, the DVFA⁶¹ has developed a scorecard for corporate governance, which attempts to quantify its qualitative aspects. In most “failed” companies, post mortems reveal governance abuses, which investors could be made aware of before a “crash”. There seems to be a growing trend internationally for this type of “watch-dog”. For instance, in Russia, the Vasiliev Institute for Corporate Governance will have a system for rating Russian listed companies on their governance as a core product. In Malaysia, the “Minority Shareowners Watchdog Group”, expected to be operative in 2002, will initially be funded by government and civil service pension funds. Standard & Poors have formulated a product geared to governance checks in emerging markets (sponsored by the OECD).
4. Another way of encouraging shareowner activism is through education and mechanisms by which the rights of minority shareowners can be protected. In the United States, SEC Rule 14a-8 makes recommendations for facilitating the submission of shareowner proposals at annual general meetings by creating a right for shareowners to have such proposals included in management’s notice with proxy materials distributed to all shareowners in advance of the meeting, and voted on at the meeting, so long as the proponent has a minimum investment in the company and the proposal is relevant to the business of the company.
5. In addition, sanctions should be visited upon directors and the management of companies, notably institutional shareowners, who fail to attend shareowners’ meetings of companies in which they are invested. The *Myners Report on Institutional Investment* in the United Kingdom issued on 6 March 2001 has some compelling recommendations in this respect. Directors and managers of financial

⁵⁸ Hermes – a UK pension fund joined forces with Lens Investments, a leading US shareowner activist, to advocate a constructive approach to investor activism

⁵⁹ CalPERS (The California Public Employees’ Retirement System) and TIAA-CREF (a similar body for teachers) are very active from a global perspective in shareowner activism having made large inroads into corporate behaviour. If a company breaches the Global Sullivan Principles, for example, CalPERS considers writing to and meeting with company executives or sponsoring dissident shareowner resolutions

⁶⁰ It has been suggested that the Investor Analysts Society be encouraged to rate corporate governance performance in their analysis of companies. It is, however, uncertain as to whether the necessary mechanisms are in place to enforce such a recommendation. However, listed companies would find it constructive if there was some common rules or guidance on issues of corporate governance along the lines of those released from time to time by the NAPF and ABI in the United Kingdom

⁶¹ Deutsche Vereinigung für Finanzanalyse und Asset Management

institutions such as insurance companies, and trustees and managers of financial retirement funds, who do not attend shareowners' meetings of companies in which they have a certain prescribed level of investment (say, 5% of the issued equity capital), or who fail to send representatives to such meetings, should be censured. In the United States, the Department of Labor rules under ERISA (Employee Retirement and Income Security Act) state that a vote is a trust "asset" and must be treated with the same level of care as the cash and other assets under management. By law or rule, fiduciaries should be required to vote and to disclose how they vote although the need for limitations in accordance with the law must also be kept in mind. Among big funds, only CalPERS has so far chosen to make its votes public. Now, the OTPPB⁶² in Canada has set up a new governance section on its website in which it has disclosed all its voting decisions for the year 2000 (the aim is to warn companies away from such policies as out-of-control stock option plans).

6. The current Chancellor of the Exchequer of the United Kingdom, Gordon Brown, supported by the recommendations of Myner, has pledged to introduce a path-breaking Bill making shareowner activism a fiduciary obligation of British funds, just as many funds in the United States must meet Department of Labor regulations. Subsequently, Australia has already put into legislation requirements similar to those recommended in the United Kingdom but with much wider application, while similar legislation is under consideration in a number of jurisdictions in Europe. The international trade union movement is also driving to mobilise labour-oriented funds as shareowner activists. A campaign has been co-ordinated by the Vancouver-based Shareowner Association for Research and Education ("SHARE"), which was established by British Columbia unions to promote pension fund activism. SHARE joins US, British and Australian counterparts in targeting companies through investor capital. The goal is to pool financial power across borders to press labour interests in corporate governance and social issues.
7. The absence of shareowner activism in South Africa seriously undermines good levels of managerial compliance. Institutional investors and pension funds remain passive for the most part despite some very obvious instances of poor or undesirable corporate governance practices by South African companies. A moderate level of activism has, however, recently emerged.
8. Reputational agents also play a critical role in ensuring good governance. These would typically include accountants, auditors, lawyers, credit rating agencies, investment bankers, financial media, investment advisors, corporate governance analysts and others. These reputational experts should, *inter alia*, be very careful in allowing their names or logos to be used in circulars or advertisements relating to transactions that do not deserve the imprimatur of a decent and respected reputational agent.

Chapter 7

The Role of Organised Business

1. Organised business institutions in South Africa should assume a much greater responsibility for the implementation of good corporate governance.

2. Peer pressure could be imposed on delinquent directors and managers.⁶³
3. The Companies Act provides, for example, in sections 311, 400 and 402, for liquidators and judicial managers to compile reports on possible criminal and personal liability as well as for the possible disqualification of directors and officers of the company and provide their names to the Master. Businesses should demand that the reports be furnished to them as creditors and that these reports should be comprehensive enough to enable them to enforce possible liability.
4. Peer pressure can be exerted by organised business and the financial press against delinquent directors and managers could play a fundamentally important role in curbing delinquency, and promoting high standards of corporate governance. A suggestion has been made to require reference to corporate governance, not only in annual reports, but also in prospectuses and listing statements required in the Listings Requirements of the JSE although not in the Companies Act. A further suggestion has been to conduct an annual questionnaire to be completed by all listed companies and to devise a measure to capture information from, at least, large non-quoted companies (the questionnaire to be devised by the King Committee with input and driven by the Institute of Directors). The findings of the survey should be published whilst this idea has merit, if the aim is to have the revised Code applicable to all entities, there is no solution for how it is to be implemented or what the sanctions might be. For listed companies, the process can be managed through the JSE, but the problem is what regulatory body could be used for larger, unquoted companies. The office of the Registrar of Companies does not at present have the resources to do this. There has been a suggestion that a private sector monitoring body be tasked with the monitoring of compliance with governance standards.⁶⁴
5. Another very effective way to ensure compliance with any suggestions that may be incorporated in this Report is an emphasis (through continuing education and publicity) of the growth in importance of governance matters. In this regard, issues dealt with in the Introduction and Background to this Report can be helpful.
6. In other words, the conviction of corporate and institutional investors that better corporate governance delivers higher shareowner returns should be taken seriously by companies in the formal sector of the market in their attempts to raise capital, and in the informal sector. For corporate governance to work, the business community must accept it as “good sense” rather than as “external interference”. In addition, considerations of governance are increasingly being taken into account by investors in their decision-making processes. The Dow

⁶³ As indicated earlier, the South African Companies Regulatory Office should be encouraged to establish a register of delinquent directors (those who have been disqualified from acting as such and such register should be available on their website). The terms for such “disqualification” could be equated to the terms for rehabilitation for an insolvent individual. Further, section 219 should be actively used to disqualify directors

⁶⁴ The suggestion has been made that the same proposed body tasked with monitoring compliance with accounting standards be used for this purpose. Complaints by shareowners are lodged with this body and if, after investigation, it is found that there is substance to any complaint, the relevant authority is notified

Jones Sustainability Index⁶⁵ is another example of this new way of thinking as is the PricewaterhouseCoopers Opacity Index.⁶⁶

7. One way of initiating stronger governance cultures in regulated industries can be seen in the current new regulations introduced by the South African Reserve Bank – in terms of these (effective from January 2001)⁶⁷, directors are obliged to establish objectives for the year. The directors then have to assess performance against the set objectives. The auditors are obliged to report any non-compliance with these provisions to the Registrar of Banks.⁶⁸
8. Timely reporting on compliance with the provisions is easier in a highly regulated industry but this does not help in unregulated environments. It is, therefore, imperative that the value placed on governance issues be “palpable” – i.e. makes an impact on the bottom line. All business entities must recognise the importance of following governance standards. The work currently being done by such bodies such as NBI⁶⁹ should be encouraged and promoted in other sectors.

Chapter 8

Enforcement in Other Jurisdictions

1. The High Level Finance Committee Report on Corporate Governance published by the Malaysian Institute of Corporate Governance in 1999 specifically dealt with the issue of enforcement:
 - 1.1. Chapter 9 dealing with “Implementation Programme”, is instructive in that it indicates such a plan is based on the premise that:
 - to be effective, it requires buy-in from all relevant stakeholders;
 - while responsibility for implementation relies on different bodies, the Committee will be a central body supervising and ensuring effective implementation;
 - the Committee, with senior representatives from the public and private sectors, will continue to be the means through which all policy recommendations relating to corporate governance are made to the Government.
 - 1.2. In regard to implementation:

⁶⁵ This index is reviewed on a continual basis and measures sustainability issues, e.g. environmental concerns, governance culture and stakeholder issues

⁶⁶ Opacity is the “lack of clear, accurate, formal and widely accepted practices”. This index provides a ranking for each country based on “opacity” data divided into five areas that create the acronym “CLEAR” viz. Corruption, Legal, Economic, Accounting and Regulatory. Details of the index are given on the website at www.opacityindex.com. The measures used show real costs associated with “opacity”

⁶⁷ Chapter III of the new regulations is dedicated to corporate governance issues – relating from breaches in fiduciary duties to reporting obligations of the directors. See Appendix III

⁶⁸ This is a “soft way” of involving the auditors in the governance review process, and should possibly be used as a framework for other regulated bodies

⁶⁹ National Business Initiative recently published a brochure titled *Democratic Local Government 2000-2001: A Guide for Councillors*, which aims to “assist with improving the competencies and understanding of people involved with local government”

- recommendations may vary from amendments to laws, regulations and listing rules, which must be tightly supervised by the Committee;
 - an implementation project team represents every regulatory authority and organisation relevant to the recommendations of the report;
 - the team should report to the Committee on a three-monthly basis and to industry on a six-monthly basis.
2. In the United Kingdom, the Company Law Review has submitted a consultation draft that suggests a new institutional structure. This will include a Companies Commission (responsible for keeping company law and governance issues under review and suggesting reform quickly and effectively where necessary), a Standards Committee (with responsibility for policing the Combined Code), a Monitoring and Enforcement Committee and a Private Companies Committee.
 3. The answers to enforcement or compliance with a Code are not easily found, especially in an emerging economy where funds are scarce. Further, there has always been the perception that voluntary adoption of governance codes is preferable to legislated solutions. A voluntary Code will not work if there is no sanction and, in our current environment, any legislation will take time. An independent body may not work either, as it may be perceived as just “another” body. It would have to be given “teeth”, especially in view of the problems being experienced with existing legislation.
 4. So-called “reputational agents”, viz. lawyers, accountants, stock exchange, sponsors, etc. should take care to ensure that disreputable organisations are not abusing their good name to lend credence to dishonourable ventures.

Recommendations

- The recommendations set out in this Section should be pursued as a matter of urgency.
- Urgent liaison should be initiated between the leadership of the business community and the State with a view to determining how the business community can enhance the resources and capacity of the State to handle breaches of criminal law by delinquent directors and officers. In this regard, the role of the State is vital. It is equally essential that the office of the Registrar of Companies be provided with sufficient resources to monitor compliance with the Companies Act. The resources of the South African Police Service and those of the judicial system also need to be enhanced to ensure that complaints are adequately investigated.

Recommendations continued

- An approach should be made to the General Council of the Bar and to the Law Society of South Africa for the use of contingency fees in the context of delinquency in the management of a company in promoting easier access to the law for minority shareowners. The Law Society, South African Law Commission and the Standing Advisory Committee should be asked to lobby for the formulation of Rules of Court for the purpose of permitting a more liberal use of class actions.
- Regulators should be encouraged to enforce sanctions against delinquent directors and be more pro-active in their monitoring of governance issues.
- The Companies Act should be amended to require that the annual financial statements of private companies be filed with the Registrar of Companies and thereby open to public inspection.
- The business community should help develop financial journalism in South Africa as an appropriate monitor of corporate conduct.
- The office of the Registrar of Companies should be encouraged to establish a register of delinquent directors, being those who have been disqualified from acting as such under the Companies Act (and amendments made to the Companies Act where necessary). This register should be available on its website, and the list of such directors regularly updated. The Registrar should work in conjunction with other regulators, such as the JSE, FSB and the SARB with the aim of creating a database of delinquent directors for public information.
- Institutional investors should be more transparent in their dealings with companies, and should be encouraged to demand the highest governance standards.
- Investment analysts must consider governance issues when assessing companies. Shareowner organisations should be encouraged and promoted.
- Schedule 3 to the Companies Act should be amended to require reference to corporate governance in prospectuses.
- Boards and regulators should be encouraged to censure directors found wanting in their fiduciary obligations.
- The implementation of qualitative governance standards should be viewed by all as a dynamic process. A sub-committee of the King Committee should be established, in conjunction with the Institute of Directors, to monitor the progress of enforcement of the principles embodied in this Report and to address areas where insufficient action has been taken.

APPENDIX I

MEMBERS OF THE KING COMMITTEE ON CORPORATE GOVERNANCE

1. Chairperson – Mervyn E King S.C.

- Senior Counsel;
- Former Judge of the Supreme Court of South Africa;
- Past President of the Commonwealth Association for Corporate Governance;
- Member of the Private Sector Advisory Group to the World Bank on Corporate Governance;
- Former Governor of the International Corporate Governance Network;
- Chairperson and director of several listed companies in South Africa and abroad;
- President of the Advertising Standards Authority of South Africa;
- Chairperson of Share Transactions Totally Electronic Southern Africa (STRATE);
- Past President of the South African Chamber of Business (SACOB);
- South African representative and member of the International Chamber of Commerce Court of Arbitration, Paris;
- Past Deputy Chairperson of the Standing Advisory Committee on Company Law;
- Fellow and First Vice-President of the Institute of Directors in Southern Africa.

2. Roy C Andersen

- Chartered Accountant (South Africa);
- Certified Public Accountant (Texas), 1974;
- Group Chief Executive and Deputy Chairperson – Liberty Group;
- Director of Standard Bank Investment Corporation Limited and The Standard Bank of South Africa Limited;
- Trustee of the International Accounting Standards Board;
- Former Executive President of the JSE Securities Exchange South Africa;
- Former Deputy Chairperson, Securities Regulation Panel;
- Former Member Ethics and Auditing Standards Committees, SA Institute of Chartered Accountants;
- Former member of the Standing Advisory Committee on Company Law;
- Former Executive Chairperson of Ernst & Young (South Africa).

3. Philip A Armstrong

- Chartered Secretary;
- Managing Director, ENF Corporate Governance Advisory Services (Pty) Limited;
- President of the Institute of Chartered Secretaries and Administrators in Southern Africa;
- Fellow and member of Council of the Institute of Directors in Southern Africa;
- Member of the Standing Advisory Committee on Company Law;
- Council member of, and special advisor to, the Commonwealth Association for Corporate Governance;
- Co-ordinator of the Pan-African Consultative Forum on Corporate Governance;
- Member of the Cross-Border Voting Practices Committee of the International Corporate Governance Network;
- Member and advisor to various international organisations and bodies on corporate governance;
- Former Senior Vice-President: Company Secretary of Anglo American Corporation of South Africa Limited.

4. Ms Irene Charnley

- MAP CPIR PGL (Programme for global leadership) Harvard University, Part 1 completed
- Executive Director – Telecommunications, Johnnic Limited;
- Chairperson - M-Cell Limited
- Director on the boards of: Johnnic Holdings, Johnnic Communications, MTN Holdings, M-Net, Metropolitan and various others;
- 2000 Businesswoman of the Year.

5. Derek E Cooper

- Chartered Accountant (South Africa);
- Chairperson of Standard Bank Investment Corporation Limited and The Standard Bank of South Africa Limited, Liberty Holdings Limited and Liberty Group Limited, and Reunert Limited;
- Director of Nampak Limited, S A Foundation, Tiger Brands Limited and National Business Initiative;
- Member of the University of the Witwatersrand Council;
- Former Vice-Chairperson & Managing Director of Barlow Rand Limited;
- Former Chairperson of C G Smith Limited.

6. Malcolm D Dunn

- Chartered Accountant (South Africa);
- Fellow of the Institute of Chartered Accountants in England and Wales;
- Partner and member of the Executive Committee of PricewaterhouseCoopers, Southern Africa;
- Leader of the Assurance and Business Advisory Services (ABAS) division of PricewaterhouseCoopers in Southern Africa.

7. Ms Miranda J Feinstein

- BA LLB (Wits);
- Chairperson of the Company Law sub-committee of the Law Society of the Northern Province;
- Executive Director of Edward Nathan & Friedland (Pty) Limited and member of its EXCO;
- Director, ENF Corporate Governance Advisory Services (Pty) Limited;
- Admitted Attorney.

8. Michael M Katz

- B.Com;
- LLB (Witwatersrand University);
- LLM (Harvard Law School);
- LDD (h.c.) (Witwatersrand University);
- Member of the Faculty of Law of the University of Witwatersrand;
- Honorary Professor of Company Law, University of Witwatersrand;
- Course Director Higher Diploma in Company Law, and Master of Company Law, University of Witwatersrand;
- Chairperson – Commission of Enquiry into Tax System;
- Chairperson – Tax Advisory Committee to the Minister of Finance;
- Director of numerous companies;
- Past President of the South African Jewish Board of Deputies;
- Member of the Securities Regulation Panel;
- Member of Company Law, Corporate Law and Taxation Committees of the Law Society of South Africa.

9. Reuel Khoza

- MA;
- PMD;
- IPBM;
- Chairperson: Eskom Electricity Council; Co-ordinated Network Investments; Akani Leisure; Unihold;

- Director: Standard Bank Investment Corporation Limited; The Standard Bank of South Africa Limited; JSE Securities Exchange South Africa; Liberty Group Limited;
- Previous Chairmanships include: Glaxo Wellcome SA; Tolcon; Vodac; Sun Air; Creda Communications;
- Previous Directorships include: Munich Reinsurance SA; S C Johnson & Son; Servgro; Vodacom Group; JCI; IBM SA; Datacentrix; Norwich Holdings; Comair;
- Executive member of the World Business Council for Sustainable Energy;
- Member of the G8 Renewable Energy Task Force;
- Fellow and President of the Institute of Directors in Southern Africa.

10. Dr Len Konar

- B.Com;
- Chartered Accountant (South Africa);
- MAS (Illinois USA);
- D.Com;
- Consultant in Corporate Governance, Internal Audit and Technical Accounting and Auditing Issues;
- Formerly Head of Investments and Internal Audit at The Independent Development Trust;
- Previously Professor and Head of the Department of Accountancy, University of Durban-Westville;
- Currently a non-executive director of South African Reserve Bank, Old Mutual South Africa, JD Group Limited, Kumba Resources Limited and Steinhoff International Holdings Limited amongst others.

11. Paul du Plessis Kruger

- B.Sc (Eng) (Wits);
- MBL (UNISA);
- Chairperson of Sasol Limited & subsidiary companies, ABSA, Industrial Environmental Forum;
- Vice President - South African Foundation;
- Formerly Chairperson Business South Africa (BSA), now member of the board of Trustees of BSA;
- Board of Trustees - Rand Afrikaans University, Afrikaanse Handelsinstituut;
- Chancellor of the Rand Afrikaans University.

12. Russell M Loubser

- Chartered Accountant (South Africa);
- M.Com (Statistics);
- Chief Executive Officer of the JSE Securities Exchange South Africa;

- Previously Director of Financial Markets, Rand Merchant Bank;
- Past Chairperson and Deputy Chairperson South African Futures Exchange;
- Part of the team that started the Futures Industry in South Africa;
- Member of the Policy Board for Financial Services and Regulation;
- Member of the Financial Markets Advisory Board;
- Member of the Securities Regulation Panel;
- Member of the Executive Committee of the World Federation of Exchanges.

13. Adv. Felix D M Malunga

- B.Juris LLB;
- Registrar of Companies and Close Corporations: Department of Trade and Industry;
- Advocate of the High Court of South Africa;
- Nominated to serve on the Examination Board of the Southern African Institute of Government Auditors (SAIGA);
- Member of: Public Accountants' and Auditors' Board; Standing Advisory Committee on Company Law; Securities Regulation Panel; Departmental Tender Committee, Department of Trade and Industry.

14. Nigel G Payne

- B.Com (Hon);
- Chartered Accountant (South Africa);
- MBL;
- General Manager: Transnet Group Audit Services;
- Member of IoD Council and Convenor of IoD Corporate Governance Portfolio Committee;
- Member of IIA Global Committee on Quality;
- Chairman or member of various boards of directors and audit committees.

15. Ignatius Schoole

- Chartered Accountant (South Africa);
- Executive President: The South African Institute of Chartered Accountants;
- Board member: The International Federation of Accountants (IFAC); Eastern, Central and Southern African Federation of Accountants (ECSAFA); Association for the Advancement of Black Accountants of Southern Africa (ABASA); Development Bank of Southern Africa;
- Member: The Nominating Committee of the IFAC; Higher Education Quality Committee (HEQC) of the Council on Higher Education; Audit Committee of the DBSA;
- Commissioner: PIC;

- Chairperson: Finance Committee of the DBSA; Audit Committee of the Public Investment Commissioners (PIC);
- Director of KYD Steelwood Africa (Pty) Limited.

16. **Bheki Sibiyi**

- Executive Director: Aviation & Human Resources, Transnet;
- President: Black Management Forum;
- Non-Executive Director: Institute of People Management.

17. **Andre Swanepoel**

- B.Sc FIA;
- Deputy Executive Officer, Financial Services Board (Insurance supervision);
- Member of the Management Board of the Insurance Institute of South Africa;
- *Ex officio* attending meetings of the Policy Board for Financial Services and Regulation, Long-term, Short-term and Pension Funds Advisory Committees;
- Member of the Executive Committee of the International Association of Insurance Supervisors (IAIS) and chairperson of the Emerging Markets Committee of the IAIS;
- Member of the international Joint Forum's Working Group 2 on Corporate Governance and Transparency.

18. **David Sylvester**

- BA (Hons);
- Stockbroker with HSBC Securities (South Africa) (Pty) Limited;
- Chairperson of the Shareholders' Association of South Africa.

19. **Leslie I Weil**

- B.Com;
- Chartered Accountant (South Africa);
- MBA;
- Executive Chairperson - JHI Real Estate Ltd;
- Past President - S A Chamber of Business;
- Appraiser appointed by the Minister of Justice;
- Registered Valuer;
- Commissioner of Oaths;
- Fellow of the Institute of Directors;
- Main directorships: Pareto Limited, Property Fund Managers Limited.

20. **Richard S Wilkinson**

- Secretary to, and member of, the King Committee on Corporate Governance;
- Executive Director of the Institute of Directors in Southern Africa;
- Member: Corporate Governance Forum; Commonwealth Association for Corporate Governance; International Corporate Governance Network;
- Director of Companies;
- Commissioner: South African Sports Commission;
- Executive Committee Member: National Olympic Committee of South Africa.

21. **William (Bill) S Yeowart**

- MA (Oxon);
- BA (Rhodes);
- Former Chairperson: HSBC/Simpson McKie;
- Director of Companies;
- Member: Securities Regulation Panel; South African Securities Exchange;
- Chairperson: Order of St John;
- Governor: Rhodes University;
- Trustee: UNISA; Endangered Wildlife Trust.

APPENDIX II

TERMS OF REFERENCE OF REVIEW AND MEMBERSHIP OF TASK TEAMS

1. Guiding Principles for Review of Corporate Governance in South Africa

- 1.1. To review the King Report 1994 on Corporate Governance and to assess its currency against developments, locally and internationally, since its publication on 29 November 1994.
- 1.2. To review and clarify the earlier proposition in the King Report 1994 for an “inclusive approach” for sustainable success of companies.
- 1.3. To recognise the increasing importance placed on non-financial issues worldwide, and to consider and to recommend reporting on issues associated with social and ethical accounting, auditing and reporting (SEAAR) and safety, health and environment (SHE).
- 1.4. To recommend how compliance with a new Code of Corporate Governance for South Africa can be measured and made outcomes based, i.e. to measure for success of companies through the “balanced scorecard” approach for reporting.

2. Membership of task teams

2.1. ***Principal Convenor and Editor***

Philip A Armstrong.

2.2. ***Boards and Directors***

Convenor: Roy C Andersen
 Dr Danisa Baloyi, Brian P Connellan, Ms Miranda Feinstein, Ms Kathryn Curr, Prof. Michael Larkin, David M Lawrence, Ms Joanne Matisonn, Roy Shough, Bheki Sibiyi, Ms Annamarie van der Merwe, Mike J Woods (late) and Misheck Mbewe (secretary).

2.3. ***Risk Management and Internal Audit***

Convenor: Nigel Payne
 Anton Barnard, Riaan D Bredell, Steve Briers, Ms Kay P Darbourn, Michael Duncan, Johan Hattingh, Ms Emmie Heyn, Darrin Kelly, Ms Hester Hickey, Gert Krzywagen, Danie Louw, Mohammed Abdool-Samad, Gideon Serfontein, Prof. Adriaan Steyn, and Anton van Wyk.

2.4. ***Integrated Sustainability Reporting***

Convenor: Reuel Khoza (Deputy - Ms Dolly Mokgatlé)
 Mohamed Adam, Ms Linda Botha, Sid Cassim, Ms Irene Charnley, Derek Cooper, Enrico du Plessis, Andrew Johnson, Joel Klotnick, Paul Kruger, Robert (Rob) Newsome, Rodney WRawlinson, Ian Sampson,

Ms Gloria Serobe, Andrew Smith, Konrad Taeuber, “JJ” van Rensburg and Leo Dlamini (secretary).

2.5. ***Accounting and Auditing***

Convenor: Malcolm D Dunn
Robert (Bob) P Garnett, Suresh Kana, Dr Len Konar, Ms Samantha Louis, Craig McLeary, Terence Nombembe (Alt. Ms Amanda Botha), Ms Vanessa Naidoo, Ms Alta Prinsloo, Dieter Schultze, Ignatius Sehoole and Prof. Enrico Uliana.

2.6. ***Compliance and Enforcement***

Convenor: Michael M Katz
Malixole (Mac) Gantsho, Roland Krabbenhöft, Russell Loubser (Alt. John Burke), Adv. Felix Malunga, Robert (Bob) A Phipps, Sven Richter, Gideon Serfontein, Andre Swanepoel, David Sylvester, Leslie Weil, Peter Wilmot and William (Bill) Yeowart.

2.7. ***Secretariat***

IoD: Richard Wilkinson

2.8. ***Research Team***

Ms Loren Wulfsohn, Ms Mariaan van Kaam, Dr G Rossouw, Ms Jennifer Wilkinson and Prof. Nick Segal.

APPENDIX III

DIRECTORS' LEGAL DUTIES

1. The legal duties and responsibilities attributed to the position are central to the appointment of an individual to a board of directors as the legal duties to be considered arise from both statutory law and the common law. The extent of legislation applicable to companies is significant and accordingly, only a limited examination of the most pertinent provisions can be accommodated in this appendix.
2. Given some of the recommendations contained in this Report of which the appendix forms part, relevant provisions taken from the Companies Act and from the Banks Act are listed below.
3. **Companies Act (No. 61 of 1973), as amended**
 - 3.1. ***Section 50(1) Company name and registration number on notices, etc.***
 - Every company must display its name on the outside of its registered office and every office or place where its business is carried on. (s50(1)(a))
 - All notices and publications must bear the company name. (s50(1)(c))
 - All bills of exchange, promissory notes, endorsements, cheques, and orders for money and goods signed on behalf of the company must bear the company name and registration number. (s50(1)(c))
 - All letters, delivery notes, invoices, receipts and letters of credit must bear the company name and registration number. (s50(1)(c))
 - 3.2. ***Section 171 Names of directors on letterheads, etc.***

No company business letter, business circular or business catalogue may be circulated without bearing the forenames (or initials) and surname of each director, his or her former surname (if applicable) and nationality (if not South African).
 - 3.3. ***Section 208 Number of directors***
 - Every public company must have at least two directors.
 - Every private company must have at least one director.
 - Subscribers to the memorandum of a company are deemed to be directors until directors are appointed.

3.4. **Section 211 Appointment of directors (who are not the first directors appointed)**

- Any person appointed as director or officer of a company after its commencement, must within 28 days lodge his/her consent to act as such with the Registrar on the prescribed forms.
- It is an offence to knowingly falsely publish the name of any person as a director.

3.5. **Section 213 Qualification shares of directors**

Directors who are required to hold qualification shares must vacate the office if they do not acquire such shares within two months of their appointment.

3.6. **Sections 218/219 Disqualification from appointment as a director**

- Persons disqualified from being a director:
 - a body corporate;
 - a minor or other person under a legal disability;
 - any person who is disqualified by an order under the Companies Act;
 - an unrehabilitated insolvent;
 - any person removed from an office of trust on account of misconduct; and
 - any person convicted of fraud, theft, forgery, perjury or an offence under the Prevention of Corruption Act or any offence involving dishonesty.
- The High Court may make an order declaring a person disqualified from acting as a director or officer for such period as the Court may determine.

3.7. **Section 220 Removal of directors from office**

This section entitles a company to remove a director by resolution before the expiration of his/her period of office and sets out the manner in which this can be achieved.

3.8. **Section 221 Restrictions on powers of directors to issue share capital**

- Directors of a company may only allot or issue shares of the company with the prior approval of the company in general meeting.
- If a general authority is given, it will be valid only until the next annual general meeting of the company.

3.9. ***Section 222 Restriction on issue of shares and debentures to directors***

In addition to the restrictions in section 221, directors may not allot shares to other directors (or their nominees) or to a body corporate which acts on the instructions of a director, or at a general meeting where a director holds more than 20% of the voting rights, unless:

- the company has specifically approved the allotment in general meeting; or
- the shares are allotted under an underwriting contract in respect of such shares; or
- the shares allotted are in proportion to existing holdings and on the same terms and conditions as apply to other shareowners; or
- the shares allotted are offered on the same terms and conditions as to members of the public.

3.10. ***Section 223 Share option plans where director interested***

No right or option to shares or convertible debentures may be given to directors, except if authorised by special resolution and if in compliance with this section.

3.11. ***Section 225 Prohibition of tax free payments to directors***

This section prohibits the payment of any remuneration by a company to its directors free of income tax.

3.12. ***Section 226 Prohibition of loans to, or security in connection with transactions by, directors and managers***

No company may directly or indirectly loan money to any director or manager of the company or of its holding company or of any subsidiary company or any other body corporate controlled by one or more of the directors or managers.

3.13. ***Section 227 Payments to directors for loss of office or in connection with arrangements and take-over schemes***

This section prohibits a company from paying a past director or retiring director (or director of its subsidiaries or holding company) any benefit for loss of office or in connection with their retirement from office, unless full details are disclosed to the members and approved by special resolution.

3.14. ***Section 234 Duty of director or officer to disclose interest in contracts***

A director who is materially interested in a contract (directly or indirectly) or proposed contract which will be entered into by the company, or

becomes interested in a contract already concluded by the company, must declare their full interest in the contract to the company.

3.15. ***Section 236 Written resolutions where director interested***

The provisions of sections 234 and 235 must be complied with even if directors in writing (round robin) take a resolution.

3.16. ***Section 238 When particulars to be stated in notice of meeting***

The notice convening a meeting at which a director's interest in a contract will be tabled, must include notice of such interest.

3.17. ***Section 239 Minuting of declarations of interest***

Every declaration of interest under sections 234, 235 and 237 must be recorded in the minutes of the directors' meeting at which it is made.

3.18. ***Section 240 Register of interests in contracts of directors and officers***

- Every company must keep a register of interests in contracts disclosed under sections 234, 235 or 237.
- Sections 110 and 113 will apply in respect of keeping the register and inspecting it.

3.19. ***Section 242 Keeping of minutes of directors' meetings (see also Sections 244 and 245)***

- Minutes of all directors' or managers' meetings must be kept in a minute book at the company's registered office or at the office where they are prepared.
- Any resolution in writing will be deemed to be a minute and must similarly be kept in the minute book.
- The version of the minutes signed by the chairperson of the meeting, or of the succeeding meeting, will be deemed to be evidence of the proceedings of that meeting.

3.20. ***Section 228 Disposal of Undertaking or greater part of assets***

The directors may only dispose of the whole or substantially the whole of the company's assets or undertaking with the authority of the company in general meeting.

3.21. ***Section 251 Liability for making or concurring with the making, circulating or publication of a certificate, report or statement which is false in any material aspect***

Every director or officer of a company who makes, circulates or publishes or concurs in making, circulating or publishing any certificate, written

statement, report or financial statement in relation to any property or affairs of the company which is false in any material respect shall be guilty of an offence.

3.22. **Section 271 Auditor**

If no auditor is appointed or re-appointed at an annual general meeting, the directors must within 35 days fill the vacancy, or report to the Registrar that the vacancy has not been filled within seven days after the end of the 35 day period.

3.23. **Section 284(1) Fixed asset register**

A company must keep such accounting records as are required to fairly present the state of affairs of the company, and the business of the company, including:

- records of the assets and liabilities;
- register of fixed assets;
- cash received and paid out.

3.24. **Section 286 Annual financial statements**

The directors of a company shall have annual financial statements prepared for each financial year of the company and present them to the annual general meeting of the company.

3.25. **Sections 288–290 Group financial statements**

Where a company (which is itself not a wholly-owned subsidiary) has subsidiaries, group annual financial statements must be laid before the company at its annual general meeting.

3.26. **Section 295 Particulars of loans to or security in favour of directors are to be disclosed**

The annual financial statements of a company must:

- state the amount and particulars of every loan referred to in section 226 and any balance due;
- state the particulars of every security and the transaction to which it relates in terms of section 226 and any balance outstanding.

3.27. **Section 297 Disclosure of directors' emoluments and pensions in annual financial statements**

The annual financial statements of a company must contain details of the amount of emoluments received by directors, the amount of pensions paid out or receivable by directors and past directors, the amount paid to any

director in respect of loss of office, and details of the directors' service contracts.

3.28. ***Section 299 Directors' report in annual financial statements***

Except if a company is a wholly-owned subsidiary of a South African company, it will as part of its annual financial statements, lay before the annual general meeting a report of directors on the state of affairs, business and profit or loss of the company and its subsidiaries.

3.29. ***Section 303 Interim financial reports***

Every company with a share capital which is not a wholly-owned subsidiary must send an interim report to every member and debenture holder within three months of the end of the first six months of the financial year.

3.30. ***Schedule 4 paragraph 34A and section 37 Disclosure of loans and security by subsidiary***

The schedule sets out the particulars to be disclosed in a company's annual financial statements in respect of funds employed by a company, directly or indirectly, in a loan to any company which is that company's holding company or a subsidiary of its holding company.

4. **Banks Act (No. 94 of 1990), as amended**

4.1. ***Section 22 Use of name of bank***

Any institution which is registered as a bank under this Act shall not use (or refer to itself by) a name other than under which it is so registered, or any literal translation or abbreviation thereof which has been approved by the Registrar.

4.2. ***Section 42 Restriction of right to control bank***

No person other than a bank or an institution approved by the Registrar and which conducts business similar to the business of a bank in a country outside South Africa may exercise control over a bank, unless such person is a public company and is registered as a controlling company in respect of such bank.

4.3. ***Section 51 Application of Companies Act to banks and controlling companies***

A company registered as a bank or controlling company shall continue to be a company in terms of the Companies Act, and the provisions of the Companies Act will continue to apply to any such company, to the extent that they are not inconsistent with any provision of the Banks Act, except that:

- the provisions of the Companies Act regulating the conversion of public companies to other forms of companies shall not apply to such company; and

- in the application of section 171(1) of the Companies Act the reference to “director” will be deemed to be a reference only to a director whose name appears in the company’s register and the reference to “business letter” shall be deemed not to include a reference to any printed form or advice.

4.4. **Section 59 Returns regarding shareowners**

Every bank and controlling company shall within 30 days of 31 December of each year furnish the Registrar with a return regarding its shareowners as at 31 December.

4.5. **Section 60 Directors of bank or controlling company**

- Each director of a bank or controlling company shall stand in a fiduciary relationship to the bank or controlling company, as the case may be, of which they are a director.
- For the purposes hereof, “fiduciary” implies:
 - acting honestly and in good faith and, in particular, exercising such powers as they may have exclusively in the best interests of, and for, the benefit of the bank and its depositors; and
 - acting in accordance with the guidelines and requirements of regulations published under the Banks Act.

4.6. **Section 64 Audit committee**

The board of directors of a bank shall appoint at least three of its members to form an audit committee (of which a majority must be non-executive directors) to:

- assist the board in evaluating the adequacy and efficiency of the internal control systems, accounting practices, information systems and auditing processes applied within the bank;
- facilitate and promote communication regarding the matters referred to above between the board, executive officer(s) and auditors of the company; and
- introduce such measures as may enhance the objectivity and credibility of financial statements and reports prepared in respect of the affairs of the bank.

4.7. **Section 73 Large exposures**

A Bank shall not make investments or grant loans and advances or credit to any person in an amount exceeding a prescribed percentage of the bank’s capital and reserves without first obtaining permission of the board of directors (or a committee appointed for such purpose by the board – at least one member of the committee must be a non-executive director as

defined in the section and the Registrar must give prior written approval for the composition of the committee).

4.8. **Section 91 Offences and penalties**

- Any person who:
 - fails to comply with a direction under section 7 (i.e. to furnish the Registrar with specified information);
 - furnishes the Registrar with information on any questionnaire which to the knowledge of the person is untrue or misleading in any material aspect;
 - contravenes one of the 29 listed provisions of the Banks Act,shall be guilty of an offence.
- It is also an offence for a director of a bank or controlling company:
 - to accept any benefit for or in connection with any advance granted by that bank (or by the bank controlled by the controlling company); or
 - otherwise than with the written consent of the Registrar or at a duly advertised public auction, to purchase any immovable property owned by the bank or mortgaged to that bank (or by the bank controlled by the controlling company) and which is sold by or at the instance of the bank or in a judicial sale at the instance of a third party.

4.9. **Regulation 38 Process of corporate governance**

- The board of directors of a bank is ultimately responsible for ensuring that an adequate and effective process of corporate governance, which is consistent with the nature, complexity and risk inherent in the bank's on-balance sheet and off-balance sheet activities and which responds to changes in the bank's environment and conditions, is established and maintained. The board of directors may appoint supporting committees to assist it with its responsibilities.
- The conduct of the business of a bank entails the management of risks, which may include the following types of risk, namely:
 - solvency risk;
 - liquidity risk;
 - credit risk;
 - currency risk;
 - market risk (position risk);

- interest-rate risk;
 - counterparty risk;
 - technological risk;
 - operational risk;
 - compliance risk; and
 - any other risk regarded as material by the bank.
- The overall effectiveness of the process of corporate governance shall be monitored, on an ongoing basis, by the board of directors or by a committee appointed by the board of directors.
 - The board of directors of a bank shall at least once a year assess and document whether the process of corporate governance implemented by the bank successfully achieves the objectives determined by the board.
 - The external auditors of a bank shall annually review the process followed by the board of directors in assessing the corporate governance arrangements, including the management of risk, and report, to the Registrar, whether any matters have come to their attention to suggest that they do not concur with the findings reported by the board of directors (if they do not concur, they must provide reasons).

4.10. ***Regulation 39 Guidelines relating to the conduct of directors***

- Every director of a bank and of a controlling company shall acquire a basic knowledge and understanding of the conduct of the business of a bank and of the laws and customs that govern the activities of such institutions. While it is not required of every member of the board of directors of a bank or controlling company to be fully conversant with all aspects of the conduct of the business of the bank, the competence of every director of a bank shall be commensurable with the nature and the scale of the business conducted by that bank and, in the case of a director of a controlling company, shall be commensurable with the nature and scale of the business conducted by the banks in the group.
- A director and executive officer of a bank and of a controlling company shall perform their functions with diligence and care and with such a degree of competence as can reasonably be expected from a person with their knowledge and experience.
- In view of the fact that the primary source of funds administered and utilised by a bank in the conduct of its business is deposits loaned to it by the general public, it shall be the duty of every director and executive officer of a bank to ensure that risks that are of necessity taken by such bank in the conduct of its business are managed in a prudent manner.

- The directors (including alternate directors) of a bank shall annually report to the Registrar whether or not:
 - the bank's internal controls provide reasonable assurance as to the integrity and reliability of the financial statements and safeguard, verify and maintain accountability of the bank's assets;
 - the internal controls are based on established policies and procedures and are implemented by trained, skilled personnel, whose duties have been appropriately segregated;
 - adherence to the implemented internal controls is continuously monitored by the bank;
 - procedures have been taken to ensure that all bank employees maintain high ethical standards, thereby ensuring that the bank's business practices are conducted in a manner that is above reproach;
 - anything has come to the directors' attention to indicate that any material malfunction, as defined and documented by the board of directors, which definition has to be submitted to the Registrar, in the functioning of the aforementioned controls, procedures and systems has occurred during the period under review.
- The directors of a bank shall annually report to the Registrar that there is no reason to believe that the bank will not be a going concern in the year ahead and should there be reason to believe so, such reason shall be disclosed and explained.
- The directors of a bank are required to submit the reports on the internal controls and going concern aspect of their bank within 120 days after the financial year end of the bank.
- The external auditors of a bank shall annually report to the Registrar whether or not they concur with the reports mentioned above, and must provide reasons if they do not concur.

4.11. **Regulation 40 Composition of board**

Except where a deviation is consented to by the Registrar, at least two of the members of the board of a bank shall be employees of that bank.

4.12. **Regulation 41 Statements relating to attributes of serving, or prospective directors or executive officers**

The chairperson (or his duly appointed representative) shall furnish the Registrar with a duly completed form DI 020 in respect of:

- every person who, for the first time, accepts an appointment as a director or executive officer of a bank or controlling company at least 30 days prior to the appointment becoming effective; and

- any serving director or executive officer of a bank or a controlling company, at the request of the Registrar.

5. **Criminal Procedure Act (No. 56 of 1995), as amended**

Section 332(5)

- Where a company commits an offence, each director will be deemed liable unless they can prove that they did not take part in the commission of the offence and that they could not have prevented the commission of the offence.
- Until recently, this section of the Criminal Procedure Act was most relied upon by the State in prosecuting offences under the Companies Act.
- Where a company commits an offence, each director will be deemed liable unless they can prove that they did not take part in the commission of the offence **and** that they could not have prevented the commission of the offence.
- The constitutionality of the reverse onus deeming provisions of this section were, however, challenged successfully in the case of *S v Coetzee* 1997 (3) SA 527 (CC).
- As a consequence of the ruling of the Constitutional Court, a redrafting of this section is anticipated but remains a relevant reference for all directors and officers of companies until such time as that should take place.

APPENDIX IV

BOARD SELF-EVALUATION

*Reproduced and adapted from the Report of the NACD
Blue Ribbon Commission on
Director Professionalism (2001 Edition)*

It is axiomatic that to assess the board's performance in carrying out its responsibilities, the board first must have a firm understanding of just what its responsibilities are. Therefore, the assessment process begins with a review of the board's areas of responsibilities. In addition to board consideration of its own view of its governance role, it might also be useful to consider the management's expectations of the board. In this regard, the chief executive officer could be invited to present the board with a statement of his or her own expectations of the board for the board to consider as it defines its responsibilities.

Once the board has reviewed, articulated, and prioritised its tasks and thereby identified the information it requires from management, it can then benchmark its own success against its expectations, and identify substantive areas for improvement.

Rank answers from:

**1 = Needs significant improvement; 2 = Needs improvement;
3 = Consistently good; 4 = Outstanding, one of the best in this area.**

1. **Board Role and Agenda Setting (Monitoring Performance and Strategic Planning)**
 - 1.1 Has the board defined its role and responsibilities and communicated the scope of its authority? 1 2 3 4
 - 1.2 In what ways should the board's role be expanded or reduced? 1 2 3 4
 - 1.3 Has the board identified, prioritised and scheduled those issues that it believes should be discussed/reviewed by the board on a regular basis? 1 2 3 4
 - 1.4 Has the board identified the information (both internal and external) it requires on a regular basis, including information by which to benchmark the strategic plan? 1 2 3 4
 - 1.5 Has the board considered/implemented mechanisms designed to identify areas of potential problems in performance before a crisis occurs? 1 2 3 4
 - 1.6 Has the board developed performance objectives that 1 2 3 4

respond to the company's specific needs (including comparisons to other similar companies)?

- | | | | | | |
|-----|--|---|---|---|---|
| 1.7 | Is the board effective in monitoring operational and financial performance, the integrity of the processes involved and the company's system of internal controls? | 1 | 2 | 3 | 4 |
| 1.8 | How does this board compare to other boards on which a director serves? | 1 | 2 | 3 | 4 |

2. **Size, Composition and Independence of Board**

- | | | | | | |
|-----|--|---|---|---|---|
| 2.1 | Has the board designed, articulated and implemented the policies – including board eligibility criteria – that ensure an appropriate board size and a composition of skills, breadth of experience and other characteristics among its membership to be effective? | 1 | 2 | 3 | 4 |
| 2.2 | Does the board have a majority of outside directors? | 1 | 2 | 3 | 4 |
| 2.3 | Is the proportion of inside/outside directors appropriate? | 1 | 2 | 3 | 4 |
| 2.4 | Is the board sufficiently independent of management | 1 | 2 | 3 | 4 |
| 2.5 | Do outside directors have an opportunity to meet without the chief executive officer on a regular basis? | 1 | 2 | 3 | 4 |
| 2.6 | Do board membership criteria ensure that outside directors have sufficient time and independent stature? | 1 | 2 | 3 | 4 |
| 2.7 | Does the board seek outside advice when appropriate? | 1 | 2 | 3 | 4 |
| 2.8 | How could the composition and organisation of the board, including committee structure, be improved? | 1 | 2 | 3 | 4 |

3. **Director Orientation and Development**

- | | | | | | |
|-----|---|---|---|---|---|
| 3.1 | Has the board defined and communicated its expectations concerning director responsibilities? | 1 | 2 | 3 | 4 |
| 3.2 | Are new directors provided with adequate information about the company and the board? | 1 | 2 | 3 | 4 |
| 3.3 | Are directors effectively recruited and retained? | 1 | 2 | 3 | 4 |
| 3.4 | Do directors receive proper training in corporate governance matters? | 1 | 2 | 3 | 4 |
| 3.5 | Do directors receive continuing education on issues facing the company? | 1 | 2 | 3 | 4 |
| 3.6 | Has a director been specifically appointed to oversee and be responsible for SHE and sustainability | 1 | 2 | 3 | 4 |

issues?

4. **Board Leadership, Teamwork and Management Relations**

- | | | | | | |
|-----|---|---|---|---|---|
| 4.1 | How effective is the board's leadership, both at the board and the committee levels? | 1 | 2 | 3 | 4 |
| 4.2 | Is board leadership distinct from management leadership? | 1 | 2 | 3 | 4 |
| 4.3 | Does the board effectively manage the conduct of board business? | 1 | 2 | 3 | 4 |
| 4.4 | Is the board effective as a team? | 1 | 2 | 3 | 4 |
| 4.5 | How well does the board work with the chief executive officer and other managers? Do the directors and the chief executive officer work to create an open culture that encourages frank discussion? | 1 | 2 | 3 | 4 |

5. **Board (and Committee) Meetings**

- | | | | | | |
|------|---|---|---|---|---|
| 5.1 | Are board (and committee) meetings productive? | 1 | 2 | 3 | 4 |
| 5.2 | Are the number of scheduled meetings sufficient? | 1 | 2 | 3 | 4 |
| 5.3 | Does the agenda-setting process allow for appropriate issues to be raised as necessary? | 1 | 2 | 3 | 4 |
| 5.4 | Is the agenda ordered with sufficient time to discuss the most complex and critical issues? | 1 | 2 | 3 | 4 |
| 5.5 | Can and do directors influence the content of the agenda? | 1 | 2 | 3 | 4 |
| 5.6 | Do directors receive sufficient information about agenda items in advance? | 1 | 2 | 3 | 4 |
| 5.7 | Is the quality, quantity, and timing of information given to directors adequate? | 1 | 2 | 3 | 4 |
| 5.8 | Is sufficient meeting time devoted to discussion of corporate performance and review of strategic issues? | 1 | 2 | 3 | 4 |
| 5.9 | How could board committees be improved in terms of meeting frequency, duration, content, location, and interests? | 1 | 2 | 3 | 4 |
| 5.10 | How well informed are non-committee members about the deliberations of each committee? | 1 | 2 | 3 | 4 |
| 5.11 | How could the information prepared for the board be improved in terms of presentation, timeliness, level | 1 | 2 | 3 | 4 |

of detail, content or focus?

5.12 In what ways are the information needs of the board expected to change over the next few years? 1 2 3 4

6. Director and Board Evaluation, Compensation and Ownership

6.1 Are directors, committees and the board regularly and effectively evaluated? 1 2 3 4

6.2 Is the board ensuring that directors are meeting board standards and expectations? 1 2 3 4

6.3 Has the board assessed its maximum potential, both individually and as a group? 1 2 3 4

6.4 Has the board surveyed others who perform better than it does, and assessed how it can learn from them? 1 2 3 4

6.5 Has the board considered benchmarks by which to gauge board performance? 1 2 3 4

6.6 Does the board have a credible process for reviewing its progress in meeting its goals and for maintaining the necessary resources and corporate support to function effectively? 1 2 3 4

6.7 Is the board committed to continuously improving performance, with well established procedures for setting performance goals? 1 2 3 4

6.8 Is there a process for reducing evaluations to recommendations that are monitored for compliance? 1 2 3 4

6.9 Is the free and open exchange of views encouraged? 1 2 3 4

6.10 Are directors properly compensated? 1 2 3 4

6.11 Does director compensation provide incentives for maximum performance? 1 2 3 4

6.12 Is director compensation structured so as to align the interests of the directors with the long-term interests of the corporation? 1 2 3 4

6.13 Are there clear policies and programmes in place to encourage director stock ownership over the short- and long-term? 1 2 3 4

6.14 Is the stock ownership position of individual directors and the board as a whole acceptable? 1 2 3 4

- 7. Management Evaluation, Compensation and Ownership**
- 7.1 Does the board regularly evaluate the performance of the chief executive officer? Performance of other senior managers? Company performance? 1 2 3 4
- 7.2 How can the board's methods of measuring management performance be improved? 1 2 3 4
- 7.3 Has the board created an appropriately designed management compensation plan? Does it effectively reward performance? 1 2 3 4
- 7.4 Are there clear policies and programmes in place to encourage management stock ownership as appropriate? 1 2 3 4
- 8. Succession Planning**
- 8.1 Does the board have a company-wide succession plan in place? 1 2 3 4
- 8.2 Does the board have a specific succession plan for the chief executive officer? 1 2 3 4
- 8.3 Is the board familiar with other senior managers in the company and does it regularly review their strengths as possible successors? 1 2 3 4
- 9. Ethics**
- 9.1 Does the board communicate the proper ethical and legal responsibilities to its members? 1 2 3 4
- 9.2 Does the board ensure ethical behaviour and proper compliance standards throughout the organisation and set the right "tone at the top" by its own behaviour? 1 2 3 4
- 10. Constituencies**
- 10.1 Does the board ensure appropriate consideration for and treatment of various constituencies, including shareowners, employees, customers, and communities? 1 2 3 4
- 10.2 Does the board communicate effectively with institutional shareowners? 1 2 3 4

As regards management/board relations, it may be beneficial to obtain management views on the board's performance. In this regard, the chief executive officer might be asked to consider how he or she would assess the board, perhaps with input from other senior executives that have regular contact with the board – the chief operating officer, chief financial officer, general counsel, corporate secretary, or others. The issues that management might consider include:

- Is the division of responsibility between management and the board appropriate and clear? 1 2 3 4
- Does the board provide wise counsel? 1 2 3 4
- Does the board provide clear direction? 1 2 3 4
- Does the board challenge management as appropriate? 1 2 3 4
- Does the board engender management's trust (and does the board hold information confidential)? 1 2 3 4
- Does the board focus on the appropriate issues? 1 2 3 4
- Is the board too "micro" in its supervision? 1 2 3 4
- Does the board request appropriate, relevant information? 1 2 3 4
- Are board members prepared for board meetings? 1 2 3 4
- Are board members knowledgeable about the company and the issues it faces? 1 2 3 4
- Is the proper mix of expertise reflected on the board? 1 2 3 4

APPENDIX V

MODEL TERMS OF REFERENCE FOR BOARD COMMITTEES

Note: The following specimen terms of reference for typical board committees are not intended to be definitive nor to specifically represent any particular position of the King Committee, but are provided as guidance on some of the more standard terms regulating such committees. It is for each board to define precisely the terms necessary to meet its particular requirements.

1. **Executive [or Management] Committee**

1.1. **Constitution**

The Executive Committee (“EXCO”) is constituted to assist the chief executive to manage the group. The chief executive’s authority in managing the group is unrestricted. The board of directors (“board”) takes regular cognisance of authorities delegated to the chief executive by means of resolutions. The EXCO assists the chief executive in acting for the board in managing the business of the group when the board is not in session, subject to the statutory limits and the board’s limitations on delegation of authority to the chief executive. The EXCO assists the chief executive to guide and control the overall direction of the business of the group and acts as a medium of communication and co-ordination between business units, group companies, and the board.

1.2. **Membership**

- EXCO shall consist of not less than five directors appointed by the board, all of whom shall be executive directors.
- EXCO shall be chaired by the chief executive and in his absence, by _____.
- The Committee shall nominate a committee secretary.

1.3. **Terms of reference**

- Powers and Responsibilities

EXCO is conferred with all the powers conferred upon the directors by the articles of association and EXCO shall be responsible for:

- implementation of strategies and policies of the company;
- managing the business and affairs of the company;
- prioritising the allocation of capital and technical and human resources;

- establishing the best management practices and functional standards; and
- senior management appointments and monitoring the performance of senior management.

EXCO shall be responsible for ensuring that regular detailed reports are submitted to the board on each of the businesses in which the company is invested.

- Sub-committees

EXCO is authorised to form sub-committees and in particular the divisional executive committees and administration committees, to assist it in the execution of its duties. In exercising the powers and authorities delegated to it, EXCO shall act in accordance with, and subject to, the directives and requirements as may be laid down from time to time by the board.

- Matters reserved for board decision

The following matters shall be reserved for decision by the board, on the basis of any recommendation as may be made from time to time by EXCO or other Committees:

- Financial
 - (i) adoption of any significant change or departure in the accounting policies and practices of the company;
 - (ii) raising of incremental borrowing facilities involving amounts in excess of R_____;
 - (iii) approval of the strategy, business plans and annual budgets and of any subsequent material changes in strategic direction or material deviations in business plans;
 - (iv) approval of annual financial statements, the approval of interim reports, the valuation of unlisted investments, the declaration of dividends and the forfeiture of unclaimed dividends;
 - (v) recommendation to shareowners of any increase, reduction or alteration to the share capital of the company and the allotment, issue or other disposal of shares of the company (except for shares allotted under any share incentive scheme);
- Statutory and administrative
 - (i) recommending amendments to the memorandum of articles of association of the company;

- (ii) appointment, removal or replacement of the external auditor of the company;
- (iii) frequency of meetings of the board;
- (iv) convening of general meetings of shareowners of the company;
- (v) approval of proxy forms for annual and general meetings of shareowners of the company;
- (vi) formulation of recommended policies in relation to industrial relations;
- (vii) prosecution, defence or settlement of legal or arbitration proceedings where material and except in the ordinary course of business;
- (viii) appointment of responsible persons as may be required in terms of any statute in South Africa or elsewhere in respect of the company;
- (ix) approval of the rules and amendments to pension and provident funds having a material effect on the actuarial liabilities of those funds;
- (x) granting of general signing authorities pursuant to the articles of association of the company;
- (xi) appointment and removal of the company secretary or any deputy company secretary;
- (xii) establishing any overseas branch or duplicate register of shareowners of the company;
- (xiii) variation of the rights attaching to shares where such powers are vested in the directors;
- (xiv) formulation and amendment of the company's Statement of Business Principles;

➤ Regulatory

- (i) approval of terms and conditions of the company's rights issues, public offers, capital issues or issues of convertible securities including shares or convertible securities issued for acquisitions;
- (ii) approval and authority to issue circulars to shareowners of the company;
- (iii) approval of and authority to issue prospectuses, listing particulars, rights offers or takeover or merger documents;

- (iv) recommending to shareowners that they approve any ordinary or special resolutions in respect of the company;
 - (v) recommending that the shareowners take a particular course of action proposed by the company;
 - (vi) any decision to list the company's shares on any stock exchange or to terminate any such listing;
- Human resources
- (i) appointments to and removals from the board including the appointment of the chairperson, any deputy chairperson, chief executive, executive directors and non-executive directors, and the approval of nominations of alternate directors (if any) as recommended by the Nomination Committee;
 - (ii) appointment of, terms of reference and changes in the composition of the Executive, Audit, Remuneration, Nomination, Investment, Human Resources, Safety, Health and Environment, Employment Equity and such other Committees as the board may appoint from time to time;
 - (iii) any increase of directors' fees as recommended by the Remuneration Committee;
 - (iv) approval of any share or other incentive scheme, the rules applicable to any such scheme and any amendment to such rules as recommended by the Remuneration Committee, for submission to shareowners, if applicable;
 - (v) formulation of recommended policies in relation to equal opportunity employment, environment, health and safety.

Note: Nothing in paragraph 1.3 shall restrict the board from delegating to any committee in accordance with the articles, the exercise of any powers conferred on the directors in connection with any particular transaction or matter considered by the board and in respect of which it resolves to establish such committee for such purpose.

1.4. **Meetings – Frequency and quorum**

- Meetings of EXCO will be held at such time at such venue as the Committee deems appropriate but it will normally meet at least twice a month or at the call of the chairperson of EXCO.
- The quorum for decisions of EXCO shall be a majority of members present who shall vote on the matter for decision in person, by video or tele-conference.

1.5. ***Proceedings***

- Unless varied by these terms of reference, the company's articles of association regulating the meetings and proceedings of directors will govern meetings and proceedings of EXCO.
- Except under exceptional circumstances, at least 48 hours' notice will be given of a meeting of EXCO. Such notice will, where possible, include the agenda and any supporting papers.
- Minutes of meetings shall be taken by the committee secretary and will be circulated to all members of EXCO, and may also, if EXCO so decides, be circulated to the other members of the board.

1.6. ***General***

- EXCO, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board may amend these terms of reference when required.

2. **Audit Committee**

2.1. ***Constitution***

Every company should establish a Committee to be known as the Audit Committee ("Committee") to assist the board in discharging its duties relating to the safeguarding of assets, the operation of adequate systems, control processes and the preparation of accurate financial reporting and statements in compliance with all applicable legal requirements and accounting standards. The Committee should not perform any management functions or assume any management responsibilities. It provides a forum for discussing business risk and control issues for developing relevant recommendations for consideration by the board. The Committee should mainly make recommendations to the board for its approval or final decision. The membership, resources, responsibilities and authorities (composition, functions and operation) of the Committee to perform its role effectively, is stipulated in these terms of reference, which may be amended by the board as and when required. The Committee is constituted in terms of the requirements of sound corporate governance practices and operates within that framework.

2.2. ***Membership***

- The members shall consist of not less than three directors appointed by the board, the majority of whom shall be non-executive directors and (where possible) shall be independent non-executive directors.
- The board shall appoint a chairperson from the non-executive members of the Committee and determine the period for which he or she shall hold office. The chairperson of the board shall not be eligible to be appointed as chairperson of the Committee.

- The board shall have the power at any time to remove any members from the Committee and to fill any vacancies created by such removal.
- The company secretary shall be the secretary of the Committee.

2.3. **Responsibilities of the committee**

- Auditors and external audit
 - The Committee may be requested to recommend to the board which firm(s) should be appointed as external auditor(s). Several firms should be screened and the Committee should obtain written or verbal proposals to enable it to arrive at its recommendation.
 - The Committee will:
 - (i) evaluate the independence and effectiveness of the external auditor(s) and consider any non-audit services rendered by such auditors as to whether this substantively impairs their independence;
 - (ii) evaluate the performance of the external auditor(s);
 - (iii) consider and make recommendations on the appointment and retention of the external auditor(s), and any questions of resignation or dismissal of the auditor(s);
 - (iv) discuss and review, with the external auditor(s) before the audit commences, the auditor(s) engagement letter, the terms, nature and scope of the audit function, procedure and engagement, the audit fee, and to ensure co-ordination (where more than one audit firm is involved) and maintenance of a professional relationship between them;
 - (v) negotiate procedures, subject to agreement, beyond minimum statutory and professional duties – there are certain minimum non-negotiable procedures required from the external auditors;
 - (vi) agree to the timing and nature of reports from the external auditor(s);
 - (vii) consider any problems identified in going concern or statement of internal control;
 - (viii) make suggestions as to problem areas that the audit can address;

- (ix) consider any accounting treatments, significant unusual transactions, or accounting judgments, that could be contentious;
- (x) identify key matters arising in the current year's management letter and satisfy itself that these are being properly followed up;
- (xi) consider whether any significant ventures, investments or operations are not subject to external audit;
- (xii) review overall audit role, to explore objectives, minimise duplication, discuss implications of new auditing standards and ensure that the external audit fee will sustain a proper audit and provide value for money;
- (xiii) agree to the timing and nature of reports from the external auditor(s);
- (xiv) obtain assurance from the external auditor(s) that adequate accounting records are being maintained.

- Financial statements

The Committee will examine and review the annual financial statements, the interim reports, the accompanying reports to shareowners, the preliminary announcement of results and any other announcement regarding the company's results or other financial information to be made public, prior to submission and approval by the board, focusing particularly on:

- the implementation of new systems;
- tax and litigation matters involving uncertainty;
- any changes in accounting policies and practices;
- major judgmental areas;
- significant adjustments resulting from the audit;
- the basis on which the company has been determined a going concern;
- capital adequacy;
- internal control;
- compliance with accounting standards, local and international, compliance with stock exchange and legal requirements;
- the efficiency of major adjustments processed at year end;
- compliance with the financial conditions of loan covenants; and

- reviewing special documents such as prospectuses as and when prepared.

- Internal control and internal audit

An important role of the Committee will be to monitor and supervise the effective function of the internal audit, ensuring that the roles and functions of the external audit with internal audit are sufficiently clarified and co-ordinated to provide an objective overview of the operational effectiveness of the company's systems of internal control and reporting. This will include:

- evaluating the performance of internal audit;
- reviewing the internal audit function's compliance with its mandate as approved by the Committee;
- reviewing the effectiveness of the company's systems of internal control, including internal financial control and business risk management and to maintaining effective internal control systems;
- considering the appointment, dismissal or re-assignment of the head of the internal audit function;
- reviewing and approving the internal audit charter, internal audit plans and internal audit's conclusions with regard to internal control;
- reviewing the adequacy of corrective action taken in response to significant internal audit findings;
- reviewing significant matters reported by the internal audit function;
- reviewing the objectives and the operations of the internal audit function;
- assessing the adequacy of performance of the internal audit function, and the adequacy of available internal audit resources;
- reviewing the co-operation and co-ordination between the internal and external audit functions and co-ordinating the formal internal audit work plan with external auditors to avoid duplication of work;
- reviewing significant differences of opinion between management and the internal audit function;
- maintaining proper and adequate accounting records;
- evaluating the independence and effectiveness of the internal auditors;

- controlling the overall operational and financial reporting environment;
 - safeguarding company's assets against unauthorised use or disposal;
 - directing and supervising investigations into matters within its scope, for example, evaluations of the effectiveness of the company's internal control, cases of employee fraud, misconduct or conflict of interest.
- Ethics
 - There are a number of statutory, common law and other requirements that covers the ethical behaviour of directors, managers and officers of companies. In addition, the company can establish a clearly defined and documented code of ethics. The directors must declare the nature and extent of their interest in contracts.
 - The Committee will be responsible for:
 - (i) monitoring the ethical conduct of the company, its executives and senior officials;
 - (ii) reviewing any statements on ethical standards or requirements for the company and assisting in developing such standards and requirements;
 - (iii) compliance with the requirements of the articles of association;
 - (iv) compliance with the law and regulations of any other applicable statute and of controlling bodies;
 - (v) identification of any violations of ethical conduct
 - (vi) environmental and social issues.
 - The Committee will also give recommendations on any potential conflict of interest or questionable situations of a material nature.

2.4. ***Reporting and accountability***

- The chairperson of the Committee shall account to the board for its activities and make recommendations to the board concerning the adoption of the annual and interim financial statements and any other matters arising from the above responsibilities.
- The chairperson (or, in his/her absence, an alternate member) of the Committee shall attend the annual general meeting to answer

questions concerning matters falling within the ambit of the Committee.

2.5. **Activities of the committee**

In discharging its responsibilities, the Committee will:

- Financial statements
 - review the quality of financial information, interim and financial statements and other public and regulatory reporting;
 - review the annual report and accounts taken as a whole, to ensure they present a balanced and understandable assessment of the position, performance and prospects of the company;
 - review the external auditor(s) proposed audit certificate;
 - discuss problems and reservations arising from the audit, and any matters the auditor(s) may wish to discuss (in the absence, where requested by the Committee, of executive directors and any other person that is not a member of the Committee);
 - review the external auditors' management letter and management response;
 - review the credibility, independence and objectivity of the auditor(s), taking into account their audit and non-audit fees. Where the auditors also supply a substantial volume of non-audit services to the company, the Committee should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity with value for money.

- Internal control and internal audit
 - review the company's statement on internal control systems prior to endorsement by the board, and in particular to review:
 - (i) the procedures for identifying business risks and controlling their impact on the company;
 - (ii) the company's policies for preventing or detecting fraud;
 - (iii) the company's policies for ensuring that the company complies with relevant regulatory and legal requirements;
 - (iv) the operational effectiveness of the policies and procedures;
 - consider whether or not the objectives, organisation, staffing plans, financial budgets, audit plans and standing of the internal audit function provide adequate support to enable the Committee to meet its objectives;

- review the results of work performed by the internal audit function in relation to financial reporting, corporate governance, internal control, and any significant investigations and management responses;
 - review co-ordination between the internal audit function and the external auditors and deal with any issues of material or significant dispute or concern;
 - review such significant transactions not directly related to the company's normal business as the Committee might deem appropriate;
 - review significant cases of employee conflicts of interest, misconduct or fraud, or any other unethical activity by employees or the company;
 - review the controls over significant risks;
 - consider other relevant matters referred to it by the Board.
- The Committee, in carrying out its duties under these terms of reference, will have due regard to the principles of governance and code of best practice as contained in the King Report on Corporate Governance for South Africa 2002.

2.6. ***Meetings***

- Meetings of the Committee will be held as frequently as the Committee considers appropriate, but it will normally meet not less than four times a year. The board or any member thereof, including members of the Committee, the external auditors, and the head of internal audit may call further meetings.
- Reasonable notice of meetings and the business to be conducted shall be given to the members of the Committee, the chairperson of the board, the chief executive, executives and managers responsible for finance, the head of internal audit and the external audit partners to make proposals as necessary.
- The quorum for decisions of the Committee shall be any two members of the Committee present throughout the meeting of the Committee.
- The finance director, senior audit partner in charge of the external audit and head of internal audit shall be in attendance at meetings of the Committee and shall have unrestricted access to the chairperson or any other member of the Committee as is required in relation to any matter falling within the remit of the Committee.
- The chairperson, at his/her discretion, may invite other executives to attend and to be heard at meetings of the Committee.

- No attendee shall have a vote at meetings of the Committee.
- The minutes of all meetings of the Committee, or summaries thereof, shall be submitted to the board at the immediate following board meeting, the agenda for each such board meeting shall provide an opportunity for the chairperson of the Committee to report orally on any matters of importance as well as on the Committee's findings and recommend actions.

2.7. *Proceedings*

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and committees.
- The committee secretary shall take minutes of meetings. These shall be reviewed and approved by the members of the Committee.

2.8. *Authority of the Committee and resources available to it*

The Committee, in carrying out its tasks under these terms of reference:

- is authorised to investigate any activity within its terms of reference;
- may, at the discretion of the Committee, require other employees of the company to attend meetings or parts of meetings;
- may consult with and seek any information it requires from any employees, and all employees shall be required to co-operate with any request made by the Committee in the course of its duties;
- shall at least once a year meet with external auditors without any executive member of the board in attendance;
- shall at least once a year meet with the internal auditors without any executive member of the board in attendance.

2.9. *Remuneration*

- Having regard to the functions performed by the members of the Committee in addition to their functions as directors and in relation to the activities of the Committee and pursuant to the specific power conferred upon the board by the articles of association of the company, members of the Committee shall be paid such special remuneration in respect of their appointment as shall be fixed by the board.

- The chairperson of the Committee shall, in addition to his or her remuneration as member, receive a further sum as determined by the board.
- Such special remuneration in terms hereof shall be in addition to the annual fees payable to directors.

2.10. **General**

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside the company in order for it to perform its duties.
- These terms of reference may be amended as required, subject to the approval of the board.

3. **Remuneration Committee**

3.1. **Constitution**

Every company should establish a formal and transparent procedure for developing a policy on executive remuneration and for fixing the remuneration packages of individual directors, within agreed terms of reference, to avoid potential conflicts of interest. A formal appointed remuneration committee of the board, composed wholly or substantially of non-executive directors, with access to independent surveys and consultants, can be a useful mechanism for facilitating the determination of all the essential components of remuneration and establishing remuneration credibility with shareowners. The Committee's function in relation to remuneration of non-executives, for reason of self-interest, should be limited to making recommendations to the full board and, as applicable, to the shareowners. The financial reward offered by the company should be sufficient to attract people of the required calibre. Failure to attract the right people will have a negative impact on the efficiencies of the company and, consequently, on the returns to its shareowners.

3.2. **Membership**

- The Remuneration Committee ("Committee") shall consist of not less than three directors appointed by the board of directors ("board"), all of whom shall be non-executive directors and the majority deemed to be independent.
- The board shall appoint the Committee chairperson and determine the period for which he or she shall hold office. The chairperson of the board, if he or she is an independent non-executive director, may be eligible to be appointed as chairperson of the Committee.

- The Committee shall nominate a committee secretary.

3.3. **Terms of reference**

- The role of the Committee will be to work on behalf of the board and be responsible for its recommendations and will, within these terms of reference:
 - determine, agree and develop the company's general policy on executive and senior management remuneration;
 - determine specific remuneration packages for executive directors of the company, including but not limited to basic salary, benefits in kind, any annual bonuses, performance-based incentives, share incentives, pensions and other benefits; and
 - determine any criteria necessary to measure the performance of executive directors in discharging their functions and responsibilities.
- The Committee will aim to give the executive directors every encouragement to enhance the company's performance and to ensure that they are fairly, but responsibly, rewarded for their individual contributions and performance.
- The Committee will review (at least annually) the terms and conditions of executive directors' service agreements, taking into account information from comparable companies where relevant.
- The Committee will determine any grants to executive directors and other senior employees made pursuant to the company's executive share scheme(s).
- The Committee will be kept informed of relevant information for other group executives and senior managers.
- The Committee will not determine the remuneration or terms of any consultancy agreement of any non-executive director, although it may make recommendations to the Board if requested.
- The Committee will co-ordinate its activities with the chairperson of the board and the chief executive as well as consult them in formulating the Committee's remuneration policy and when determining specific remuneration packages.
- The broad framework and cost of executive remuneration should be a matter for the board on advice of the Committee.
- The Committee may wish to consult other non-executive directors in its evaluation of the chairperson of the board and the chief executive.

- The Committee will have due regard to the principles of governance and code of best practice.
- The Committee will liaise with the board in relation to the preparation of the Committee's report to shareowners as required and will consider each year (and minute its conclusions) whether the circumstances are such that the annual general meeting of the company should be invited to approve the remuneration policy set out in the Committee's report.

3.4. ***Guidelines for components of remuneration***

As part of achieving and maintaining reasonable, acceptable levels of remuneration, the Committee is encouraged to consider the following guidelines:

- Base fees
 - the general level of hourly or daily rates of fees earned by directors in their professional capacities (e.g. as lawyers, accountants, executives, management consultants);
 - the hours spent in travel and preparation for meetings, as well as actual attendance;
 - whilst indirect costs pertinent to the role of directors are separately reimbursed, a fair and reasonable allowance for any direct costs should, however, be made in the base fee;
 - in the case of companies of unusual size or complexity, a comparison can be made, and a relativity established with the level of the chief executive officer's remuneration disregarding any incentive package;
 - company performance (i.e. profit, dividend and share price) is not considered to be of special significance for the purpose of setting a base fee;
 - the fee must be fair.
- Forms of payment
 - cash;
 - shares or share options - this can have the advantage of aligning remuneration with the interests of the shareowners by increasing the focus of directors on company performance and share value. Where share options are to be offered to non-executive directors, shareowners must approve this offer in a general meeting prior to the allocation being implemented.
- Reviews

The dates for review would be an appropriate time also to undertake evaluations of the performances of individual directors.

- Equal sharing

In line with the principle of collective responsibility, base fees should, wherever possible, be shared equally except in the case of additional responsibility or workload such as the chairperson and deputy chairperson. The level will depend on the extent of their involvement with the company.

- Supplementary fees

Supplementary work resulting from the membership of board committees (e.g. audit, remuneration, etc.) should be spread as evenly as possible among board members and recognised in the level of the base fee. If supplementary fees are charged separately, they may be calculated as an hourly or daily rate rather than annually, and should be subject to review in the same manner as base fees.

- Reimbursement of expenses

- Directors should ensure that they are reimbursed for all direct and indirect expenses reasonably and properly incurred (e.g. office, secretarial, accommodation, travelling expenses).
- Accommodation and travelling expenses should include those incurred in attending all meetings of directors and board committees, shareowners' meetings or otherwise in connection with company business.
- Where a director uses personal transport, travelling expenses should include a realistic kilometric allowance.
- Expenses applicable to multi-directorships should be apportioned on a fair and reasonable basis, having regard to the time spent on each directorship including travelling costs.
- Directors should ensure that the company's articles of association do not restrict the reimbursement of expenses.

- Directors' and Officers' liability insurance

- Directors should, wherever practical, arrange for such insurance to be taken out, and for such insurance to be paid by the company.
- The cover provided by the insurance should be as extensive as permitted by law, including all risks relating to legal costs.
- Directors should ensure that the payment of insurance cover is authorised by the company's articles of association.

- Payments on termination
 - The payment of retirement benefits to executive directors is an accepted practice among many companies and should be determined on the company's particular circumstances. Alternatively, a termination payment can be negotiated as part of their overall remuneration package.
 - If retirement benefits are paid it is recommended that, unless authorised otherwise by shareowners, the lump sum amount or the base for the pension should not exceed the total remuneration of the director in his or her capacity as a director in any three years chosen by the Committee.
 - The Committee should ensure that the payments or benefits of any nature on termination are not restricted by the company's articles of association but are fair to the company and can be adequately justified to shareowners if called on to do so.
- Flexibility

All the components of remuneration are, in the normal course, a matter of negotiated commercial contract and, accordingly, should be sufficiently flexible to suit each individual circumstance.

3.5. **Shareholder acceptance**

- Every effort should be made to promote acceptance of the necessity for, and benefits of, a realistic realignment of director remuneration.
- Requirements to disclose remuneration in the annual report is seen as a constructive opportunity to communicate with shareholders on all aspects of remuneration.
- The information disclosed could in relation to each director, usefully include such matters as a breakdown of remuneration into its individual components, the remuneration package as a total cost to the company, the number of meetings attended and, if practicable, the number of hours worked.
- The adoption by companies of formal remuneration policies, encompassing such matters as the philosophy behind remuneration assessments, the criteria for remuneration setting, the remuneration components, and the composition and role of the Committee, and the disclosure of such policies to shareholders, can also indicate to the public a responsible approach by companies to remuneration issues.

3.6. **Meetings**

- Meetings of the Committee will be held as the Committee deems to be appropriate, however, the Committee should meet at least once

each year. Further meetings may be called by the chairperson of the Committee or any member of the Committee.

- The notice of each meeting of the Committee, confirming the venue, time and date and enclosing an agenda of items to be discussed, shall other than under exceptional circumstances be forwarded to each member of the Committee not less than four working days prior to the date of the meeting.
- The quorum for decisions of the Committee shall be any two members present who shall vote on the matter for decision.
- The Committee shall normally invite the chairperson of the board and the chief executive to attend meetings to discuss the performance of other executive directors and to make proposals as necessary.
- The chairperson (or in his/her absence, an alternative member) of the Committee shall attend the annual general meeting and be prepared to answer questions concerning the appointment of executive and non-executive directors and maintain contact as required with the company's principal shareholders about the appointment of executive and non-executive directors in the same way as for other matters.

3.7. *Proceedings*

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and committees.
- The committee secretary shall take minutes of meetings. Any director may, provided that there is no conflict of interest and with the consent of the chairperson, obtain copies of the Committee's minutes.
- No Committee attendee shall participate in any discussion or decision in respect of their own remuneration.

3.8. *Remuneration*

- Having regard to the functions performed by the members of the Committee in addition to their functions as directors in relation to the activities of the Committee, and pursuant to the specific power conferred upon the board by the articles of association of the company, members of the Committee may be paid such special remuneration in respect of their appointment as shall be fixed by the board.
- Such special remuneration shall be in addition to the annual fees payable to directors.

3.9. **General**

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside the company in order for it to perform its duties.
- These terms of reference may from time to time be amended, as required, subject to the approval of the board.

4. **Nomination Committee**

4.1. **Constitution**

Unless the board is small, every company should establish a nomination committee, with a clear remit and whose authority is well accepted, to make recommendations to the board on all new board appointments. A formal process of reviewing the balance and effectiveness of the board, identifying the skills needed and those individuals that might best be seen to be providing such skills in a fair and thorough manner, is increasingly required as an appropriate mechanism for ensuring that the board remains effective and focused.

4.2. **Membership**

- The Nomination Committee (“Committee”) shall consist of not less than three directors appointed by the board of directors (“board”), all of whom shall be non-executive directors and the majority deemed independent.
- The chairperson of the Committee shall be the chairperson of the board if he or she is an independent non-executive director or, failing which, an independent non-executive director shall be appointed chair.
- The Committee shall nominate a committee secretary.

4.3. **Terms of reference**

- The Committee shall make recommendations to the board on the appointment of new executive and non-executive directors, including making recommendations on the composition of the board generally and the balance between executive and non-executive directors appointed to the board.
- The Committee shall regularly review the board structure, size and composition and make recommendations to the board with regards to any adjustments that are deemed necessary.

- The Committee shall be responsible for identifying and nominating candidates for the approval of the board to fill board vacancies as and when they arise, as well as put in place plans for succession, in particular for the chairperson and chief executive.
- The Committee shall make recommendations to the board for the continuation (or not) in services of any director that has reached the age of 70.
- The Committee shall recommend directors that are retiring by rotation, for re-election.
- The Committee will have due regard to the principles of governance and code of best practice.
- The Committee will liaise with the board in relation to the preparation of the Committee's report to shareholders, as required.

4.4. **Meetings**

- Meetings of the Committee will be held as the Committee deems appropriate. However, the Committee should meet at least once each year. Meetings should be organised so that attendance is maximised. The chairperson of the Committee or any member of the Committee may call a meeting at any other time.
- The notice of each meeting of the Committee, confirming the venue, time and date, and enclosing an agenda of items to be discussed, shall other than under exceptional circumstances be forwarded to each member of the Committee not less than four working days prior to the date of the meeting.
- The quorum for decisions of the Committee shall be any two members present throughout the meeting who shall vote on the matter for decision.
- The chairperson (or in his/her absence, an alternative member) of the Committee shall attend the annual general meeting and be prepared to answer questions concerning the appointment of executive and non-executive directors.

4.5. **Proceedings**

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and Committees.
- The committee secretary shall take minutes of meetings. Minutes of all meetings shall be circulated to all the members of the Committee, and may also, if the chairperson of the Committee so decides, be

circulated to other members of the board. Any director may, provided that there is no conflict of interest and with the agreement of the chairperson, obtain copies of the Committee's minutes.

4.6. **Remuneration**

- Having regard to the functions performed by the members of the Committee in addition to their functions as directors in relation to the activities of the Committee, and pursuant to the specific power conferred upon the board by the articles of association of the company, members of the Committee may be paid such special remuneration in respect of their appointment as shall be fixed by the board.
- Such special remuneration shall be in addition to the annual fees payable to directors.

4.7. **General**

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside the company in order for it to perform its duties.
- These terms of reference may be amended as required, subject to the approval of the board.

5. **Employment Equity and Skills Retention Committee**

5.1. **Constitution**

The primary objective of the company's Employment Equity Programme ("Programme") is to develop and implement a competitive human resource strategy to ensure that the company is able to attract, retain and develop the best possible talent to support superior business performance. To obtain this objective, the company will establish a committee to be known as the Employment Equity and Skills Retention Committee ("Committee"). The Programme's objective is to create an organisational culture, structures and process that seek to support the development of people and the optimisation of their potential. The Programme shall form part of the business plans of the divisions, and the Committee shall be responsible for enforcing, monitoring and auditing development and progress. The exclusion of any person capable of contributing to the company's affairs is not good business practice and accordingly a secondary, but equal objective, is the need to address any existing inequalities in staff profiles and organisational practice. Those staff that have been disadvantaged must be given the appropriate support so that they, too, will be equipped for successful careers in the company.

5.2. **Membership**

- The Committee shall consist of not less than three directors and/or senior executives appointed by the board of directors (“board”), the majority of whom shall be directors.
- Suitably qualified persons may be co-opted onto the Committee when necessary to render such specialist services as may be necessary to assist the Committee in its deliberations on any particular matter.
- The chairperson of the Committee shall be the chairperson of the board.
- The Committee shall nominate a committee secretary.

5.3. **Terms of reference**

- The Committee is tasked with implementing the company’s employment equity policy, which is underpinned by a commitment to:
 - enhance business performance through progressive and innovative human resource management;
 - create an environment where individuals that demonstrate the qualities of initiative, enterprise, ability, effort and loyalty are able to develop rewarding careers at all levels, irrespective of their backgrounds;
 - ensure that all employees have the right to work in an environment that is free from discrimination and harassment;
 - ensure equitable access to opportunity;
 - maintain an environment where employment and progression is based on merit;
 - provide meaningful support and appropriate education and training to those from historically disadvantaged backgrounds;
 - enhance diversity through:
 - (i) recruitment targets that ensure equitable access to employment opportunities; and
 - (ii) developing a culture that values and optimises the benefits of diversity.
- The following factors are critical to the success of the initiative:
 - executive leadership;
 - management accountability;

- employee participation; and
- employment equity infrastructure.
- To this end, the following structures should have been put in place or should be in the process of being put in place in the various divisions of the company and the Committee is tasked with giving strong encouragement to the implementation of employment equity and skills retention within group subsidiaries and associated companies:
 - The Employment Equity and Skills Retention Committee is:
 - (i) to provide leadership;
 - (ii) to determine policy;
 - (iii) to approve annual budgets;
 - (iv) to review progress; and
 - (v) to review the company's annual report on implementing the "reasonable progress" requirements of the Employment Equity Act.
 - The Diversity Forum is where employee representatives and management representatives collectively monitor employment equity implementation.
 - The Employment Equity Office is:
 - (i) to co-ordinate the programme;
 - (ii) to support line managers and employees in implementation; and
 - (iii) to provide expertise.
- To ensure compliance with the Employment Equity Act by the company, the following effort is required in the following areas to support legislative compliance:
 - A comprehensive policy that addresses, amongst other matters:
 - (i) discrimination;
 - (ii) harassment;
 - (iii) affirmative action; and
 - (iv) internal dispute resolution.
 - The employer is required to develop an employment equity plan, which details:

- (i) objectives;
 - (ii) affirmative action measures;
 - (iii) numerical goals;
 - (iv) time line;
 - (v) management systems including monitoring systems;
 - (vi) appointment of a senior person accountable for implementation; and
 - (vii) income differentials.
- Process and strategy to identify possible discriminatory practices, that include:
- (i) recruitment;
 - (ii) job grading;
 - (iii) remuneration;
 - (iv) conditions of employment;
 - (v) work environment and facilities (with particular focus on people with disabilities);
 - (vi) training and development;
 - (vii) performance management;
 - (viii) disciplinary action; and
 - (ix) medical and psychometric testing.

5.4. ***Meetings***

- Meetings of the Committee will be held as the Committee deems to be appropriate, however the Committee should meet at least once each year. Meetings should be organised so that attendance is maximised. The chairperson of the Committee or any member of the Committee may call a meeting at any other time.
- The notice of each meeting of the Committee, confirming the venue, time and date, and enclosing an agenda of items to be discussed, shall other than under exceptional circumstances be forwarded to each member of the Committee not less than five working days prior to the date of the meeting.
- The quorum for decisions of the Committee shall be any two members present and voting on the matter for decision, of whom at least one shall be a director of the company.

5.5. ***Proceedings***

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and committees.
- The committee secretary shall take minutes of meetings . Minutes of all meetings shall be circulated to all the members of the Committee, and may also, if the chairperson of the Committee so decides, be circulated to other members of the board. Any director may, provided that there is no conflict of interest and with the agreement of the chairperson, obtain copies of the Committee's minutes.

5.6. ***General***

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside the company in order for it to perform its duties.
- These terms of reference may from time to time be amended as required, subject to the approval of the board.

6. **Environmental, Health and Safety Committee**

6.1. ***Constitution***

The company will establish a committee to be known as the Environmental, Health and Safety Committee ("Committee").

6.2. ***Membership***

- The Committee shall consist of not less than three directors appointed by the board, the majority of whom shall be non-executive directors and (where possible) shall be independent non-executive directors.
- The board shall appoint a chairperson from the non-executive directors on the Committee and determine the period for which he/she shall hold office.
- The Committee shall nominate a committee secretary.
- Suitably qualified persons may be co-opted onto the Committee when necessary to render such specialist services as may be necessary to assist the Committee in its deliberations on any particular matter, but shall have no rights of voting.

6.3. **Terms of reference**

- The role of the Committee shall be:
 - to develop the framework policies and guidelines for environmental, health and safety management;
 - to review the policies and performance of the company, its divisions and its managed subsidiaries and the progressive implementation of its environmental, health and safety policies;
 - to encourage independently managed subsidiaries, associates and significant investments to develop policies, guidelines and practices congruent with the company's environmental, health and safety policies;
 - to receive reports covering matters relating to substantive environmental, health and safety risks and liabilities relating to:
 - (i) the company's head office and its divisions (and may request such reports from appropriate directors of the company);
 - (ii) managed subsidiaries (and may request such reports from the relevant representatives of the companies serving on the boards of these companies or their equivalent committees); and
 - (iii) independently managed subsidiaries, associates and significant investments where appropriate, and may request the relevant representatives of the company serving on the boards of these companies or their equivalent committees to assess whether such matters are receiving due attention in the manner congruent with the company's policies.
 - to monitor key indicators on accidents and incidents and, where appropriate, ensure that such information is communicated to other companies managed by or associated with the company;
 - to consider substantive national and international regulatory and technical developments in the fields of environmental, health and safety management; and
 - to facilitate participation, co-operation and consultation on environmental, health and safety matters of governments, national and international organisations, super-national authorities, other companies and other environmental, health and safety bodies.
- The Committee will ensure that the chairperson (or in his/her absence, an alternative member) of the Committee attends the company's annual general meeting to answer questions concerning

environmental, health and safety policies and their developments and/or implementation.

6.4. **Meetings**

- Meetings of the Committee will be held as the Committee deems to be appropriate, however the Committee should meet at least twice each year. Meetings should be organised so that attendance is maximised. The Chairperson of the Committee or any member of the Committee may call a meeting at any other time.
- The notice of each meeting of the Committee, confirming the venue, time and date and enclosing an agenda of items to be discussed, shall other than under exceptional circumstances, be forwarded to each member of the Committee not less than five working days prior to the date of the meeting.
- The quorum for decisions of the Committee shall be a majority of members present who shall vote on the matter for decision.

6.5. **Proceedings**

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and committees.
- The committee secretary shall take minutes of meetings. Minutes of all meetings shall be circulated to all the members of the Committee, and may also, if the chairperson of the Committee so decides, be circulated to other members of the board. Any director may, provided that there is no conflict of interest and with the agreement of the chairperson, obtain copies of the Committee's minutes.

6.6. **Remuneration**

- Having regard to the functions performed by the members of the Committee in addition to their functions as directors in relation to the activities of the Committee and pursuant to the specific power conferred upon the board by the articles of association of the company, members of the Committee may be paid such special remuneration in respect of their appointment as shall be fixed by the board.
- Such special remuneration shall be in addition to the annual fees payable to directors.
- Those members of the Committee who are not directors of the company shall be paid such special remuneration in respect of their appointment as shall be fixed by the board.

6.7. **Limitation of responsibility**

- The appointment of the Committee shall in no way impinge upon any delegations of authority or responsibility made by the company and other individual companies or entities pursuant to environmental, health and safety legislation, or any other relevant legislation, which may be in force at the time.
- Subject to the above provisions and any relevant legislation, the members of the Committee shall not attract any personal liability arising from their appointment, and the company shall indemnify members of the Committee against all and any claims howsoever arising.

6.8. **General**

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside of the company in order for it to perform its duties.
- These terms of reference may be amended as required, subject to the approval of the board.

7. **Risk Management Committee**

7.1. **Constitution**

The quality, integrity and reliability of the company's risk management is delegated to the Risk Management Committee ("Committee"). The objective of the Committee is to assist the board of directors ("board") in the discharge of its duties relating to corporate accountability and the associated risk in terms of management, assurance and reporting. The Committee will review and assess the integrity of the risk control systems and ensure that the risk policies and strategies are effectively managed. The Committee will set out the nature, role, responsibility and authority of the risk management function within the company and outline the scope of risk management work. The Committee will monitor external developments relating to the practice of corporate accountability and the reporting of specifically associated risk, including emerging and prospective impacts. The Committee provides an independent and objective oversight and review of the information presented by management on corporate accountability and specifically associated risk, also taking account of reports by management and the Audit Committee to the board on financial, business and strategic risk.

7.2. **Membership**

- The Committee shall consist of an equal number of executive and non-executive directors appointed by the board.

- At least one member of the Committee shall be a non-executive director sitting on the Audit Committee.
- The board shall appoint the Committee chairperson, a non-executive director, and determine the period for which he/she shall hold office. The chairperson of the board shall not be eligible to be appointed as chairperson of the Committee.
- The Committee shall nominate a committee secretary.

7.3. ***Terms of Reference***

- The committee together with the company's legal advisor, will review any legal matters that could have a significant impact on the company's business.
- The Committee will review the Executive Committee's ("EXCO") reports detailing the adequacy and overall effectiveness of the company's risk management function and its implementation by management, and reports on internal control and any recommendations, and confirm that appropriate action has been taken.
- The Committee will review the risk philosophy, strategy and policies recommended by EXCO and consider reports by EXCO. The Committee will ensure compliance with such policies, and with the overall risk profile of the company. Risk in the widest sense includes market risk, credit risk, liquidity risk, operation risk and commercial risk, which together cover detailed combined risks such as :
 - interest rate risk;
 - country risk;
 - counterpart risk, including provisioning risks;
 - currency and foreign exchange risk;
 - technology risk;
 - price risk;
 - disaster recovery risk;
 - operational risk;
 - prudential risk;
 - reputational risk;
 - competitive risk;

- legal risk;
 - compliance and control risks;
 - sensitivity risks, e.g. environmental, health and safety;
 - concentration of risks across a number of portfolio dimensions;
 - investment risk;
 - asset valuation risk; and
 - other risks appropriate to the business, which may be identified from time to time.
- The Committee will review the adequacy of insurance coverage.
 - The Committee will review risk identification and measurement methodologies.
 - The Committee will monitor procedures to deal with and review the disclosure of information to clients.
 - The Committee will have due regard for the principles of governance and codes of best practice.
 - The Committee will liaise with the board in respect of the preparation of the Committee's report to shareholders as required.

7.4. **Meetings**

- Meetings of the Committee will be held as the Committee deems appropriate. However the Committee should meet at least twice a year. Meetings should be organised so that attendance is maximised. The chairperson of the Committee or any member of the Committee may call a meeting at any other time.
- The notice of each meeting of the Committee, confirming the venue, time and date and enclosing an agenda of items to be discussed, shall other than under exceptional circumstances, be forwarded to each member of the Committee not less than seven working days prior to the date of the meeting.
- The quorum for decisions of the Committee shall be any three members present and voting on the matter for decision.
- The chairperson, in his/her discretion, may invite such executives and senior management as appropriate to attend and be heard at meetings of the Committee. In addition, the finance director, chief executive officer and executives specifically responsible for risk in the company, including the head of internal audit, shall attend meetings of the Committee but shall not have a vote.

7.5. ***Proceedings***

- Unless varied by these terms of reference, meetings and proceedings of the Committee will be governed by the company's articles of association regulating the meetings and proceedings of directors and committees.
- The committee secretary shall take minutes of meetings. Minutes of meetings shall be circulated to all the members of the Committee, and shall be included in the board papers for the next meeting and circulated to all board members, together with any specific corporate accountability and risk management reports prepared by or on behalf of the Committee. The minutes will also be forwarded to the chairperson of all other board committees.

7.6. ***Remuneration***

- Having regard to the functions performed by the members of the Committee, in addition to their functions as directors in relation to the activities of the Committee, and pursuant to the specific power conferred upon the board by the articles of association of the company, members of the Committee who are non-executive directors may be paid such special remuneration in respect of their appointment as shall be fixed by the board.
- Such special remuneration shall be in addition to the annual fees payable to directors.

7.7. ***General***

- The Committee, in carrying out its tasks under these terms of reference, may obtain such outside or other independent professional advice as it considers necessary to carry out its duties.
- The board will ensure that the Committee will have access to professional advice both inside and outside the company in order for it to perform its duties.
- The Committee will have access to any information it needs to fulfil its responsibilities.
- The Committee will investigate matters within its mandate.
- These terms of reference may from time to time be amended as required, subject to the approval of the board.

APPENDIX VI

SAMPLE INTERNAL AUDIT CHARTER

1. **Mission and Scope of Work**

The mission of the internal auditing department is to provide independent, objective assurance and consulting services designed to add value and improve the organisation's operations. It helps the organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the internal auditing department is to determine whether the organisation's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- 1.1. Risks are appropriately identified and managed.
- 1.2. Interaction with the various governance groups within the organisation occurs as appropriate.
- 1.3. Significant financial, managerial, and operating information is accurate, reliable, and timely.
- 1.4. Employees actions are in compliance with policies, standard, procedures and applicable laws and regulations.
- 1.5. Resources are acquired economically, used efficiently, and adequately protected.
- 1.6. Programmes, plans and objectives are achieved.
- 1.7. Quality and continuous improvement are fostered in the organisation's control process.
- 1.8. Significant legislative or regulatory issues impacting the organisation are recognised and addressed appropriately.

Opportunities for improving management control, profitability, and the organisation's image may be identified during audits. These will be communicated to the appropriate level of management.

2. **Accountability**

The chief audit executive, in the discharge of his/her duties, shall be accountable to management and the audit committee to:

- 2.1. provide annually an assessment on the adequacy and effectiveness of the organisation's processes for controlling its activities and managing its risks set forth under the mission and scope and work;

- 2.2. report significant issues related to the processes for controlling the activities of the company and its affiliates, including potential improvements to those processes, and provide information concerning such issues through active and constructive resolution;
- 2.3. periodically provide information on the status and results of the annual audit plan and the sufficiency of department resources; and
- 2.4. co-ordinate with, and provide oversight of, other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

3. **Independence**

To provide for the independence of the internal auditing department, its personnel report to the chief audit executive, who reports functionally and administratively to the chief executive officer and periodically to the audit committee in a manner outlined under Accountability above. It will include, as part of its reports to the audit committee, a regular report on internal audit personnel.

4. **Responsibility**

The chief audit executive, and staff of the internal auditing department, have responsibility to:

- 4.1. develop a flexible annual audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the audit committee for review and approval as well as periodic updates;
- 4.2. implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by management and the audit committee;
- 4.3. maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter;
- 4.4. evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion;
- 4.5. issue periodic reports to the audit committee and management summarising results of audit activities;
- 4.6. keep the audit committee informed of emerging trends and successful practices in internal auditing;
- 4.7. provide a list of significant measurement goals and results to the audit committee;
- 4.8. assist in the investigation of significant suspected fraudulent activities within the organisation, and notify management and the audit committee of the results; and

- 4.9. consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organisation at a reasonable overall cost.

5. **Authority**

The chief audit executive, and staff of the internal auditing department, are authorised to:

- 5.1. have unrestricted access to all functions, records, property and personnel;
- 5.2. have full and free access to the audit committee;
- 5.3. allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives; and
- 5.4. obtain the necessary assistance of personnel in units of the organisation where they perform audits, as well as other specialised services from within or outside the organisation.

The chief audit executive and staff of the internal auditing department are not authorised to:

- Perform any operational duties for the organisation or its affiliates.
- Initiate or approve accounting transactions external to the internal audit department.
- Direct the activities of any employee in the organisation not employed by the internal auditing department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.

6. **Standards of audit practice**

The internal auditing department will meet, or exceed, the Standard for the Professional Practice of Internal Auditing of the Institute of Internal Auditors.

APPENDIX VII

RISK MANAGEMENT AND INTERNAL CONTROLS

1. Responsibilities in the Risk Management Process

1.1. **Board of Directors**

- The total process of risk management, which includes a related system of internal control, is the responsibility of the board. The board is also responsible for disclosures on risk management in the annual report and financial statements.
- The board is furthermore responsible to ensure that a risk assessment is undertaken at least annually for the purposes of making its public statement on risk management, as well as ensuring that at appropriately considered intervals, it receives and reviews reports on the risk management process.
- The board is responsible for considering the significant risk exposures that face the company and state that it has given these risks due consideration and application, as well as whether or not the board believes that the business will be a going concern in the year ahead.
- The board is also responsible to report significant risks that affect decisions of stakeholders (including shareowners) in their dealings with the company, and which should be disclosed in the annual report.

1.2. **Board Committee**

- This can be either a dedicated board Risk Committee or, for reasons of economy or other operational priorities, could be combined with the Audit Committee (*but see comments in Section 2 of the Report*).
- This body is responsible for reviewing the risk management process and the significant risks facing the company on behalf of the board.
- The results of this committee's work must be reported to, and considered by, the board.

1.3. **Management**

- Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it with the day-to-day activities of the company.
- Management is also accountable to the board for providing assurance that it has fulfilled its mandate and the manner in which this has been done.

- Management is also responsible for ensuring that generally accepted risk management frameworks and models, including internal control, are embedded in the organisational operations and processes.

1.4. **Chief Risk Officer/Risk Facilitator**

- The primary role of this function is to act as the line managers' coach, assisting them to implement the risk management architecture and working with them on an ongoing basis to ensure that it is suitably reviewed and regularly updated to enable new elements of risk in the company to be addressed.
- The chief risk officer ("CRO") monitors the company's entire risk profile, ensuring that major risks are identified and reported upwards.
- The CRO also provides and maintains the risk management infrastructure to assist the board in fulfilling its responsibilities.
- The CRO assists in the execution of the risk management process but the accountability to the board, which is ultimately responsible, remains with management and employees.

1.5. **Internal Audit**

- Internal audit does not assume the functions, systems and process of risk management but assists the board and management in the monitoring of risk management in the company.
- Internal audit also monitors, through its own assurance processes, the progress of business units in managing their risk in co-ordination with the CRO.

1.6. **Compliance Officer**

- The primary role of the compliance office is to assist management in discharging its responsibility to comply with statutory, regulatory and supervisory requirements by facilitating the development, establishment and maintenance of an efficient and effective compliance risk management process.
- The compliance officer must at all times maintain a high degree of professional independence in order to discharge his/her responsibilities objectively.
- Although the compliance officer must function independently, he/she cannot function in isolation and should interact with other role players in the risk management process. The role played by the compliance officer will differ from institution to institution, but in general they will be focused on the following:

- providing a service to management by assisting them in identifying and prioritising all applicable regulatory requirements;
- providing awareness training to enable management to manage applicable compliance risks appropriately; and
- conducting monitoring programmes to identify and report aspects of non-compliance to the CEO and board.

1.7. **Financial Director/Financial Manager**

- The financial director (“FD”) is responsible for risk management activities in the company traditionally falling within his/her functional area, such as treasury and insurance.
- The FD, together with the operations director or equivalent, also acts on behalf of the chief executive officer that, operationally, would usually spearhead the implementation of the risk management architecture and infrastructure.

1.8. **Operations Director**

- The operations director or equivalent (“OD”) is responsible for risk management activities falling within the areas of operations and manufacturing.
- The OD on the operational aspects of risk together with the FD on the financial aspects of risk, would head the risk management initiative under the direction of the chief executive officer (see 1.7 above).

1.9. **Legal Counsel**

Legal counsel is responsible for reporting to the board on significant external legal and compliance exposures (new legislation, lawsuits and litigation, investigations, government enquiries, etc.) and internally generated matters (criminal acts, conflicts of interest, environmental issues, health and safety issues, harassment, etc.).

1.10. **Chief Executive Officer**

The chief executive officer (“CEO”) brings the power of his/her office to risk architecture implementation operationally and needs to support, and be seen as clearly supporting, the necessary focus on risk management.

2. **Specimen Internal Control Disclosure Statement**

- 2.1. “The executive committee, as mandated by the board, has established a group-wide system of internal control to manage significant group risks. This system supports the board in discharging its responsibility for ensuring that the wide range of risks, associated with the group’s diverse *[international]* operations, are effectively managed in support of the creation and preservation of shareowner wealth.

- 2.2. The board's policy on risk management encompasses all significant business risks to the group, including operational risk, which could undermine the achievement of its business objectives. The board has determined the level of acceptable risk and requires that operations manage and report in terms thereof. Unacceptable risk is defined as financial exposure exceeding R[figure to be included] or a [5]% variance, whichever is the greater, arising from a change in an operation's forecast earnings, contingent liabilities, net debt and/or returns on capital employed. Issues and circumstances, which could give rise to material adverse reputational considerations, are considered to be unacceptable risk.
- 2.3. This system of internal control is designed so that the different divisions are able to tailor and adapt their risk management processes to suit their specific operational circumstances. This flexible approach has the commitment of the group's senior management. There is clear accountability for risk management, which is a key performance area of line managers throughout the group. The requisite risk and control capability is assured through board challenge and appropriate management selection and skills development. Managers are supported in giving effect to their risk responsibilities through sound policies and guidelines on risk and control management. Continuous monitoring of risk and control processes, across [15] significant risk areas, provides the basis for regular and exception reporting to operations management and divisional boards, the executive committee and the board.
- 2.4. A formalised risk management oversight structure has been established for each significant risk area, group risk owners have been appointed and board policies issued. Practical guidance for each risk area is detailed in the operational risk management handbook. The risk assessment and reporting criteria are designed to provide the board with a consistent, group-wide perspective of the key risks. They report to the board at least every six months, providing an assessment of the likelihood and impact of risks materialising, as well as risk mitigation initiatives and their effectiveness.
- 2.5. The system of internal control, which is embedded in all key operations, provides reasonable rather than absolute assurance that the group's business objectives will be achieved within the risk tolerance levels defined by the board.
- 2.6. Regular management reports, which provide a balanced assessment of key risks, is an important component of board assurance. Additional sources include assertions by divisional heads and chief financial officers, as well as board committees established to focus on specific risks such as safety, health and environment, and capital investment. The board also receives assurance from the audit committee, which derives its information, in part, from regular internal and external audit reports throughout the group on risk and internal control.
- 2.7. The group seeks to have a sound system of internal control, based on the group's policies and guidelines, all material associates and joint ventures. Where this is not possible, the group's directors, who are represented on these activities' boards, seek assurance that significant risks are being managed.

- 2.8. In conducting its annual review of the effectiveness of risk management, the board considers the key findings from the ongoing monitoring and reporting processes, management assertions and independent assurance reports. The board also takes account of material changes and trends in the risk profile, and considers whether the control system, including reporting, adequately supports the board in achieving its risk management objectives.
- 2.9. During the course of the year, the board considered the group's responsiveness to changes within its business environment and material inadequacies in systems of control. Remedial steps have been effected and the board is satisfied that there is an ongoing process, which has been operational since *[1 January 2002]*, for identifying, evaluating and managing the significant risks faced by the group."

APPENDIX VIII

KEY DECISIONS IN DEVELOPING A CODE OF ETHICS

Excerpted from:

Rossouw, Deon. 2002. Business Ethics in Africa. Cape Town: Oxford University Press, pages. 125-134.

Codes of ethics have an ambiguous reputation. Some ethical codes are powerful instruments that guide the behaviour of organisations; others are totally ineffectual. This clearly indicates that a special effort is required to make an ethical code effective.

The purpose of this document is to discuss the most important decisions that need to be made in order to develop an effective code of ethics. Before doing so, it will first be determined what is meant by a 'code of ethics'. Finally, the limitations of ethical codes will be explored.

1. **What is a code of ethics?**

It sometimes happens that other names are used to refer to a code of ethics. These include:

- credo;
- declaration of business principles;
- value statement;
- standard of conduct; and
- code of conduct.

Sometimes statements or documents are called ethical codes, when they are clearly not worthy of the name. A code of ethics is a document or agreement that stipulates morally acceptable behaviour within an organisation. It defines the moral standards or guidelines that need to be respected by all members of an organisation in their dealings with internal and external stakeholders.

2. **Key decisions in developing a code of ethics**

In developing a code of ethics a number of key decisions need to be made. The quality of these decisions will determine the ultimate effectiveness of the code. These key decisions revolve around the following six aspects of ethical codes:

- Purpose.
- Process.
- Form.

- Content.
- Tone.
- Implementation

2.1. ***The purpose of a code of ethics***

The first decision that needs to be made in developing an ethical code is about the purpose(s) that the code is supposed to serve. Codes of ethics can be developed to serve a number of purposes. A distinction can be drawn between internal and external purposes that a code can serve.

A code of ethics for internal purposes

An ethical code can be used to achieve a number of internal organisational goals:

- (a) It can establish agreement about standards of morally acceptable behaviour within an organisation.
- (b) It can provide guidance in moral decision-making.
- (c) It can promote organisational integration and co-ordination. An ethical code can rally staff around specific moral values, and strengthen commitment to the organisation.

A code of ethics for external purposes

Ethical codes can also be adopted to satisfy external stakeholders. A code of ethics sends a message to external stakeholders that will bolster their trust in or their expectations of an organisation. In some cases this is the main purpose of a code of ethics. A number of studies found that ethical codes are in some cases not even distributed to employees of organisations, but only to external stakeholders.

In the case of ethical codes for external purposes, the audience might be:

- (a) Consumers or society at large: The intention might be to enhance the reputation of an organisation amongst its external stakeholders.
- (b) The State: The purpose might be to deflect state interference in the internal affairs of a business or even an industry. The code of ethics is then intended to communicate a public commitment to moral responsibility.
- (c) Potential litigants: An ethical code can be used to pre-empt legal action against a company. Through publication of an ethical code, an organisation can demonstrate its intention to avoid moral malpractice.

The above lists of internal and external purposes that a code can serve are not exhaustive lists and can consequently be further extended. What matters is that as a first step in developing an ethical code, clarity must be gained on what single purpose or combination of purposes the code is supposed to serve. This decision will have an impact on the remaining decisions that need to be made in developing an ethical code.

2.2. ***The process of developing a code of ethics***

The ultimate purpose and intended audience of a code of ethics determine the process that will be followed in formulating the code. The process of developing the code is vital to the ultimate success of the code. In the process of developing a code, one can already start building support for the values and directives that will be written into it.

A code might be intended to impose certain moral standards upon the workforce. If so, it would be sufficient to determine the employer's expectations and formulate them into a code of ethics. Should the purpose of the code be to establish trust amongst external stakeholders, the process would have to be structured differently. It would have to involve some engagement with these stakeholders. Should a code be intended to discourage state regulation, the process would have to be structured in such a way that it includes discussion and negotiation with the government.

If the purpose of a code is to establish agreement about shared values between members of an organisation, a consensus-seeking process is required. This will require extensive consultation and consensus-building interventions. Commitment to a common set of ethical values cannot be imposed upon any organisation. People need to discover the need of ethical values for themselves before they will subscribe to them. The process of establishing a common set of values should allow for the personal discovery as well as for the opportunity to develop a commitment to such values. If this is not allowed to happen, the chances are slim that the values espoused in an ethical code will live in the hearts and minds of the people who are supposed to hold them. Although this might be a time-consuming process, it is the only way of ensuring that the final product enjoys everyone's support.

2.3. ***The form of the code***

Ethical codes can take one of two forms: It can either be an aspirational code or a directional code (or a combination of the two forms). Each of these forms has benefits and limitations.

Aspirational code

This is usually a short document that spells out the ethical values that should guide behaviour towards internal and external stakeholders of an organisation. It is aspirational in that it sets standards that all members of an organisation are expected to meet.

The benefits of an aspirational code, include the following:

- It is a concise document, so it is easy to remember.

- Being brief, it does not contain much detail and so is less likely to be confusing.
- It does not spell out every single moral action, and so shows respect for the maturity and discretion of people to apply these values as they see fit.

The strengths of an aspirational code also point to its weaknesses:

- Its general nature does not provide specific guidance on what is expected from organisational members in morally complex situations.
- This also makes it difficult to specify the consequences for someone who disregards the code. This means that it might be hard to enforce.

Directional code

In this format the ethical code is a more extended document that provides specific guidelines about what is expected from members of an organisation in specific circumstances. It has a definite directional purpose, as it spells out clearly how people within an organisation are expected to behave.

A directional code has obvious strengths:

- It is specific. It gives clear guidance to everyone within an organisation and leaves little room for misinterpretation.
- It is easy to enforce. It can spell out the consequences that will follow if someone should contravene the code.

The strength of this format is simultaneously its greatest weakness:

- Because it is so specific it tends to be long. This makes it difficult to remember.
- It does not allow much discretion. This can breed an attitude that encourages what some have come to name the eleventh commandment: 'Thou shalt not be caught out'.

2.4. ***The content of the code***

All or some of the following categories of content might be included in a code of ethics:

- the rationale for the code;
- ethical values or standards;
- prescriptions or prohibitions; and

- sanctions.

The rationale of the code

This is the justification for the code. It explains why the code has been developed and what purpose it is meant to serve for the organisation. The rationale for the code intends to convince the readers of the importance of the code by explaining what everyone stands to win from adherence to it.

Ethical values or standards

These provide the norms that will guide organisational behaviour. They set ethical targets for all, and can be considered the backbone of any ethical code. When a code takes the form of an aspirational code, it is not likely to go much beyond the stating of ethical values or standards. In a directional code the implications of these values and standard for organisational behaviour are likely to be spelt out.

Prescriptions or prohibitions

These are more likely to be found in directional codes. They prescribe or prohibit specific actions. Their purpose is either to avoid malpractice or to promote ethical behaviour by giving explicit directions about what is expected from organisational members.

Sanctions

These stipulate the consequences of disregard for the code. In the case of an aspirational code, sanctions can only be specified in a general way, while a directional code can refer to specific transgressions and sanctions. Common sense would seem to suggest that sanctions will make people more mindful of an ethical code, but research has not yet been able to prove this. Reward for ethical behaviour seems to be a stronger incentive for adhering to an ethical code.

2.5. ***The tone of the code***

The spirit in which the content of a code is being communicated is important. The tone of an ethical code can have a marked influence on its effectiveness. The tones of codes can vary on a spectrum from negative and prohibiting to positive and supporting. In general, codes intended to stamp out ethical malpractice by imposing sanctions will have a negative and prohibiting tone. Codes intended to inspire members of an organisation to live up to ethical values are likely to have a positive and supportive tone.

2.6. ***Implementation of the code***

Proper consideration needs to be given to the implementation of the code of ethics. Without this, the code will remain words on paper. It is important to realise that plans for the implementation of the code should not be postponed until after its completion. Communication of the code does not need to wait until it is finished, but should start long before that. The development process should also be a communication process. This

can happen when a code is developed through consultation, negotiation, and participation. If a code is created in a transparent way the credibility of the code is greatly enhanced.

Once finalised, the ethical code needs to be communicated regularly and in different ways so that it is reinforced over and over again. Communication of the code does not always have to be direct. It can also be done through the discussion of moral dilemmas or case studies. In training sessions the code can be introduced as an aid to resolution of the case at hand. The idea of a launch, where all members of an organisation are expected to subscribe to the code by undersigning it is a good idea, but it is not enough. A special effort should also be made to ensure that new appointees are acquainted with the code.

Measures to enforce the code should also be taken well in advance. There should be clarity about what would happen if a member of the organisation were to contravene the code. If special structures need to be created to deal with such transgressions, they should be in place by the time the code is officially adopted by an organisation. The ways in which a code can be enforced can be through positive or negative enforcement. Positive enforcement rewards those who behave in an exemplary fashion in terms of the code. In the case of negative enforcement some form of punishment is meted out to transgressors.

There are also other factors that have a marked influence on the effectiveness of a code. Communication of the code should be accompanied by public commitment on the part of prominent and visible people in the organisation. Should a prominent person contravene the code and get away with it, the code's credibility will be damaged. The opposite is equally true. By demonstrating a commitment to the code in word and deed, a prominent person can enhance its influence.

The level of trust that prevails in an organisation is crucial. If the level of trust is low there will be a lot of scepticism about the ethical code. It will be regarded with suspicion. Introducing a code into such an environment is usually ineffectual. In such cases, the issue of trust needs to be addressed simultaneously.

3. **Limitations of ethical codes**

A well-developed and properly implemented ethical code can be a valuable asset to an organisation. It can be a powerful instrument for preventing ethical malpractice as well as for raising standards of moral behaviour in an organisation. Useful and important though it is, it would be a mistake to overestimate the value of an ethical code. An ethical code can play a vital role, but it should not be regarded as the sole instrument for managing the ethical performance of an organisation. Some of the limitations of ethical codes are identified below.

Moral autonomy

Moral autonomy refers to the ability to think independently and originally about moral matters. Members of an organisation are expected to obey an ethical code. Such obedience can be a very good thing, especially if the code offers sound ethical guidelines. It may, however, blunt people towards issues not

covered by the code. A blind reliance on a code of ethics can mean that people do not develop moral sensitivity on their own. Various initiatives should be taken to keep moral debate alive in an organisation such as ongoing discussions of ethical dilemmas or new moral issues that employees have to face. This will assist them in cultivating their moral sensitivity.

Moral decision-making

A further limitation of an ethical code is that although it can provide valuable guidance, it cannot ensure that people will be able to apply the code in situations that require ethical decision-making. To make proper moral decisions, one needs to develop the relevant skills and knowledge. This implies once more that the ethical code on its own is not enough. Training in moral analysis and moral decision-making must complement it.

Dissident views

Ethical codes tend to silence dissident voices in organisations. As the purpose of a code is to enforce uniformity in moral behaviour, it follows that by its very nature an ethical code will tend to silence alternative moral views. It might well be that there are other valid moral viewpoints within an organisation that are not accommodated in the existing code. In such cases, the existing code could be viewed as oppressive and intolerant by some. The debate on ethical matters must remain open and it is important to make provision for the regular revision of the ethical code. Ironically, those codes that are most regularly re-opened for revision are the ones that most often survive a revision exercise unscathed.

Counterproductive

Introducing a code of ethics can be counterproductive when there is a discrepancy between the professed and actual behaviour of an organisation. If the ethical code is perceived by external stakeholders, for example, to be nothing but a ploy intended to pacify or impress, they are likely to react with greater cynicism towards the organisation. The same can happen within an organisation, when employees perceive the ethical code to be an insincere effort at manipulation by the employer.

4. **Conclusion**

Ethical codes can be effective instruments for promoting better behaviour in organisations. A code of ethics can help to limit ethical malpractice. But its effectiveness is not guaranteed, and much depends upon careful planning and a number of vital decisions that need to be taken during its development and implementation. Even in cases where ethical codes are effective, they will have limitations and need to be complemented by other measures.

APPENDIX IX

UNITED NATIONS GLOBAL COMPACT

THE GLOBAL COMPACT AND HUMAN RIGHTS

To understand what human rights are all about, the 1948 Universal Declaration of Human Rights (UDHR) is the best place to begin. The UDHR contains an internationally accepted set of standards and is the foundation of the body of international human rights law which has developed over the past 50 years. Increasingly, companies are also looking to the Universal Declaration as the measure of their human rights policies. And because it is so widely accepted, corporations can use it as a legitimate point of reference almost anywhere in the world. The UDHR also provides a good basis of dialogue with NGOs and others concerned about human rights.

WHAT DOES THE UNIVERSAL DECLARATION SAY?

Equality

The Declaration begins by laying down its basic premise, that "all human beings are born free and equal in dignity and rights". The Declaration then goes on to give content to its understanding of equality by prohibiting any distinction in the enjoyment of human rights on such grounds as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.

Life and security

The rights to life, liberty, security, and the right to be free from slavery, servitude, torture or cruel, inhuman or degrading treatment or punishment further develop the notion of personal dignity and security. The rights of the individual to a just national legal system are also set out. The right to recognition as a person before the law, to equal protection of the law, to a judicial remedy before a court for human rights violations, to be free from arbitrary arrest, to a fair trial before an independent court, to the presumption of innocence and not to be subjected to retroactive penal laws are all set out in the Declaration.

Personal freedom

Rights protecting a person's privacy in matters relating to family, home, correspondence, reputation and honour and freedom of movement are all part of the Universal Declaration. The right to seek asylum, to a nationality, to marry and found a family and the right to own property and the prohibition of arbitrary deprivation of property are also proclaimed by the Declaration. Freedom of thought, conscience and religion and freedom of opinion and expression are set out along with the right of peaceful assembly and association and the right to take part in government.

Economic, social and cultural freedoms

Touching other aspects of the daily lives of people, the Declaration proclaims the right to social security and to the economic, social and cultural rights indispensable to human dignity and the free development of each individual's personality. These rights are to be realized through national efforts and international cooperation and in accordance with the conditions in each State.

The right to work is set out, and to equal pay for equal work, and to just and favourable remuneration ensuring for the worker and the worker's family an existence worthy of human dignity (which can be supplemented, if necessary, by other means of social protection). The Declaration also recognizes the right to form and join trade unions, the right to rest and leisure, reasonable limitations on working hours and periodic holidays with pay. The right to a standard of living adequate for health and well-being, including food, clothing, housing, medical care, and to social services and security, if necessary, are also proclaimed as are the rights to education, to participate in the cultural life of the community, and to the protection of the moral and material interests resulting from any scientific, literary or artistic production.

TO WHOM IS THE UNIVERSAL DECLARATION ADDRESSED?

The Declaration's authors were well aware that the rights they were proclaiming were far from universally respected. They also knew that reaching their objective of universal enjoyment of those rights by everyone would require immense efforts by every individual and group in society. They thus addressed their call to action to realize those rights, not specifically to governments, but to "every individual and organ of society", within which, of course, governments are included.

HUMAN RIGHTS AND BUSINESS

But what does "human rights" really mean for business in practical terms? While there may be broad agreement that human rights are a "good thing" and should thus be supported by all people, what specific responsibilities do business leaders take on when they express their commitment to human rights?

Corporate leadership in human rights is good for the community and for business. The benefits of responsible business engagement include: being more in touch with markets, customers and consumers by better understanding the opportunities and problems of the social context; the advantages of a good social reputation; a greater chance of a stable and harmonious atmosphere in which to do business; a reduction of damaging criticism, which, in the extreme, can lead to lost investment, contracts or customers. And there is the long-term benefit of a more stable and peaceful society in which investments can prosper.

1. THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO SUPPORT AND RESPECT THE PROTECTION OF INTERNATIONALLY PROCLAIMED HUMAN RIGHTS WITHIN THEIR SPHERE OF INFLUENCE.

Corporate leadership in human rights is good for the community and for business. The benefits of responsible engagement merit being spelled out.

For business they include: being more in touch with markets, customers and consumers by better understanding the opportunities and problems of the social context; the advantages of a good social reputation; a greater chance of a stable

and harmonious atmosphere in which to do business; a reduction of damaging criticism, which, in the extreme, can lead to lost investment, contracts or customers. And there is the long-term benefit of a more stable and peaceful society in which investments can prosper.

For society, the benefits of corporate social responsibility include: less adverse impacts from ill-thought-through business initiatives; a gearing-up of social partnerships: capacity and innovation brought to bear on problems; and the full contribution of influential citizens to the general well-being.

Companies committing themselves to human rights would ensure:

In the workplace

- safe and healthy working conditions;
- freedom of association;
- non-discrimination in personnel practices;
- no forced or child labour; and
- rights to basic health, education and housing (if operations are located in areas where these are not provided).

Outside the workplace

- respect for existing international guidelines and standards for the use of force (UN Code of Conduct for Law Enforcement Officials and UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials)

In the Wider Community

- prevent the forcible displacement of individuals, groups or communities;
- protect the economic livelihood of local communities; and
- contribute to the public debate. Companies interact with all levels of governing bodies in the countries where they operate. Within this context, they have the right and the responsibility to express their views on matters which affect their operations, their employees, their customers and the communities of which they are part.

2. THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO MAKE SURE THEY ARE NOT COMPLICIT IN HUMAN RIGHTS ABUSES.

An effective human rights policy will help companies avoid being implicated in human rights violations.

Use of security forces

For example, while corporations have the right to provide security for personnel and property in areas where they operate, companies should:

- respect existing international guidelines and standards for the use of force (UN Basic Principles on the Use of Force and Firearms by Law Enforcement Officials and the UN Code of Conduct for Law Enforcement Officials);
- if financial or material support is provided to security forces, establish clear safeguards to ensure that these are not then used to violate human rights; and
- make clear in any agreements with security forces that they will not condone any violation of international human rights laws. All such agreements should be made public and transparent.

Relationships with Governments

Of course, if a corporation directly engages in acts of discrimination or undermines the political or judicial system through bribery or intimidation, the conclusion is clear. Should a corporation benefit from violations by the authorities, or entice, encourage or support them in violating human rights, corporate complicity would be evident.

Taking positive action

In order to avoid such situations, companies may wish to consider the following:

- Has the company made a human rights assessment of the situation in countries where they are or intend to do business to identify the risks of involvement in human rights abuses and the company's potential impact on the situation?
- Does the company have explicit policies which protect the human rights of workers in its direct employment and in its supply chain?
- Does the company have an explicit policy to ensure that security arrangements, whether its own, contracted or supplied by the State, do not contribute to human rights violations?
- Has the company established a monitoring system to ensure that its human rights policies are being implemented?

3. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO UPHOLD FREEDOM OF ASSOCIATION AND EFFECTIVE RECOGNITION OF THE RIGHT TO COLLECTIVE BARGAINING.**

Why should business care?

- Businesses face many uncertainties in a rapidly changing global market. Establishing genuine dialogue with freely chosen workers' representatives enables both workers and employers to understand each other's problems better and find ways to resolve them. Security of representation is a foundation for building trust on both sides.

- Freedom of association and the exercise of collective bargaining provide opportunities for constructive rather than confrontational dialogue, which harness energy to focus on solutions that result in benefits to the enterprise, its stakeholders, and society at large.
- Business management and other studies indicate that the dynamic that results from freedom of association can set in motion a "decent work"-cycle that increases productivity, incomes and profits for all concerned.
- Representational security, through exercise of "voice at work", facilitates local responses to a globalized economy and serves as a basis for sustainable growth and secure investment returns. The results help bridge the widening representational gap in global work arrangements, and facilitate the input of those people, regions and economic sectors – especially women and informal sector workers -- who otherwise may be excluded from participating in processes that build decent work environments.

What does the principle mean?

- Establishing and joining organizations are essential aspects of freedom of association. The principle applied in the workplace means that both workers and employers can establish and join organizations to represent their interests. These organisations are free to affiliate with national and international counterparts.
- Activities involved in establishing and joining organizations include drawing up constitutions and rules, selecting representatives in full freedom, organising administration and activities, and formulating programmes.
- Bargaining collectively on conditions of work is key to effective functioning of the relationship between workers and their organisations, and employers and/or their organisations, and is the expression in practice of freedom of association in the world of work.
- Recognizing, on both sides of the table, the duty to bargain in good faith and make every effort to come to an agreement builds trust and productive workplace relations.
- An integral component of this principle involves industrial action by workers and their organizations to promote and defend their economic and social interests.

What can business do?

In the workplace

- Ensure that all workers are able to form and join a trade union of their choice without fear of intimidation or reprisal
- Ensure union-neutral policies and procedures in such areas as applications for employment and record-keeping; and decisions on advancement, dismissal or transfer.

- Provide facilities to help worker representatives carry out their functions within the company's needs, size and capabilities. These facilities include the ability to collect union dues on company premises, posting of trade union notices, and distribution of union documents related to normal trade union activities in the enterprise, and time-off with pay for union activities.

At the bargaining table

- Recognise representative organizations for the purpose of collective bargaining
- Use collective bargaining as a constructive forum for addressing working conditions and terms of employment and relations between employers and workers, or their respective organisations
- Address any problem-solving or preventive need within the imagination and interests of workers and management, including restructuring and training needs, redundancy procedures, safety and health issues, grievance and dispute settlement procedures, disciplinary rules, and family and community welfare
- Provide information needed for meaningful bargaining
- Balance dealings with the most representative trade union to ensure the viability of smaller organizations to continue to represent their members

In the community of operation

- Take account of the labour-management relations climate in the country in ensuring freedom of association and collective bargaining. In countries with insufficient legal protections, take steps to preserve the safety and confidentiality of trade unions and their leaders
- Support the establishment and functioning of local/national employers organisations, and trade unions
- Inform the local community, media and public authorities of your company's endorsement of the UN Global Compact and its intention to respect its provisions, including those on fundamental workers' rights

WHAT POINTS OF REFERENCE CAN BUSINESS USE?

The Global Compact labour principles are taken from the **ILO Declaration on Fundamental Principles and Rights at Work**, adopted by the International Labour Organization in 1998. The ILO is the only UN agency whose membership is composed of governments and business (employers' organizations and trade unions). Hence, the Declaration represents a universal consensus among those concerned with labour issues that the principles need to be promoted and protected worldwide. All countries, whether or not they have ratified the relevant Conventions, have an obligation "to respect, to promote and to realize in good faith" the principles. Through the Global Compact the ILO aims at harnessing the support of the business community for this effort.

4. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO PROMOTE THE ELIMINATION OF ALL FORMS OF FORCED AND COMPULSORY LABOUR.**

Why should business care?

- Forced labour robs societies of the opportunities to apply and develop human resources for the labour market of today, and develop the skills in education of children for the labour markets of tomorrow.
- Forced labour retards the proper development of human resources reduces lifetime earnings of whole families, lowers the level of productivity and economic growth for society generally, and produces
- Social unrest.
- The debilitating consequences of forced labour are felt, both in the individual and in particularly children, and on the economy itself.
- Insecure investments result from the degradation of human capital and social stability arising from forced labour practices.
- Forced labour leads to loss of income due to disruption of regular jobs or income-generating activities, and with it, the loss of food, shelter, health care, and even life

What does the principle mean?

Forced or compulsory labour is "all work or service which is exacted from any person under the menace of any penalty and for which the said person has not offered himself voluntarily." Providing wages or other compensation to a worker does not necessarily indicate the labour is not forced or compulsory. Examples of forced labour include:

- bonded labour or debt bondage, an ancient practice but still in use in some countries, in which both adults and children are obliged to work in slave-like conditions to repay debts of their own or their parents or relatives
- child labour in particularly abusive conditions where the child has no choice about whether to work.
- the work or service of prisoners if they are hired to or placed at the disposal of private individuals, companies or associations involuntarily and without supervision of public authorities;
- labour for development purposes required by the authorities, for instance to assist in construction, agriculture, and other public works;
- work required in order to punish opinion or expression of views ideologically opposed to the established political, social or economic system.

The ban on forced labour does not include:

- compulsory military service for work of a purely military character;
- normal civic obligations such as jury duty;
- the work or service of prisoners resulting from a conviction in a court of law, and carried out under the supervision and control of a public authority
- work performed in emergency situations such as fire, flood, famine, earthquake, violent epidemic and in general any circumstance that would endanger the existence or the well-being of the whole or part of the population;
- minor communal services performed in the direct interest of the community.

What can business do?

Understanding the causes of forced labour is the first step toward action against forced labour, which requires a comprehensive set of interventions that addresses not only the needs of individual forced labourers, but also of their families. A combination of workplace and community actions will help ensure the eradication of forced labour practices.

In the workplace

- in planning and conducting business operations, ensure that workers in debt bondage or in other forms of forced labour are not engaged and, where found, provide for the removal of such workers from the workplace with adequate services and provision of viable alternatives in the community of operation
- institute policies and procedures to prohibit the requirement that workers lodge financial deposits with the company
- if hiring prisoners for work in or outside prison, ensure that their terms and conditions of work are similar to those of a free employment relationship in the sector involved, and that they have given their consent to working for a private employer
- ensure that large scale development operations in which an employer participates do not rely on
- make sure that professional workers who are serving public obligations relating to professional training are applying technical skills of special value to the community that meet current and pressing needs, and generally have terms of service that do not exceed two years

In the community of operation

- assist in the development of guidelines by sectoral industrial associations and small or medium enterprises where debt bondage or such practices are known to be commonplace

- support and help design education, vocational training, and counselling programmes for children removed from situations of forced labour
- help develop skills training and income-generating alternatives, including micro-credit financing programmes, for adults removed from situations of forced labour
- encourage supplementary health and nutrition programmes for workers removed from dangerous forced labour, and provide medical care to assist those affected by occupational diseases and malnutrition as a result of their involuntary work

What points of reference can business use?

The Global Compact labour principles are taken from the **ILO Declaration on Fundamental Principles and Rights at Work**, adopted by the International Labour Organization in 1998. The ILO is the only UN agency whose membership is composed of governments and business (employers' organizations and trade unions). Hence, the Declaration represents a universal consensus among those concerned with labour issues that the principles need to be promoted and protected worldwide. All countries, whether or not they have ratified the relevant Conventions, have an obligation "to respect, to promote and to realize in good faith" the principles. Through the Global Compact the ILO aims at harnessing the support of the business community for this effort.

5. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO PROMOTE THE EFFECTIVE ABOLITION OF CHILD LABOUR.**

Why should business care?

Child labour results in scores of under skilled, unqualified workers and jeopardizes future skills improvements in the workforce. Children who do not complete their primary education are likely to remain illiterate and never acquire the skills needed to get a job and contribute to the development of a modern economy.

The use of child labour can damage a company's reputation. This is especially true in the case of transactional supply and service chains, where the economic exploitation of children, even by a business partner, can damage a brand image and have strong repercussions on profit and stock value.

What does the principle mean?

- Child labour involves depriving children of their childhood and their dignity. Of particular concern are children who work long hours for low or no wages, often under conditions harmful to their health, physical and mental development, who are deprived of an education, and who may be separated from their families.
- Protecting a child from economic exploitation involves protecting him or her from performing any work that is likely to interfere with education, or is harmful to a child's health or well-being.

- The minimum age for admission to employment or work should, in principle, not be less than the age for completing compulsory schooling and in no event less than the age of 15 years, and the worst forms of child labour, including hazardous work, should be prohibited for those under 18.
- Priority is given to eliminating, for all persons under the age of 18, the worst forms of child labour, such as hazardous types of work or employment, slavery, debt bondage, child prostitution, forced recruitment for use in armed conflict, and child involvement in illicit activities.

What can business do?

Understanding the causes and consequences of child labour is the first step toward action against child labour, which requires a comprehensive set of interventions that addresses not only the needs of the children but also of their families. A combination of workplace and community actions will ensure children withdrawn from work have access to a range of supportive measures and institutions.

In the workplace

- adhere to minimum age provisions of national labour laws and regulations, and, where national law is insufficient, take account of international standards
- use adequate mechanisms for age verification in recruitment procedures
- when children below legal working age are found in the workplace, take measures which provide for their removal along with adequate services and viable alternatives for both the children and their families. These measures often include enrolling the children in schools and offering income-generating alternatives for the parents or above-working age siblings
- exercise influence on subcontractors, suppliers and other business affiliates to combat child labour
- develop and implement child labour detection mechanisms
- make sure adult workers are given secure employment and decent wages and working conditions, so that they do not need to send their children to work.

In the community of operation

- assist in the development of guidelines by sectoral industrial associations and small to medium sized enterprises
- support and help design educational, vocational training, and counselling programmes for working children, and skills training for parents of working children

- encourage and assist in launching supplementary health and nutrition programmes for children removed from dangerous work, and provide medical care to cure children of occupational diseases and malnutrition
- help raise awareness about child labour and mobilize business sectors and society in general to take action against child labour

What points of reference can business use?

The Global Compact labour principles are taken from the ILO Declaration on Fundamental Principles and Rights at Work, adopted by the International Labour Organization in 1998. The ILO is the only UN agency whose membership is composed of governments and business (employers' organizations and trade unions). Hence, the Declaration represents a universal consensus among those concerned with labour issues that the principles need to be promoted and protected worldwide. All countries, whether or not they have ratified the relevant Conventions, have an obligation "to respect, to promote and to realize in good faith" the principles. Through the Global Compact the ILO aims at harnessing the support of the business community for this effort.

6. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO UPHOLD THE ELIMINATION OF DISCRIMINATION IN RESPECT OF EMPLOYMENT AND OCCUPATION.**

Why should business care?

Discrimination in employment and occupation restricts the available pool of workers and skills, and isolates an employer from the wider community.

Non-discriminatory practices help ensure the best qualified person fills the job.

Discriminatory practices can damage a company's reputation, potentially affecting profits and stock value.

Discrimination in the world of work slows economic growth for society as a whole. The lack of a climate of tolerance results in missed opportunities for development of skills and infrastructure to strengthen competitiveness in the global economy.

What does the principle mean?

- The essence of discrimination in employment and occupation is "any distinction, exclusion or preference which has the effect of nullifying or impairing equality of opportunity or treatment in employment or occupation" and is made on the basis of "race, colour, sex, religion, political opinion, national extraction or social origin". However, distinctions based strictly on the inherent requirements of the job are not discrimination.
- Discrimination can be involved in a variety of work-related activities, including access to employment and to particular occupations, access to training and vocational guidance, and various terms and conditions of employment, such as equal remuneration, hours of work and rest, paid holidays, maternity leave, security of tenure, advancement, social security; and occupational safety and health.

What can business do?

Understanding the causes of discrimination is the first step toward redressing systems and attitudes that perpetuate such practices.

In the workplace

- Institute company policies and procedures which make qualifications, skill and experience the basis for the recruitment, placement, training and advancement of staff at all levels
- assign responsibility for equal employment issues at a high level, issue clear company-wide policy and procedures to guide equal employment practices, and link advancement to desired performance in this area
- establish programs to promote access to skills development training and to particular occupations
- ensure that employees are not discriminated in hiring, advancement, dismissal, remuneration, employment related social security and that special situations are accommodate (e.g., maternity, religious holidays, etc.)
- work on a case by case basis to evaluate whether a distinction is an inherent requirement of a job, and avoid systematic applications of job requirements in a way that would systematically disadvantage certain groups
- keep up-to-date statistics on workforce hiring, training and promotion, disaggregated by race, religion, gender, etc
- establish or augment grievance procedures to handle complaints of discrimination

In communities of operation

- encourage and support local efforts to build a climate of tolerance and equal access to opportunities for occupational development, promotion, such as adult education programs and health and child care services
- in foreign operations, accommodate cultural traditions as necessary to ensure equal access to employment by women and minorities, and work, as appropriate, with representatives of workers or of the organisations of these workers and governmental authorities

WHAT POINTS OF REFERENCE CAN BUSINESS USE?

The Global Compact labour principles are taken from the **ILO Declaration on Fundamental Principles and Rights at Work**, adopted by the International Labour Organization in 1998. The ILO is the only UN agency whose membership is composed of governments and business (employers' organizations and trade unions). Hence, the Declaration represents a universal consensus among those concerned with labour issues that the principles need to be promoted and

protected worldwide. All countries, whether or not they have ratified the relevant Conventions, have an obligation "to respect, to promote and to realize in good faith" the principles. Through the Global Compact the ILO aims at harnessing the support of the business community for this effort.

THE GLOBAL COMPACT AND ENVIRONMENT

While the major trading, employment and livelihood opportunities provided by business contribute to increased prosperity throughout the world, many of its production and consumption practices also have adverse effects on the environment. However, this apparently contradictory relationship is not inevitable.

There are demonstrated ways to reconcile environmental protection and economic growth. **The preventative approach to environmental problems is embedded in company policies and practices**, resulting in both environmental and economic benefits.

Success in a globalising economy requires a redefinition of a company's policies and practices resulting in:

- efficient use of economic capital
- AND
- ability to build, sustain and effectively deploy human, social and natural capital

NINE REASONS FOR BUSINESS TO IMPROVE ITS ENVIRONMENTAL PERFORMANCE

- Application of cleaner production and eco-efficiency leads to improved resource productivity.
- New economic instruments (taxes, charges, trade permits) are rewarding clean companies.
- Environmental regulations are becoming tougher.
- Insurance companies prefer to cover a cleaner, lower risk company.
- Banks are more willing to lend to a company whose operations will not burden the bank with environmental lawsuits or large clean-up bills.
- Environmental stewardship has a positive effect on a company's image.
- Employees tend to prefer to work for an environmentally responsible company (such a company also often has good worker health and safety records).
- Environmental pollution threatens human health.
- Customers are demanding cleaner products.

Good environmental performance makes good business sense.

THREE KEY ACTION POINTS FOR BUSINESS

- taking a precautionary approach
- being environmentally responsible
- developing and promoting environmentally sound technologies

KEY DOCUMENTS

- Agenda 21
- Rio Declaration

7. THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO SUPPORT A PRECAUTIONARY APPROACH TO ENVIRONMENTAL CHALLENGES.

What is the precautionary approach?

The essence of the precautionary approach is given in Principle 15 of the Rio Declaration which states:

"where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation"

Key element of a precautionary approach

Prevention rather than cure -- it is more cost-effective to take early actions to ensure that the irreversible environmental damage does not occur. This requires developing a life-cycle approach to business activities to:

- manage the uncertainty;
- ensure transparency.

Why should business apply the precautionary approach?

✓ **Adopting a precautionary approach makes sound business sense**

While it is true that preventing environmental damage entails both opportunity and implementation costs, remediating environmental harm after it has occurred can cost much more (e.g. treatment costs, company image).

✓ **Avoiding risks makes a better investment**

Investing in production methods that are not sustainable, that deplete resources and that degrade the environment has a lower, long-term return than investing in sustainable operations. In turn, improving environmental performance means less financial risk, an important consideration for insurers.

Ways to apply the precautionary approach

- analyse potential environmental impacts of production processes and products (technology assessment)
- build-in safety margins when setting standards in areas where significant uncertainty still exists
- ban or restrict an activity whose impact on the environment is uncertain
- promote best available technology
- implement cleaner production
- communicate with stakeholders

8. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO UNDERTAKE INITIATIVES TO PROMOTE GREATER ENVIRONMENTAL RESPONSIBILITY.**

What is environmental responsibility?

As outlined in Agenda 21, environmental responsibility is:

"...[the] responsible and ethical management of products and processes from the point of view of health, safety and environmental aspects. Towards this end,

business and industry should increase self-regulation, guided by appropriate codes,

charters and initiatives integrated into all elements of business planning and decision-making, and fostering openness and dialogue with employees and the public."

Given the increasingly central role of the private sector in global governance issues, the public is demanding that business manage its operations in a manner which will enhance economic prosperity, ensure environmental protection and promote social justice.

Business can demonstrate its commitment to greater corporate accountability, transparency, and responsibility in a number of ways:

traditional approach

inefficient resource use
end-of-pipe
public relations
reactive
management systems
one way passive communication

responsible approach

resource productivity
cleaner production
corporate governance
proactive
life-cycles, business design
multi-way, active dialogue

Benefits of being environmentally responsible

- stimulate greater awareness throughout the company
- improve credibility -- license to operate
- retain customers and employees

- enhance business development opportunities
- build corporate reputation
- facilitate dialogue and partnership with many of business's key clients and partners: customers, employees, shareholders, business partners, suppliers, and community at large

Key elements of environmental responsibility

- apply precautionary approach
- adopt same operating standards regardless of location
- ensure supply-chain management
- facilitate technology transfer
- contribute to environmental awareness in company locations
- communicate with local community
- share equitably benefits

Why should business promote greater environmental responsibility?

- ✓ Better environmental management is a key source of competitive advantage for business.
- ✓ Wide range of benefits can accrue from improved environmental performance, ranging from reduced effluent charges to better community relations.
- ✓ Better environmental management and better management are the same thing: a company that manages its impacts on the environment well is a well-managed company.
- ✓ Maintaining financial performance and improving it over the long-term requires a balancing of three types of capital - social, economic and environmental.

Steps towards increasing environmental responsibility

- implement International Declaration on Cleaner Production;
- work with suppliers to improve environmental performance (supply chain management)
- re-define company strategies and policies to include the 'triple bottom line' of sustainable development -- economic prosperity, environmental quality and social equity
- set quantifiable objectives and targets

- develop sustainability indicators (economic, environmental, social)
 - measure, track, and report progress in incorporating sustainability principles into business practices, including reporting against global operating standard
 - adopt voluntary charters, codes of conduct, codes of practice in global and sectoral initiatives
 - ensure transparency and unbiased communication with stakeholders
9. **THE SECRETARY-GENERAL ASKED WORLD BUSINESS TO ENCOURAGE THE DEVELOPMENT AND DIFFUSION OF ENVIRONMENTALLY FRIENDLY TECHNOLOGIES.**

What are environmentally sound technologies?

Environmentally sound technologies (ESTs), as defined by Agenda 21:

"...protect the environment, are less polluting, use all resources in a more, sustainable manner, recycle more of their wastes and products, and handle, residual wastes in a more acceptable manner than the technologies for which, they were substitutes. [ESTs] are not just individual technologies, but total, systems which include know-how, procedures, goods and services, and, equipment as well as organisational and managerial procedures."

ESTs includes a variety of cleaner production process technologies, pollution prevention technologies as well as end-of-pipe and monitoring technologies.

Why should business develop, use and diffuse ESTs?

Production processes and technology that do not use resources efficiently generate residues and discharge wastes:

- company is responsible for treating and storing the pollutant
- represents on-going costs
- ✓ *Technology innovation creates new business opportunities for companies.*
- ✓ *Implementing ESTs helps a company reduce the use of raw materials leading to increased efficiency and overall competitiveness of the company.*

ESTs reduce day-to-day operating inefficiencies, emissions of environmental contaminants, worker exposure to hazardous materials and risks of technological disasters. Technologies that use materials more efficiently and cleanly can be applied in most companies with long-term economic and environmental benefits.

Methods for promoting the use and diffusion of ESTs

- establish corporate policy on the use of ESTs

- make available information on the environmental performance of ESTs and the associated cost benefits
- encourage the use of EST criteria by including them in the tendering process
- create joint ventures between suppliers and recipients of ESTs
- work with suppliers and contractors that use ESTs (supply chain management)

Website: www.unglobalcompact.org

APPENDIX X

THE GLOBAL SULLIVAN PRINCIPLES OF CORPORATE SOCIAL RESPONSIBILITY

The Preamble

The Objectives of the Global Sullivan Principles are to support economic, social and political justice by companies where they do business, to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision making committees and boards; to train and advance disadvantaged workers for technical, supervisory and management opportunities; and to assist with greater tolerance and understanding among peoples, thereby helping to improve the quality of life for communities, workers and children with dignity and equality.

I urge companies large and small in every part of the world to support and follow the Global Sullivan Principles of corporate social responsibility wherever they have operations.

The Late Reverend Leon H.Sullivan

The Principles

As a company that endorses the Global Sullivan Principles, we will respect the law, and as a responsible member of society we will apply these Principles with integrity consistent with the legitimate role of business. We will develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to these principles throughout our organisation. We believe the application of these Principles will achieve greater tolerance and better understanding among people, and advance the culture of peace.

Accordingly, we will:

1. express our support for universal human rights and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business;
2. promote equal opportunity for our employees at all levels of the company with respect to issues such as colour, race, gender, age, ethnicity, or religious belief, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude, or other forms of abuse;
3. respect our employees' voluntary freedom of association;
4. compensate our employees to enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities;
5. provide a safe and healthy workplace, protect human health and the environment, and promote sustainable development;

6. promote fair competition including respect for intellectual and other property rights, and not offer, pay or accept bribes;
7. work with governments and communities in which we do business to improve the quality of life in those communities – their educational, cultural, economic and social well-being – and seek to provide training and opportunities for workers from disadvantaged backgrounds; and
8. promote the application of these principles by those with whom we do business.

We will be transparent in our implementation of these principles, and provide information that demonstrates publicly our commitment to them.

APPENDIX XI

AA1000 STANDARD – EXECUTIVE SUMMARY

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1 Executive Summary

1.1 AccountAbility 1000 – The foundation standard

Introduction

AccountAbility 1000 (AA1000) is an **accountability** standard, focused on securing the quality of **social and ethical** accounting, auditing and reporting.

It is a **foundation** standard, and as such can be used in two ways:

- A) As a common currency to underpin the quality of specialised accountability standards, existing and emergent.
- B) As a stand-alone system and process for managing and communicating social and ethical accountability and performance.

Accountability standards and guidelines

Recent years have witnessed a proliferation of standards and guidelines to support and measure accountability and performance. These include process standards and substantive performance standards, standards focused on a single-issue or encompassing a variety of issues, and mandatory and voluntary standards.

The processes and issues covered by these standards include stakeholder dialogue and social and ethical reporting, organisational culture, fair trade and ethical trade, working conditions, human resource management and training, environmental and animal protection, community development and human rights. Some of the more notable examples are the:

Australian Criminal Code Act, Caux Round Table Principles for Business, CERES Principles, EMAS, Ethical Trading Initiative, Forest Stewardship Council, Global Reporting Initiative, Global Sullivan Principles, Humane Cosmetics Standard, ICFTU Basic Code of Labour Practice, Investors in People, ICC Business Charter for Sustainable Development, ISO 14001, OHSAS18001, PERI Reporting Guidelines, Social Accountability 8000 (SA8000), South African Government Employment Equity Act, Sunshine Corporate Reporting, and the US Government Federal Sentencing Guidelines.

AA1000 comprises **principles** (the characteristics of a quality process) and a set of **process standards**. The process standards cover the following stages:

- A) Planning.
- B) Accounting.
- C) Auditing and reporting.
- D) Embedding.
- E) Stakeholder engagement.

The principles and process standards are underpinned by the principle of accountability to stakeholders.

Accountability and performance

The AA1000 process standards link the definition and embedding of an organisation's values to the development of performance targets and to the assessment and communication of organisational performance. By this process, focused around the organisation's engagement with stakeholders, AA1000 ties social and ethical issues into the organisation's strategic management and operations.

AA1000 aims **to support organisational learning and overall performance – social and ethical, environmental and economic - and hence organisations' contribution towards a path of sustainable development.**

It seeks to achieve its aim through **improving the quality of social and ethical accounting, auditing and reporting.**

What is social and ethical?

The terms ethical and social have a number of theoretical and practical traditions in organisational accountability. For some, ethical (or ethics) refers to an organisation's systems and the behaviour of individuals within the organisation, whereas social refers to the impacts of the organisation's behaviour on its stakeholders, both internal and external. For others, ethical embraces both the systems and individual behaviour within an organisation, and the impacts of the systems and behaviour – on stakeholders, on the environment, on the economy, etc.

AA1000 recognises these different traditions. It combines the terms **social and ethical** to refer to the systems and individual behaviour within an organisation **and** to the **direct and indirect** impact of an organisation's activities on stakeholders.

Social and ethical issues (relating to systems, behaviour and impacts) are defined by an organisation's values and aims, through the influence of the interests and expectations of its stakeholders, and by societal norms and expectations.

Building performance not compliance

The Institute recognises and advocates the need for experimentation and innovation in embedding the management of (and accountability for) social and ethical issues in organisations' strategies and operations. It furthermore recognises that any useful standard at this stage must stimulate innovation above an agreed quality floor, rather than encouraging the development of a more rigid compliance-oriented culture.

Therefore in the first instance, the Institute has taken the decision not to position AA1000 as a certifiable standard. Rather, its design is intended to encourage innovation around key quality principles, which at this stage it considers a more effective approach in taking forward individual adopting organisations and the field as a whole.

AA1000 does, however, incorporate an auditing standard through which organisations will provide assurance to stakeholders as to the quality of their social and ethical accounting, auditing and reporting. This assurance is one basis of effective engagement between organisations and stakeholders, and hence supports organisations' strategic management and operations.

Stakeholders: leadership and engagement

An organisation's stakeholders are **those groups who affect and/or are affected by the organisation and its activities.**

These may include, but are not limited to: owners, trustees, employees and trade unions, customers, members, business partners, suppliers, competitors, government and regulators, the electorate, non-governmental organisations (NGOs) / not-for-profit organisations, pressure groups and influencers, and local and international communities.

There is growing recognition by organisations that some stakeholders possess significant influence over them:

- A) More information is publicly available on the activity of organisations and the impact of these activities on employees, shareholders, society, the environment and the economy.
- B) Stakeholders demand higher standards of behaviour from organisations.
- C) The legitimacy of these demands is more widely recognised by government, regulators and civil society.

At the same time, organisations recognise the conflicts of interest they have with stakeholders, and the lack of consensus between and within stakeholder groups.

This is a dilemma that AA1000 seeks to address. It does not provide a prescriptive framework for the resolution of conflicts, but it does provide a process for organisations to begin to address them through engaging with stakeholders to find common ground and build trust.

This process of engagement with stakeholders is at the heart of AA1000. Engagement is not about organisations abdicating responsibilities for their activities, but rather **using leadership to build relationships with stakeholders**, and hence improving their overall performance.

1.2 AccountAbility 1000 – Applications of the foundation standard

Introduction

AA1000 is focused on improving the overall performance of adopting organisations.

It therefore supports improvements in financial performance and the long-term value of the organisation to shareholders and other owners. It does this by supporting improvements in other dimensions of performance, particularly social and ethical but also indirectly environmental and economic performance.

Improving performance

There are a variety of dimensions in which AA1000 can be used to improve organisational accountability and performance. The following is not a complete list, but illustrates the possible applications of AA1000 to the benefit of an organisation and its stakeholders:

Measurement – The AA1000 standard outlines a process by which key performance indicators are identified by an organisation through engagement with its stakeholders. The organisation and its stakeholders are brought together to work towards a **common understanding of what matters** about performance.

Quality management – By measuring, communicating and obtaining feedback on its social and ethical performance an organisation will be better placed to understand

and **respond to the needs and aspirations of its stakeholders**, and to manage these alongside (and as part of) its objectives and targets.

Recruitment and retention of employees – By clarifying its values and reporting on its performance, an organisation can **improve the recruitment** of high quality employees. The **loyalty of existing employees** will also be supported by evidence of commitment to building a better organisation and by the development of programmes to improve training and others aspects of employee welfare. The corollary of this improved loyalty to the organisation should be increased productivity.

External stakeholder engagement – AA1000 can play a key role in building an organisation's relationships with its external stakeholders. Consumers, suppliers and wider society are able to see how an organisation's behaviour matches their aspirations, and are better positioned to articulate their opinions. An organisation, in turn, will have more sensitive and accurate information on which to base decisions, and a **climate of increased trust** in which to implement them.

Partnership – AA1000 can support the **deepening of value-based relations** along an organisation's supply chain and in other partnership processes. Its adoption represents a commitment by an organisation to working together with partners to achieve genuine and standardised good practice in relationships.

Risk management – AA1000 can be integral to a framework for internal control to enable an organisation to identify, evaluate and better **manage the risks** arising from its impacts on and relationships with its stakeholders. These may include risks to reputation and brand, and from customer and employee liability suits.

Investors – AA1000 can play a critical role in satisfying the increasingly complex demands for information from investors. For most investors, clear and verifiable information about social and ethical performance and stakeholder perceptions and expectations provides a valuable reference point for **assessing the quality of management and the market positioning of an organisation**. In addition, the significant growth of 'ethical funds' is generating information requirements that AA1000 can assist a company in providing in a cost-effective manner.

Governance – AA1000 can play a key role in supporting an organisation's governance. The standard feeds into the organisation's control process by which it ensures the **alignment of its values and strategy with its behaviour and the outcomes of its activities**.

Government and regulatory relations – The adoption of AA1000 can play a part in encouraging governments to **acknowledge the self-regulating processes that organisations are following** to improve accountability and performance. As a reflection of practical and useful best practice, AA1000 may also help to ensure that any future regulation in the field is viable and meaningful.

Training – AA1000 facilitates the **training and the identification of qualified and experienced service providers**. Trained social and ethical accountants and auditors will help an organisation, from inside or outside, to improve its accountability and performance.

Using AA1000

AA1000 therefore has a variety of benefits to organisations and their stakeholders. In addition, it is of benefit to standards developers and to service providers. The benefits to each user group is summarised in the box below.

AA1000 and its users
<p>Adopting organisations can use AA1000 directly in developing their practices, or can use it as a basis for assessing other available specialised standards.</p>
<p>Stakeholders, including civil society organisations and direct stakeholders (internal and external to the organisation), can use AA1000 to assess and hence to comment on the quality of an adopter's approach to social and ethical accounting, auditing and reporting.</p>
<p>Service providers can use AA1000 as a recognised benchmark against which to develop and provide services, and as a means of acquiring competencies and communicating this to potential clients.</p>
<p>Standards developers can use AA1000 as a reference point for their specialised standard, and for communicating the underlying qualities of their standard.</p>

AA1000 is designed to **encompass the needs and requirements of adopters from all types of** organisation. These include:

- A) **Large and small** organisations.
- B) **Single site** organisations, and **multi-site, multi-national** organisations.
- C) **Public, private and non-profit** organisations.

The nature of the organisation adopting AA1000 affects its approach to the application of the standards. For example, a single-site organisation may apply the AA1000 standards by:

- A) Developing a single social and ethical accounting, auditing and reporting framework.
- B) Distributing a single audited report on all aspects of the organisation's operations to its (predominantly local) stakeholders.

In contrast, a large multi-site, multi-national organisation may apply the AA1000 standards by:

- A) Driving down responsibility for the measurement and improvement of social and ethical performance to site-level.
- B) Reporting in summary form at group-level the overall activities and performance of the organisation, incorporating the indicators reported in the organisation's strategic management system.
- C) Reporting at site-level the aspects of the organisation's social and ethical performance relevant to local stakeholders.
- D) Using a mixture of auditing methodologies to reflect the assurance required by stakeholders at group-level and at site-level.

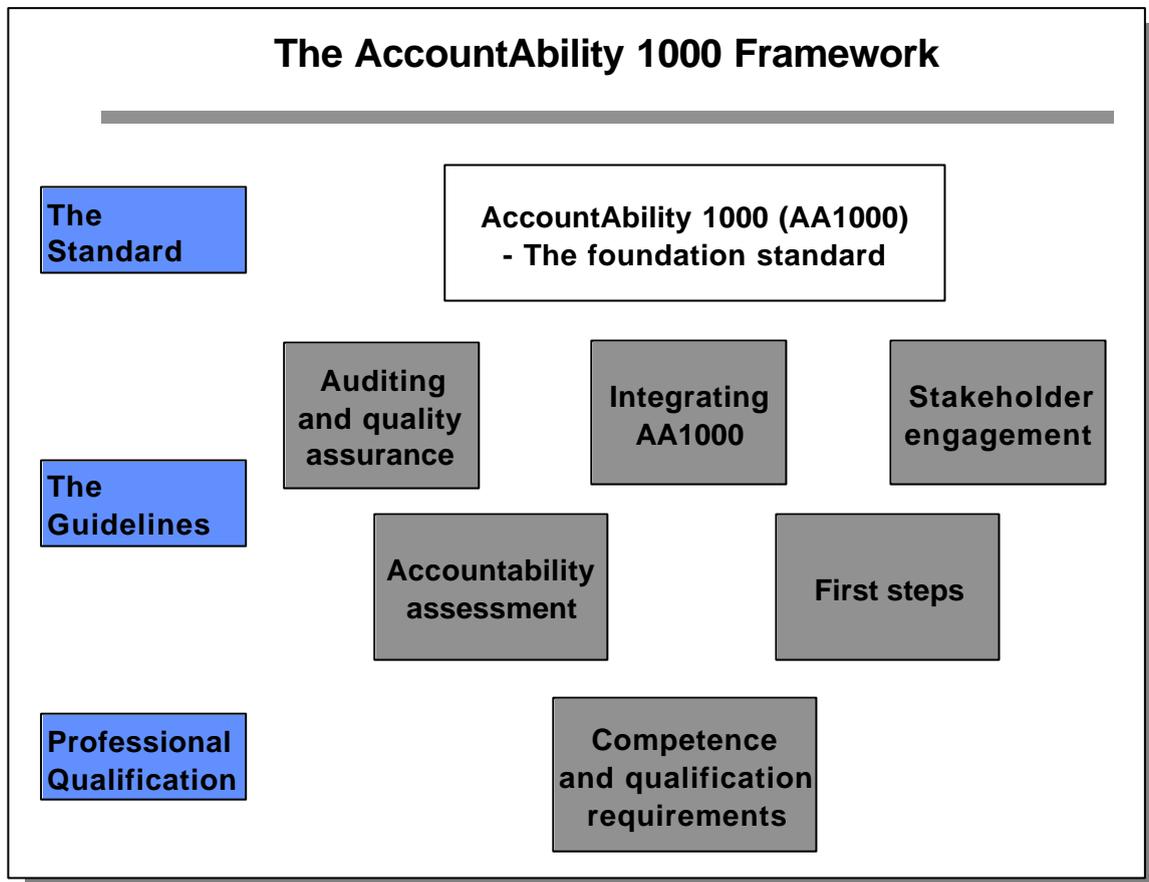
As practice develops, guidelines will be required to support the interpretation and implementation of AA1000 that recognise the diverse requirements of different organisation types, in different sectors and regions.

1.3 The AccountAbility 1000 framework

AA1000 is supported by a set of **guidelines** and a **professional qualification** as illustrated in figure 1, and described in sections 3 to 8. The guidelines and professional qualification do not form part of the AA1000 standard, but provide guidance to different user groups in the application and understanding of AA1000.

Together, the standard, the guidelines and the professional qualification are referred to as the **AA1000 framework**.

Figure 1 – The AccountAbility 1000 Framework



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APPENDIX XII

RECOMMENDATIONS OF THE GLOBAL REPORTING INITIATIVE

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PART B: REPORTING PRINCIPLES AND PRACTICES

This section of the *Sustainability Reporting Guidelines* identifies reporting principles and practices essential to producing GRI reports that are easy to use, compare, and verify. The GRI believes that reports based on these principles and practices will be more credible and transparent than those that are not.

Over many decades, financial reporting has adopted a set of underlying principles and assumptions. These, with necessary modifications, have been adapted from work by the Environmental Task Force of the European Federation of Accountants (FEE) for use by the GRI as underlying principles for GRI reporting. Financial reporting has also identified a number of qualities that make reported financial data more useful and credible. The GRI *Guidelines* incorporate these qualities, again appropriately modified for GRI reporting purposes.

The GRI's reporting principles and practices are presented in five parts:

1. underlying principles;
2. qualitative characteristics;
3. classification of performance-reporting elements;
4. absolute figures and ratios/relative indicators; and
5. disclosure of reporting policies.

1. Underlying Principles of GRI Reporting

Organisations preparing GRI reports are asked to adopt the underlying principles of reporting set forth below. Although GRI reports do not need to contain a detailed checklist showing that these principles have been adopted, reporters are asked to indicate when they have not chosen not to apply all or any principles.

The reporting entity principle: The report will clearly define the boundary of the organisation adopted for the report (e.g. equity share, management control, site, company, group). As a result, the reporting consequences of strategic business decisions, such as subcontracting or joint venture arrangements, will be transparent.

The GRI asks that reporters clearly and explicitly define the boundary conditions used in the report for the reporting organisation. Financial accounting and reporting standards currently exist to define boundaries for different forms of corporate control (joint ventures, associates, subsidiaries, etc). Such standards do not yet exist to define boundaries for GRI reports. Until such standards are developed, GRI reporters may choose to use the traditional financial accounting and reporting boundary definitions as a starting point. However, it is important for a GRI reporter to define the organisation's boundaries in a way that assures readers that the originator of, or contributor to, the material impacts of its activities is included within those boundaries. To do otherwise would open the reporting organisation to accusations of misleading reporting. Of course, a reporting organisation may wish to expand its boundaries in subsequent GRI reports to capture upstream and downstream effects of its products or services.

Organisations that form part of a supply chain face an important challenge with GRI reporting. In some cases, comprehensive reporting may require addressing in some way the total life-cycle impact of the product or service from resource extraction to end of life. At a minimum, every GRI reporter is asked to include reference to the more significant supply chain issues.

Reporters are also encouraged to provide more detailed supply chain information where feasible.

The reporting scope principle: The report will make clear the scope of activities reported (e.g. economic, environmental, and social issues or environmental issues only) and provide explanations for any restriction in reporting scope.

The GRI *Guidelines* address each of the individual elements of a full GRI report. The *Guidelines* also encourage reporters to work towards an integration of the economic, environmental, and social elements. The GRI recognises, however, that some organisations may wish to progress incrementally towards a complete GRI report, using some of the individual elements of the *Guidelines* (e.g., the environmental elements) rather than the whole package. The GRI allows incremental adoption of the *Guidelines* provided there is full disclosure of such incremental adoption. Annex 2 provides additional information on incremental adoption.

Organisations choosing incremental adoption are asked to disclose the following items:

- ◆ the fact that, the extent to which, they have used the GRI *Guidelines* as the basis for their reporting;
- ◆ the reasons for incremental adoption (e.g., expense, availability of information, stakeholder needs); and
- ◆ their intentions regard the future production of a complete GRI report.

The reporting period principle: As far as possible, reportable impacts, events and activities will be presented in the reporting period in which they occur.

The GRI asks that impacts, events and activities be reported in the reporting cycle in which they occur or are identified. Although a single reporting cycle is too short to capture many important economic, environmental, and social impacts (such as changes in employee social conditions or environmental contamination), many economic, environmental, and social indicators are likely to flow from management information systems that operate on a regular cycle.

Further, as management's concern to integrate economic, environmental, and social issues into overall corporate strategy increases, the more likely it is that economic, environmental, and social management systems will become aligned with conventional systems of financial management and control.

The going concern principle: The published data will reflect the assumption that the reporting organisation is expected to continue operations into the foreseeable future.

An organisation categorised as a "going concern" for financial reporting purposes is generally expected to be financially viable and to be able to continue operations for the foreseeable future (note that the "foreseeable future" in financial reporting terms is rarely longer than 18 months after the balance sheet date).

The GRI asks that reporting organisations pay close attention to the broader implications of the "going concern" concept. Thus, for example, organisations should consider reporting the following items in the appropriate section of their reports:

- ◆ any "going concern" qualifications contained in the financial audit report;
- ◆ any qualifications regarding the organisation's ability to fund necessary remediation activities;

- ◆ the extent to which significant internal and external operational, financial, compliance, and other risks are identified and assessed on an ongoing basis. Significant risks may, for example, include those related to market, credit, liquidity, technological, legal, health, safety, environmental, and reputation issues;
- ◆ the likely impact of prospective legislation, for example, product, environmental, fiscal, or employee-related;
- ◆ management's assessment of the consequences (including the economic and social consequences) of moving towards modes of production and/or service delivery compatible with sustainability.

The conservatism principle: GRI reports will claim credit for only those achievements that can be directly attributed to the reporting organisation. They will also be cautious in reporting expected future outcomes of current programs.

The GRI encourages reporting organisations to adopt a life-cycle approach and to report comprehensively on both the upstream and downstream (indirect) effects of operations and activities. At the same time, the GRI asks reporting organisations to be cautious when reporting on effects that occur once the product or service has been delivered (i.e., effects “outside the factory gates”). Reporters are asked to present a balanced picture, containing both positive and negative effects of their activities.

The materiality principle: Materiality in economic, environmental, and social reporting is dependent on what is relevant either to reporting organisations or to their external stakeholders.

The GRI intends all items in “Report Content” (Part C) to apply to all reporters, except of the organisation-specific environmental performance indicators contained in Section 6. Reporters that believe a particular “generally applicable” item is not applicable are asked to explain their reasoning. In Section 6, the reporting organisation is asked to determine what to report on the basis of both applicable laws and the process of stakeholder dialogue and engagement.

As discussed in Section 6, the economic, social and integrated indicators are presented for testing and experimentation by all reporting organisations. At this time, they are less developed than the environmental indicators.

The application of the materiality concept to economic, environmental, and social reporting is more complex than in financial reporting. In contrast to financial reporting, percentage-based or other precise quantitative materiality yardsticks will seldom be appropriate for determining materiality for GRI reporting purposes. Instead, materiality is heavily dependent on the nature and circumstances of an item or event, as well as its scale or magnitude. For example, in environmental terms, the carrying capacity of the receiving environment (such as a watershed or airshed) will be just one among several factors in the materiality of the release of one tonne or one kilogram of waste, air emissions, or effluent. Similarly, health and safety information is likely to be of considerable interest to GRI report users despite its typical insignificance in traditional financial accounting terms.

Different stakeholders may not agree on what is material. For the reporting organisation, the result of research into user needs, as well as continuing interaction with stakeholders, is necessary for determining materiality.

The GRI recognises that an organisation's decisions about the materiality of specific aspects of performance might affect the form of the report itself. For example, an organisation that decides to report on conditions at individual operating sites may wish to support its primary GRI report with separate detailed material, perhaps via the reporter's website.

2. Qualitative Characteristics for GRI Reporting

The qualitative characteristics (or criteria) discussed below are intended to make information published in GRI reports as useful and as relevant as possible for stakeholders, including report preparers.

These characteristics serve to enhance the credibility of reported data. In some cases, the use of the characteristics may help to determine materiality. The GRI considers the main qualitative characteristics for reporting organisations to be:

- ◆ relevance;
- ◆ reliability;
- ◆ clarity;
- ◆ comparability;
- ◆ timeliness; and
- ◆ verifiability.

Each of these qualitative characteristics is discussed in more detail below.

Relevance: To be useful, information must be relevant to the decision-making needs of user groups, recognising their diverse expectations and needs.

The most relevant information in GRI reports is likely to be useful for directing attention, building knowledge, and forming opinion, as well as for making decisions. In economic, environmental, and social reporting, the issue of what is or is not relevant may best be gauged through various forms of stakeholder engagement conducted by reporting organisations or by external parties.

Reliability: Information is reliable when it is free from bias and material error. The reliability characteristic is supported by a number of other characteristics such as valid description, substance, neutrality, completeness, and prudence.

Valid Description: The way in which the various aspects are described is important for the users' understanding. Descriptions of activities, events, and issues are valid when they are presented in a factual and logical manner.

Substance: Presenting information in accordance with its economic, environmental, or social substance and reality rather than in a strict legal form is important. In GRI reports, accurate data without context or benchmarks may not be useful. For example, a furniture manufacturer that produces hardwood furniture may accurately present the quantity of wood procured.

However, from the standpoint of report users, the source of the timber needs to be reported in order to achieve reliability.

Neutrality (freedom from bias): GRI reports are not neutral if the manner in which information is selected, omitted, or presented – rather than the nature of the information itself – is intended to influence a decision or judgement. Inappropriately constructed graphs or the omission of controversial issues, for example, may bias the judgements and opinions of stakeholders.

Completeness: The more completely a GRI report covers material economic, environmental, and social issues, the greater will be both its relevance and its ability to avoid charges of partiality or selectivity in reporting. Complete reports will include both favourable and adverse outcomes, impacts, trends, and audit findings. Reporters are asked to consider reporting on indirect, as well as direct, effects, especially if such indirect effects are particularly significant in presenting a complete and balanced picture.

Prudence: Uncertainty is a major factor in all forms of public disclosure. The exercise of a proper degree of prudence in GRI reports ensures that:

1. uncertain economic, social or environmental outcomes are not reported prematurely (although discussion is encouraged); and
2. positive progress on economic, social, or environmental issues is not misrepresented – for example, by prematurely claiming that the entity is “sustainable” in some way or other.

Clarity: The audience for GRI reports is wide and diverse. Reporting organisations are asked to ensure that their reports are understandable to a wide range of stakeholders. Stakeholders engagement and feedback may be used to test clarity.

Clarity is an essential quality of any form of reporting. Financial reporting starts from the premise that the user possesses a reasonable knowledge of business activities and accounting. In GRI reporting, such knowledge may not be sufficient to enable the user to readily understand the information being presented, although an understanding of at least some of the economic, environmental, and social issues faced by the reporting organisation is a reasonable assumption.

In financial reporting, there is an unspoken assumption concerning the general level of education and experience of the assumed “primary” user group, namely, investors. At this stage in GRI reporting, it is premature to identify any single group as the “primary” user group, since potential report users are many and diverse. Also, it is difficult to make general assumptions about the level of education and experience of user groups or their fluency in the language of the report. Consequently, technical and scientific terms should be used carefully and explained within the report, and simple words and clear, suitable graphics should be used where appropriate. A glossary may be helpful as well.

Comparability: Many users of GRI reports will wish to compare reported data against prior years and against other organisations within the same sector. Consistency in the recognition, measurement, and presentation of information is therefore essential.

Initially, consistency should be established internally, determined by the information needs of the organisation’s stakeholders. It is important that corresponding information be reported for preceding periods on a comparable and consistent basis.

To enable monitoring and benchmarking, organisations are asked to aim for consistency in both the form and content of reporting over time. In addition, organisations are asked to accelerate the process of comparability by adopting (as far as possible) and participating in the development of industry norms for economic, environmental, and social performance indicators. The GRI recognises, however, that caution is needed when comparing organisations that seem similar. Even apparently minor differences in process, product, or location may make a significant difference in the reported information.

Timeliness: To give stakeholders prompt notice of outcomes and trends, reporters are asked to report on a regular cycle. An annual reporting cycle is currently the norm, but the advent of continuous Internet reporting allows relevant information to be updated more frequently. Whatever approach is selected, reliable comparative data should be provided to enable informed comparison over time.

At this time, the GRI does not prescribe when GRI reports should be published. It is recommended, however, that GRI reports clearly indicate the reporting period used and provide reasons for the choice of a reporting period that is less frequent than annual.

Verifiability: External verification of GRI reports is addressed briefly in Section 8 of “Introduction and General Guidance” (Part A of the *Guidelines*), in more detail in Annex 3, and in greater detail still in support documents on the GRI website (www.globalreporting.org). Where feasible, reported data and information should be independently verifiable.

GRI reports may contain some data, statements, or assertions of fact that are neither objectively determined nor physically quantified, and which cannot be verified with a high level of assurance. Unverifiable statements that are significant to the broad messages contained in a GRI report may reduce the credibility of that report.

3. Classification of Performance-Reporting Elements

The following hierarchy informed the development of performance information elements in the “Report Content” (Part C of the *Guidelines*)⁷⁰:

- Categories:** The broad areas, or groupings, of economic, environmental, or social issues of concern to stakeholders (e.g., air, energy, labour practices, local economic impacts).
- Aspects:** The general types of information that are related to a specific category (e.g., greenhouse gas emissions, energy consumed by source, child labour practices, donations to host communities). A given category may have several aspects.
- Indicators:** The specific measurements of an individual aspect that can be used to track and demonstrate performance. These are usually, but not always, quantitative. A given aspect may have several indicators (e.g., tonnes of emissions, water consumption per unit of product, adherence to a specific international standard on child labour, net joules of energy used during the lifespan of a product, monetary contributions per year to host communities).

Reporters that choose to go beyond GRI information elements and provide supplementary information may benefit from applying this structure to such additional information.

Section 6 of “Report Content” contains four subsections dealing with performance information. These are environmental, economic, social and integrated.

Within the environmental subsection, the *Guidelines* present two types of indicator: generally applicable and organisation-specific. This distinction is described in that subsection. The economic, social, and integrated indicators identified in the other subsections are less developed than the environmental indicators and are presented for testing and experimentation by all organisations. The experience gained by reporters applying the *Guidelines* will inform the development of economic, social, and integrated indicators in future releases of the *Guidelines*.

Integrated indicators are of two types:

Systemic indicators, which link performance at the micro-level (e.g., organisational level) with economic, environmental, or social conditions at the macro-level (e.g., regional, national, or global level).

Cross-cutting indicators, which bridge information across two or more of the three elements of sustainability - economic, environmental, or social – of an organisation’s performance.

These are discussed in more detail in the Performance Section of “Report Content” (Part C).

4. Ratio Indicators

Reporters are encouraged to express information as ratios (as well as to provide absolute values) where such ratios will make the information easier to interpret and understand. Where appropriate, ratio indicators should use factors from Section 2 of “Report Content”.

For example, in order to illuminate the relationship between financial performance and environmental performance, an organisation may wish to use eco-efficiency indicators. One way to express eco-

⁷⁰ This approach is compatible with that used in ISO 14000 and by the World Business Council for Sustainable Development (“WBCSD”)

efficiency is as the ratio of unit of product or service value per unit of environmental influence. Unit of value can be expressed by monetary indicators such as net sales or value added, by unit of activity level such as mass or number of products sold, or by the functional value a product finally delivers to its user such as personal mobility, hygiene, or security. Unit of environmental influence, such as energy use, material consumption, or air or water pollution, may be derived from information reported in the performance section of a GRI report (see Section 6 of “Report Content”).

Ratio indicators are discussed in more detail in Annex 4.

5. Disclosure of Reporting Policies

The GRI asks that GRI reports include formal disclosure of all significant reporting and measurement policies. Reports should disclose, for example:

- ◆ that they have been prepared and presented in accordance with the GRI *Guidelines* (except as otherwise indicated);
- ◆ reasons for any significant differences between the performance indicators selected for use in the report and those customary of the organisation’s industry sector;
- ◆ the scope of the report (e.g., economic, environmental, and social, social only, environmental only);
- ◆ specific limitations on the scope of the report (e.g., targets, management systems, collection of data, collation of data);
- ◆ policies for handling mergers (including subsidiaries, associates, joint ventures, outsourcing, and other structural issues affecting the entity principle);
- ◆ significant changes in the composition of the reporting organisation since the previous report;
- ◆ significant changes from previous years in the measurement methods applied to key economic, environmental, and social information;
- ◆ the extent to which the reporting entity intends to (or has succeeded in) standardise(ing) its corporate policies across its global operations;
- ◆ the criteria/definitions used in any accounting for economic, environmental, and social costs and benefits;
- ◆ the nature and effect of any re-statements of information reported previously and the reason for such re-statement (e.g., significant changes in the composition of the organisation, change of base years/periods, change in nature of business, improved or modified measurement methods);
- ◆ the basis for any conversions of, for example, mass, volume, energy, or currencies;
- ◆ approaches used to compile data, including approaches to direct and indirect effects; and
- ◆ how the materiality or significance principle has been applied in deciding what to report or to omit.

The GRI will continuously review the applicability and clarity of all reporting principles to ensure they are relevant to and understood by reporting organisations and report users. Experience with these *Guidelines*, and associated feedback, will form the basis for this review process.

PART C: REPORT CONTENT

A Note on Report Content

All items in the “Report Content” are intended to be applicable to all reporters, except for the organisation-specific indicators identified in Section 6 below. Reporting organisations that believe a particular item is not relevant are asked to explain their reasoning. As discussed in detail in Section 6, the economic, social, and integrated indicators are presented for testing and experimentation by all reporting organisations.

The GRI believes that a report that follows the order presented below will be logical and complete, and will facilitate comparability and benchmarking. Thus, the GRI strongly recommends that reporters follow this order. Nevertheless, an organisation may choose to present certain information in a different order if it believes that is necessary to best address the needs of report users. However, to facilitate comparability and benchmarking GRI asks all reporters to follow the guidance provided on the Executive Summary of their report (Section 3 below). In addition, GRI strongly recommends reporters include an index to their reports.

GRI recognises organisations are at widely different stages in reporting. Thus, incremental adoption on an interim and transitional basis is encouraged to reflect such differences. See Section 7.1 of the “Introduction and General Guidance” (Part A of the *Guidelines*) as well as Annex 2 for more information on incremental adoption.

General Notes

1. Unless otherwise specified, all information throughout the report pertains to the “reporting organisation” defined in items 2.1 and 2.10.
2. Throughout this section, the phrase “products and services” should be interpreted to include non-physical products/services such as loans, investments, and other financial instruments.
3. Organisations are asked to report values for the current reporting period (e.g., year) and at least two previous periods, as well as values for a specified target period.
4. Organisations are asked to report absolute data. Organisations are also asked to report ratios, whenever these assist communication. When ratios are used, organisations are asked to make use of normalising factor(s) from item 2.7, where appropriate. See Section 4 of “Reporting Principles and Practices” (Part B of the *Guidelines*) and Annex 4 for a discussion of ratios.
5. Organisations are asked to report the nature and effect of any re-statements of information reported in earlier reports, and the reason for such re-statement (e.g., mergers/acquisitions, change of base years/periods, nature of business, measurement methods).
6. Organisations are asked to report the basis for reporting on joint ventures, partially owned subsidiaries, leased facilities, outsourced operations, and other situations that can significantly affect comparability from period to period and/or between reporting entities.
7. Organisations are asked to report whether and how indirect impacts are measured (e.g., emissions from sources that provide electrical energy).
8. Organisations are asked to use generally accepted international metrics (e.g., kilograms, [metric] tonnes, litres).
9. Organisations are asked to report the basis for any conversions of metrics (e.g., mass, volume, energy, currencies).
10. Organisations are asked to report measurement rules and methodologies for data compilation, where these are not obvious.

1. CEO Statement

Statement of the CEO, or equivalent senior management person, describing key elements of the report.

A statement from the reporting organisation's CEO, or equivalent senior management person, sets the tone of the report and establishes credibility with internal and external users.

While the GRI does not specify the content of the CEO statement, it believes such statements are most valuable when they explicitly refer to the key elements of the report, particularly to the mission and vision sections, and to the organisation's recent and future challenges in relation to sustainability.

Recommended elements include the following:

- ◆ highlights of report content and commitment to targets;
- ◆ declaration of commitment to economic, environmental, and social goals by the organisation's leadership;
- ◆ acknowledgement of successes and failures;
- ◆ performance against benchmarks, previous years' performance, targets, and industry sector norms; and
- ◆ major challenges for the organisation and its business sector in integrating responsibilities for financial performance with those for economic, environmental, and social performance, along with the implications of this on future business strategy.

2. Profile of Reporting Organisation

An overview of the reporting organisation and scope of the report to provide a context for understanding and evaluating information in subsequent sections.

In this section, the reporter provides an overview of the reporting organisation and scope of the report. This overview provides readers with a context for understanding and evaluating information in the rest of the report and includes organisational contacts.

The elements needed for a complete profile include those listed below. Reporters are encouraged to include additional information necessary for a full picture of the organisation's operations, products, and services.

Please refer to the general notes prior to Section 1 of "Report Content" for guidance on reporting information.

- 2.1 Name of reporting organisation.
- 2.2 Major products and/or services, including brands if appropriate.
- 2.3 Countries in which the organisation's operations are located.
- 2.4 Nature of ownership; legal form; stock exchange listings.

- 2.5 Nature of markets or customers served (e.g., retail, wholesale, governments).
- 2.6 Contact person(s) for the report, including e-mail and web addresses.
- 2.7 Relevant information on the scale of activity of the reporting organisation, including measures that may be or are used as normalising factors for creating ratios from absolute values provided in the report. Examples of potential relevant measures include:
 - ◆ Number of employees
 - ◆ Net sales
 - ◆ Product produced (mass/amount/quantity)
 - ◆ Value added
 - ◆ Total assets
 - ◆ Other relevant measures indicating activity level (e.g., gross margin, net profit)
- 2.8 Breakdown of sales/revenues by country/region for those countries/regions that make up five percent or more of total revenues, as well as by major products and/or services identified in item 2.2.
- 2.9 Breakdown of costs by country/region.
- 2.10 Coverage of report (countries/regions, products/services, divisions/facilities/joint ventures/subsidiaries). If coverage is not complete, projected timeline for complete coverage.
- 2.11 Information on scale (item 2.7), sales/revenues (item 2.8), and costs (item 2.9) for that portion of the organisation covered in the report (as specified in item 2.10).
- 2.12 Reporting period (e.g., fiscal/calendar year) for information provided (unless otherwise noted).
- 2.13 Date of most recent previous report, if any.
- 2.14 Significant changes in size, structure, ownership, or products/services that have occurred in the reporting period.
- 2.15 Public accessibility of information or reports about economic, environmental, and social aspects of organisational activities, including facility-specific information. How to obtain such information and reports.

3. Executive Summary and Key Indicators

An executive summary is a succinct overview of the GRI report. Two principles guide the content specified below: (1) the need for a reporter to communicate most effectively with its stakeholders and (2) the need for users of reports to assess the performance of an organisation both over time and in comparison with other organisations.

The executive summary is a key component of a GRI report. An effective executive summary provides the user with a balanced overview of the report's contents.

Because each report differs in what is important to the users, the GRI does not specify detailed contents for the executive summary. However, a credible executive summary provides, at a minimum, a summary of key information, presented in an easily accessible format (e.g., graphically or in a table). Such information derives directly from the remainder of the report and includes, at a minimum:

- ◆ the specified generally applicable environmental performance indicators;
- ◆ selected organisation-specific environmental performance indicators;

- ◆ selected economic performance indicators;
- ◆ selected social performance indicators; and
- ◆ selected integrated performance indicators.

Where applicable, this summary information should include information for the current reporting period, historical trends for at least the previous two reporting periods, and a target period.

4. Vision and Strategy

The reporting organisation is asked to set out its vision and discuss how that vision integrates economic, environmental, and social performance.

The reporting organisation is asked to present its vision for the future, particularly with regard to managing the challenges associated with economic (including, but not limited to, financial), environmental, and social performance. This may involve a discussion of how economic, environmental, and social goals and values intersect and are balanced in the organisation, and how such linkages and balancing shape the organisation's decision-making processes.

Reporters should use maximum flexibility and creativity in preparing this section, although it is suggested that any discussion be informed by a consideration of the reporting organisation's key direct and indirect economic, environmental, and social issues and impacts. Reporters are encouraged to draw directly from economic, environmental, and social information, as well as any integrated indicators, presented elsewhere in the report.

An organisation may also choose to use this section to articulate its long-term vision of sustainability and to discuss any challenges or obstacles it might face as it moves in this direction. See www.globalreporting.org for supporting documents on this section.

5. Policies, Organisation, and Management Systems

In this section, the organisation is asked to provide an overview of its governance structure and the management systems that are in place to implement its vision. Central to this section is a discussion of stakeholder engagement.

Policies and Organisation

- 5.1 Publicly available mission and values statement(s), codes of conduct, statements of economic, environmental, and social policy, and other policies with economic, environmental, or social provisions (e.g., procurement policy). Include date of adoption and areas of applicability (e.g., countries, business units).
- 5.2 Explanation of whether and how the precautionary principle is addressed by the organisation's policies.
- 5.3 Economic, environmental, and social, or similar, charters, codes, or voluntary initiatives (e.g., regarding labour issues, human rights, discrimination, security) to which the organisation subscribes or which it endorses, including date of adoption and countries of applicability.
- 5.4 Organisational structure and responsibilities (e.g., board of directors, senior management, special staff, operating staff, committees, and councils) for oversight and

implementation of economic, environmental, social, and related policies. Key individuals responsible for such policies.

- 5.5 Status and date, by country, of economic, environmental, and social, or similar standards, including those that require external certification (see Annex 1 for examples).
- 5.6 Principal industry and business association memberships, including those which advocate public policy positions.

Management Systems

- 5.7 Programmes and procedures pertaining to economic, environmental, and social performance (such as those aimed at employee orientation and awareness, social auditing and reporting, environmental risk assessment, environmental accounting and auditing, performance evaluation, internal communications, linkages between management compensation and economic, environmental, and social performance), with areas of applicability (e.g., countries, business units).
- 5.8 Approaches to measuring and improving management quality, including development and execution of strategy, product/service innovation, and alliance building and retention. Status of certification pertaining to economic, environmental, and social management systems.
- 5.9 Programmes and procedures for supply chain/outsourcing, including supplier selection criteria, assessment, training, monitoring, and areas of applicability (e.g., countries, business units).
- 5.10 Programmes and procedures for decisions regarding the location of operations, including facility or plant openings, closings, expansions, and contractions.

Stakeholder Relationships

- 5.11 Basis for definition and selection of major stakeholders (e.g., employees, investors, suppliers, managers, customers, local authorities, public interest groups, non-governmental organisations).
- 5.12 Approaches to stakeholder consultation (e.g., surveys, focus groups, community panels, corporate advisory panels, written communications). Frequency of such consultations by type.
- 5.13 Type of information generated by such consultations.
- 5.14 Use of such information (e.g., performance benchmarks and indicators), including use for selecting organisation-specific performance indicators in Section 6.

6. Performance

This section covers the reporting organisation's economic, environmental, and social performance. It does so through the use of quantitative and qualitative indicators as well as supplementary information. To aid interpretation, reporters are asked to report relevant objectives and programme information along with raw data. They are also asked to provide context, management explanations, and commentary on trends and unusual events. Note that in this release of the *Guidelines*, the environmental performance indicators appear first because of their more advanced development and readiness for the indicator framework described below. They have also been subject to a robust review, assessment, and pilot-testing.

In contrast, the economic, social, and integrated indicators are less advanced in terms of experience and consensus.

Organisations are asked to report information for the current reporting period, at least two previous periods, and a target period. Information should be provided in absolute terms, as well as in ratio/normalised form whenever this assists communication.

Overview

This section has four subsections: environmental, economic, social, and integrated.

Within the environmental subsection, the GRI presents two types of indicator: generally applicable and organisation-specific. This distinction is described below.

Economic, social, and integrated indicators are presented for testing and experimentation by all reporting organisations. The experience gained by reporters applying the *Guidelines* will inform the development of economic, social, and integrated indicators in future releases of the *Guidelines*. The GRI welcomes input from reporters and report users on such indicators.

Integrated indicators are of two types:

- ◆ Systemic indicators link performance at the micro-level (e.g., organisational level) with economic, environmental, or social conditions at the macro-level (e.g., regional, national, or global level).
- ◆ Cross-cutting indicators bridge information across two or more of the three elements of sustainability—economic, environmental, or social—of an organisation's performance.

The GRI solicits feedback from reporters and report users on all performance indicators to provide the basis for enhancing updated releases of the *Guidelines*.

Environmental Performance

Organisations create environmental impacts at various scales, including local, national, regional, and international. These occur in relation to air, water, land, and biodiversity resources. Some are well understood, while others present substantial measurement challenges owing to their complexity, uncertainty, and synergies.

Environmental reporting has evolved over the last 20 years and has reached a level of emerging common practices based on a shared understanding of environmental processes. At this time, the repeated appearance of certain environmental categories, aspects and indicators provides a foundation for a common information base. Nonetheless, organisational differences remain and are reflected in the variety of indicators used by reporting organisations.

Thus, in this section of the *Guidelines*, the GRI distinguishes between two types of performance indicators: generally applicable and organisation-specific.

Generally Applicable Indicators

The indicators noted as generally applicable are relevant to all organisations. In the interest of comparability, GRI asks all reporters to provide this information, regardless of sector, location, or other attributes of the organisation.

Organisation-Specific Indicators

Organisation-specific indicators are those that, while critical to an understanding of the performance of the organisations to which they apply, may not be relevant to all organisations. These indicators derive from attributes such as the organisation's industry sector and geographic location, and from the concerns of stakeholders.

Some organisation-specific indicators (such as fuel consumption by fleet vehicles) are applicable to many organisations but may be of key relevance to only a few organisations (e.g., package delivery and logistics companies). Other organisation-specific indicators are of key relevance for a particular organisation but are *not* widely applicable. Examples of such indicators include forest stewardship (for a forest products company), animal testing (for a cosmetics company), or noise (for an airline or airport operator).

Organisation-specific indicators emerge from consultation with internal and external stakeholders and should reflect the organisation's key economic, environmental, and social issues. These, in turn, are associated with operations, products and/or services, and include indirect and supply/service chain impacts.

A number of organisation-specific environmental indicators are listed below. These examples have been selected by the GRI based on (1) their wide, though not universal, applicability to different types of organisations and (2) strong concerns identified by GRI stakeholders. Because of this, the GRI asks reporters to give each one of these indicators serious consideration before determining its relevance.

Reporters are not expected to restrict themselves to the examples provided. Further organisation-specific indicators should be selected based on the needs of the reporter and its stakeholders (including indicators derived from stakeholder consultations discussed in Section 5).

Energy (joules)

Generally Applicable

- 6.1 Total energy use.
- 6.2 Amount of electricity purchased, by primary fuel source, where known. Amount self-generated if applicable (describe source).

Organisation-Specific

- 6.3 Initiatives to move towards renewable energy sources and energy efficiency.
- 6.4 Total fuel use. Vehicle and non-vehicle fuel, by type.
- 6.5 Other energy use (e.g., district heat).

Materials (tonnes or kilograms)

Generally Applicable

- 6.6 Total materials use (other than fuel and water).

Organisation-Specific

- 6.7 Use of recycled materials (with pre- versus post-consumer use distinctions).
- 6.8 Use of packaging materials.
- 6.9 Use of hazardous chemicals/materials (define basis for identification).
- 6.10 Objectives, programmes, and targets for materials replacement (e.g., substituting hazardous chemicals with less hazardous alternatives).
- 6.11 Naturally occurring (wild) animal and plant species used in production processes. Harvesting practices for these species.

Water (litres or cubic metres)**Generally Applicable**

- 6.12 Total water use.

Organisation-Specific

- 6.13 Water sources significantly affected by the organisation's use of water. (Note: *Discharges* to water sources are dealt with in "Emissions, Effluents, and Waste" below.)

Emissions, Effluents, and Waste (tonnes or kilograms)**Generally Applicable**

- 6.14 Greenhouse gas emissions (per Kyoto protocol definition) in tonnes of CO₂ equivalent (global warming potential).
- 6.15 Ozone-depleting substance emissions (per Montreal protocol definition) in tonnes of CFC-11 equivalent (ozone depleting potential).
- 6.16 Total waste (for disposal). Provide definition, destination, and estimation method.

Organisation-Specific**Waste Returned to Process or Market**

- 6.17 Quantity of waste returned to process or market (e.g., through recycling, reuse, or remanufacture) by type as defined by applicable national, sub-national, or local laws or regulations.
- 6.18 On- and off-site management type (e.g., recycling, reuse, remanufacturing).

Waste to Land

- 6.19 Quantity of waste to land by material type as defined by applicable national, sub-national, or local laws or regulations.
- 6.20 On- and off-site management type (e.g., incineration, landfilling).

Emissions to Air

- 6.21 Emissions to air, by type (e.g., NH₃, HCl, HF, NO₂, SO₂ and sulphuric acid mists, VOCs, and NO_x, metals, and persistent organic chemicals) and nature (point or non-point).

Effluents to Water

- 6.22 Discharges to water, by type (e.g., oils/greases, TSS, COD, BOD, metals and persistent organic chemicals) and nature (point or non-point).
- 6.23 Profile of water bodies into which discharges flow (e.g., ground water, river, lake, wetland, ocean).

Transport

Organisation-Specific

- 6.24 Objectives, programmes, and targets for organisation-related transport (e.g., business travel, staff commutes, product distribution, fleet operation). Include quantitative estimates of kilometres travelled, by transport type (e.g., air, train, automobile) where possible.

Suppliers

Generally Applicable

- 6.25 Performance of suppliers relative to environmental components of programmes and procedures described in item 5.9 above.

Organisation-Specific

- 6.26 Number and type of incidences of non-compliance with prevailing national or international standards.
- 6.27 Supplier issues identified through stakeholder consultation (e.g., forest stewardship, genetically modified organisms, petroleum sourced in disputed areas). Programmes and initiatives to address these issues.

Products and Services

Generally Applicable

- 6.28.1 Major environmental issues and impacts associated with the use of principal products and services, including disposal, where applicable. Include qualitative and quantitative estimates of such impacts, where applicable.
- 6.29 Organisation-Specific
- 6.29 Programmes or procedures to prevent or minimise the potentially adverse impacts of products and services, including product stewardship, take back, and life-cycle management.
- 6.30 Advertising and labelling practices in relation to economic, environmental, and social aspects of organisational operations.
- 6.31 Percentage of product weight/volume reclaimed after use.

Land-Use/Biodiversity

Organisation-Specific

- 6.32 Amount of land owned, leased, managed, or otherwise affected by the organisation. Type of ecosystem habitat affected and its status (e.g., degraded, pristine). Amount of impermeable surface as a percentage of land owned.
- 6.33 Habitat changes due to operations. Amount of habitat protected or restored.
- 6.34 Objectives, programmes, and targets for protecting and restoring native ecosystems and species.
- 6.35 Impacts on protected areas (e.g., national parks, biological reserves, world heritage sites).

Compliance

Organisation-Specific

- 6.36 Magnitude and nature of penalties for non-compliance with all applicable international declarations, conventions, and treaties, and national, sub-national, regional, and local regulations associated with environmental issues (e.g., air quality, water quality). Explain based on countries of operation.

Guidance on the Reporting of Social and Economic Performance

A GRI report should include reporting on the categories and aspects listed below under “Economic Performance” and “Social Performance”. In contrast to the GRI environmental indicators that have been subject to a substantial review, assessment, and pilot-testing process, the GRI social and economic indicators are less developed. They originate from various sources, including a working group of non-governmental organisations and a selection of company reports.

Reporters are encouraged to use the indicators presented below, as well as other social and economic indicators where such alternatives more accurately convey performance. During 2000–2002, the GRI will solicit specific feedback from reporters and report users relative to both the recommended and alternative social and economic indicators, in order to enhance these indicators over time.

Reporters are encouraged to provide context (e.g., comparisons with peers, industrial/regional/sectoral averages) when reporting on economic and social performance.

Economic Performance

Organisations affect the economies in which they operate in many ways, including through their use of resources and creation of wealth. These impacts, however, are not fully captured and disclosed by conventional financial accounting and reporting. Thus, additional measures are required to capture the full range of an organisation’s economic impacts. Sustainability reporting has rarely embraced economic measures to date, although there is a lengthy history of measuring certain economic effects, for example, of company relocation, closure, and investment.

The economic indicators proposed below aim to cover the main spheres of economic performance and impact. The GRI encourages reporters, in consultation with their stakeholders, to use these indicators as well as others that more accurately portray the economic performance of the organisation. The GRI solicits feedback from reporters and report users on these economic indicators, including the recommendation of alternatives. This will provide the basis for enhancing future revisions of the *Guidelines*.

Profit

- 6.37 Net profit/earnings/income.
- 6.38 Earnings before interest and tax (EBIT) (net sales minus expenses, except interest expense and income tax).
- 6.39 Gross margin (net sales minus cost of goods and services sold).
- 6.40 Return on average capital employed (ROACE).
- 6.41 Dividends.
- 6.42 Geographic distribution of items 6.37 to 6.41.

Intangible Assets

- 6.43 Ratio of market capitalisation to “book” value (note those components of book value that comprise intangible assets).

Investments

- 6.44 Human capital (e.g., employee training, community education).
- 6.45 Research and development.
- 6.46 Other capital investments.
- 6.47 Debt/equity ratio.

Wages and Benefits

- 6.48 Total wage expense, by country.
- 6.49 Total benefits expense, by country.

Labour Productivity

- 6.50 Labour productivity levels and changes, by job category.

Taxes

- 6.51 Taxes paid to all taxing authorities.

Community Development

- 6.52 Jobs, by type and country, absolute and net change.
- 6.53 Philanthropy/charitable donations.

Suppliers

- 6.54 Performance of suppliers relative to economic components of programmes and procedures described in item 5.9.
- 6.55 Number and type of incidences of non-compliance with prevailing national or international standards.
- 6.56 Nature and location of outsourced operations.
- 6.57 Value of goods and services that are outsourced.
- 6.58 Performance of organisation in honouring contracts with suppliers, including meeting payment schedules.

Products and Services

- 6.59 Major economic issues and impacts associated with the use of principal products and services, including disposal, where applicable. Include qualitative and quantitative estimates of such impacts, where applicable.

Social Performance

The social dimension of sustainability captures the impact of an organisation's activity on society, including on employees, customers, community, supply chain, and business partners. Social performance is a key ingredient in assuring an organisation's licence to operate, and supports the organisation's ability to deliver high-quality environmental and economic performance. Many stakeholders believe that reporting and improving social performance enhances reputation, increases stakeholder trust, creates opportunities, and lowers costs.

At present, reporting on social performance occurs infrequently and inconsistently across organisations. While there is some agreement on measures for certain dimensions of social performance, they are not as well developed as measures of environmental performance. The GRI encourages reporters, in consultation with their stakeholders, to use the social indicators identified below as well as others which more accurately portray the social performance of the organisation. The GRI solicits feedback from reporters and report users on these social indicators, including the recommendation of alternatives. This will provide the basis for enhancing future revisions of the *Guidelines*.

Workplace

Quality of Management

- 6.60 Employee retention rates.
- 6.61 Ratio of jobs offered to jobs accepted.
- 6.62 Evidence of employee orientation to organisational vision.
- 6.63 Evidence of employee engagement in shaping management decision making.
- 6.64 Ranking of the organisation as an employer in internal and external surveys.
- 6.65 Job satisfaction levels.

Health and Safety

- 6.66 Reportable cases (including subcontracted workers).
- 6.67 Standard injury, lost day, and absentee rates (including subcontracted workers).
- 6.68 Investment per worker in illness and injury prevention.

Wages and Benefits

- 6.69 Ratio of lowest wage to national legal minimum.
- 6.70 Ratio of lowest wage to local cost of living.
- 6.71 Health and pension benefits provided employees.

Non-discrimination

- 6.72 Percentage of women in senior executive and senior and middle management ranks.
- 6.73 Discrimination-related litigation—frequency and type.
- 6.74 Mentoring programmes for minorities.

Training/Education

- 6.75 Ratio of training budget to annual operating costs.
- 6.76 Programmes to foster worker participation in decision making.
- 6.77 Changes in average years of education of workforce. Incorporate achievement associated with training programmes.

Child Labour

- 6.78 Verified incidences of non-compliance with child labour laws.
- 6.79 Third-party recognition/awards for child labour practices.

Forced Labour

- 6.80 Number of recorded grievances by employees.
- 6.81 Incidences identified through organisation's auditing of suppliers.

Freedom of Association

- 6.82 Staff forums and grievance procedures in place—percentage of facilities and countries of operation.
- 6.83 Number and types of legal actions concerning anti-union practices.
- 6.84 Organisational responses to organising at non-union facilities or subsidiaries.

Human Rights*General*

- 6.85 Demonstrated application of human rights screens in investment.
- 6.85 Evidence of systematic monitoring of organisational practices.
- 6.86 Number and type of alleged violations, and organisational position and response.

Indigenous Rights

- 6.88 Evidence of indigenous representation in decision making in geographic areas containing indigenous peoples.
- 6.89 Number and cause of protests.

Security

- 6.90 Examples of incorporating security and human rights into country risk assessment and facility planning.
- 6.91 Remuneration/rehabilitation of victims of security force action.

Suppliers

- 6.92 Performance of suppliers relative to social components of programmes and procedures described in item 5.9.
- 6.93 Number and type of incidences of non-compliance with prevailing national or international standards.
- 6.93 Frequency of monitoring of contractors regarding labour conditions (e.g., child labour).

Products and Services

- 6.95 Major social issues and impacts associated with the use of principal products and services. Include qualitative and quantitative estimates of such impacts, where applicable.

6.96 Customer satisfaction levels.

Integrated Performance

Integrated indicators are those with the potential to become generally applicable or organisation-specific, but which are currently at an early and experimental stage of development. Integrated indicators are of two types:

Systemic: Systemic indicators link performance at the micro-level (e.g., organisational level) with economic, environmental, or social conditions at the macro-level (e.g., regional, national, or global level). The following are examples of this type of indicator:

- ◆ wages and benefits, or investments in research and development, at the organisational level expressed in relation to sectoral or national totals;
- ◆ workplace accident or discrimination cases at the organisational level expressed in relation to regional or sectoral totals;
- ◆ an organisation's total materials use during a product's life cycle expressed relative to globally sustainable levels measured in terms of resource availability and/or biophysical or assimilative capacity.

Systemic indicators reflect a movement towards linkage and harmonisation between (a) organisation-level information and (b) sectoral, national, regional, and global scale information.

Cross-cutting: Cross-cutting indicators bridge information across two or more of the three elements of sustainability—economic, environmental, or social—of an organisation's performance. The following are examples of this type of indicator:

- ◆ a composite measure of diversity (economic–social–environmental);
- ◆ eco-efficiency (economic–environmental); and,
- ◆ externalised costs of emissions (economic–social or economic–environmental).

In some instances, integrated indicators combine systemic and cross-cutting approaches. For example, expressing an organisation's air emissions in relation to regional totals as well as estimates of human health effects of such emissions combines the systemic (micro–macro) with the cross-cutting (environmental–social) dimensions of integrated indicators.

In this release of the *Guidelines*, reporters are asked to select and explain the measurement approach of at least one systemic and one cross-cutting indicator. The list below provides some examples, drawn primarily from the environmental area.

Systemic

- ◆ ratio of actual to sustainable resource use based on a measure of biophysical limits;
- ◆ ratio of actual to sustainable emissions/discharges based on biophysical limits defined by government or international agreements;
- ◆ effects of production emissions/discharges on biodiversity;

Cross-Cutting

- ◆ effects of production emissions/discharges on human health;

- ◆ materials intensity per unit of service for selected products and services;
- ◆ eco-efficiency (unit of service per unit of environmental influence) for selected products and services;
- ◆ estimates of externalised (social) costs of selected emissions; and
- ◆ a composite measure, or index, of diversity created or sustained by the organisation, incorporating the economic, environmental, and social manifestations of diversity.

Over time, examples with more economic and social content will be strengthened. Examples of both systemic and cross-cutting indicators will appear on the GRI website and will be continuously updated and expanded. Experimentation and feedback will provide the basis for strengthening integrated indicators in future versions of the *Guidelines*.

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APPENDIX XIII

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APPENDIX XIV**USEFUL WEBSITES ON CORPORATE GOVERNANCE**

1. Amnesty International, UK
www.amnesty.org.uk
2. Australian Stock Exchange
www.asx.com.au
3. The Business Roundtable
www.brtable.org
4. Business for Social Responsibility
www.bsr.org
5. CalPERS
www.calpers.org or www.calpers.com
6. Commonwealth Business Council
www.cbc.to/
7. The Corporate Library
www.thecorporatelibrary.com
8. Council of Institutional Investors, USA
www.cii.org
9. Confederation of Indian Industry
www.ciionline.org
10. The Conference Board
www.conferenceboard.org
11. Corporate Governance Portal
www.corpgov.net/links/links.html
12. COSO Fraudulent financial reporting
www.coso.org
13. Davis Global Advisors
www.davisglobal.com
14. The Directorship Search Group
www.directorship.com
15. The Department of Trade & Industry, UK
www.dti.gov.uk
16. Deutsche Vereinigung Für Finanzanalyse und Asset Management (German Society of Capital Market Experts)
www.dvfa.com

17. Financial Executives International, Canada
www.feicanada.org
18. Financial Services Authority
www.fsa.uk.gov
19. Financial Services Board
www.fsb.co.za
20. German Code of Corporate Governance
www.gccg.de
21. Global Corporate Governance Forum
www.gcgf.org
22. Global Reporting Initiative
www.globalreporting.org
23. General Motors Board of Directors
www.gm.com
24. Governance
www.governance.co.uk
25. Hermes
www.hermes.co.uk
26. International Corporate Governance Network
www.icgn.org
27. The Institute of Social and Ethical Accountability
www.accountability.org.uk
28. Investor Responsibility Research Centre
www.irrc.org
29. Independent Shareholder Services
www.issaustralia.com
30. JSE Securities Exchange South Africa
www.jse.co.za
31. Kuala Lumpur Stock Exchange
www.klse.com.my/website
32. London Stock Exchange
www.stockex.co.uk
33. Malaysian Securities Commission
www.sc.com.my
34. National Association of Corporate Directors, USA
www.nacdonline.org

35. National Association of Pension Funds, UK
www.napf.co.uk
36. New York Stock Exchange
www.nyse.com
37. OECD principles of corporate governance
www.oecd.org/daf/governance/principles.htm
38. Pensions Investment Research Consultants
www.pirc.co.uk
39. Policy Governance
www.boardgovernance.com/home.htm
40. South African Excellence Foundation (SAEF)
www.saef.co.za
41. Standard and Poor's
www.standardandpoors.com
42. Stock Exchange of Singapore
www.ses.com.sg
43. Stock Exchange of Hong Kong
www.hkex.hk
44. Sustainability
www.sustainability.com
45. Teachers Insurance and Annuity Association-College Retirement Equities Fund
www.tiaa-cref.org
46. Toronto Stock Exchange
www.tse.com
47. U.S. Securities and Exchange Commission
www.sec.gov
48. World Business Council for Sustainable Development
www.wbcsd.ch
49. World Bank Corporate Governance Website
www.worldbank.org/html/fpd/privatesector/cg/index.htm