

AUE 2602

Corporate Governance in Accountancy



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UNISA



Important Information

Assignment 1 due: **11 March 2019** (5%)

Assignment 2 due: **15 April 2019** (15%)

Remember the submission of either assignment allows you entry into the exam and will be used in calculating your year mark.

Interesting statistic for the second semester 2018:

Only 5.7% of the students who did assignment one passed the exam compared to 60.4% of the students who did assignment one and two who passed the exam. Therefore you can understand that it is important to work consistently throughout the semester and do the assignments.

Important Information

myUnisa has the following resources:

- Prescribed study material
- All tutorial letters
- Past examination questions
- Discussion forums
- Additional resources
- Etc.

Make sure that you familiarize yourself with the information contained in myUnisa and study guide

Structure of Course

- Topic 1: Corporate governance and statutory matters
- Topic 2: Internal control
- Topic 3: Business cycles
- Topic 4: Revenue and receipts cycles
- Topic 5: Acquisitions and payments cycle
- Topic 6: Inventory and production cycle
- Topic 7: Payroll and personnel cycle
- Topic 8: Finance and investment cycle



Topics covered

- **Topic 1:** Corporate governance and statutory matters

Topic 1: Corporate governance and statutory matters

- Background to corporate governance
- Section 76 to 78 and 94 of the Companies Act
- King IV Report (Significant matters)

The aim of this topic is to **explain** and **apply** corporate governance in practical situation, by referring to the Companies Act and the King IV Report

Background to Corporate Governance

- What is meant by Corporate Governance (CG)?

It is a system whereby **organisations** are **directed and controlled**.

- Why is there a need for Corporate Governance?

As we are all **linked** to **organisations** in various ways, a balance between economic, environmental and social goals for the stakeholders of the company is needed, as this will improve the quality of modern society for all.

- Definition of Corporate Governance

The exercise of **ethical and effective leadership** by the governing body towards the achievement of governance outcomes: ethical culture, good performance, effective control and legitimacy.

Background to Corporate Governance

What is the Basis of the King IV Report

- The report adopts an **“apply and explain”** basis.
- King IV assumes that all entities already incorporate its principles, as this is in the best interest of any business. Entities are required to explain in a narrative how the practices was implemented to address the principles.

Key aspects of King IV

Sustainable development

Development that meets the needs of the present without compromising the ability of future generations to meet their needs.

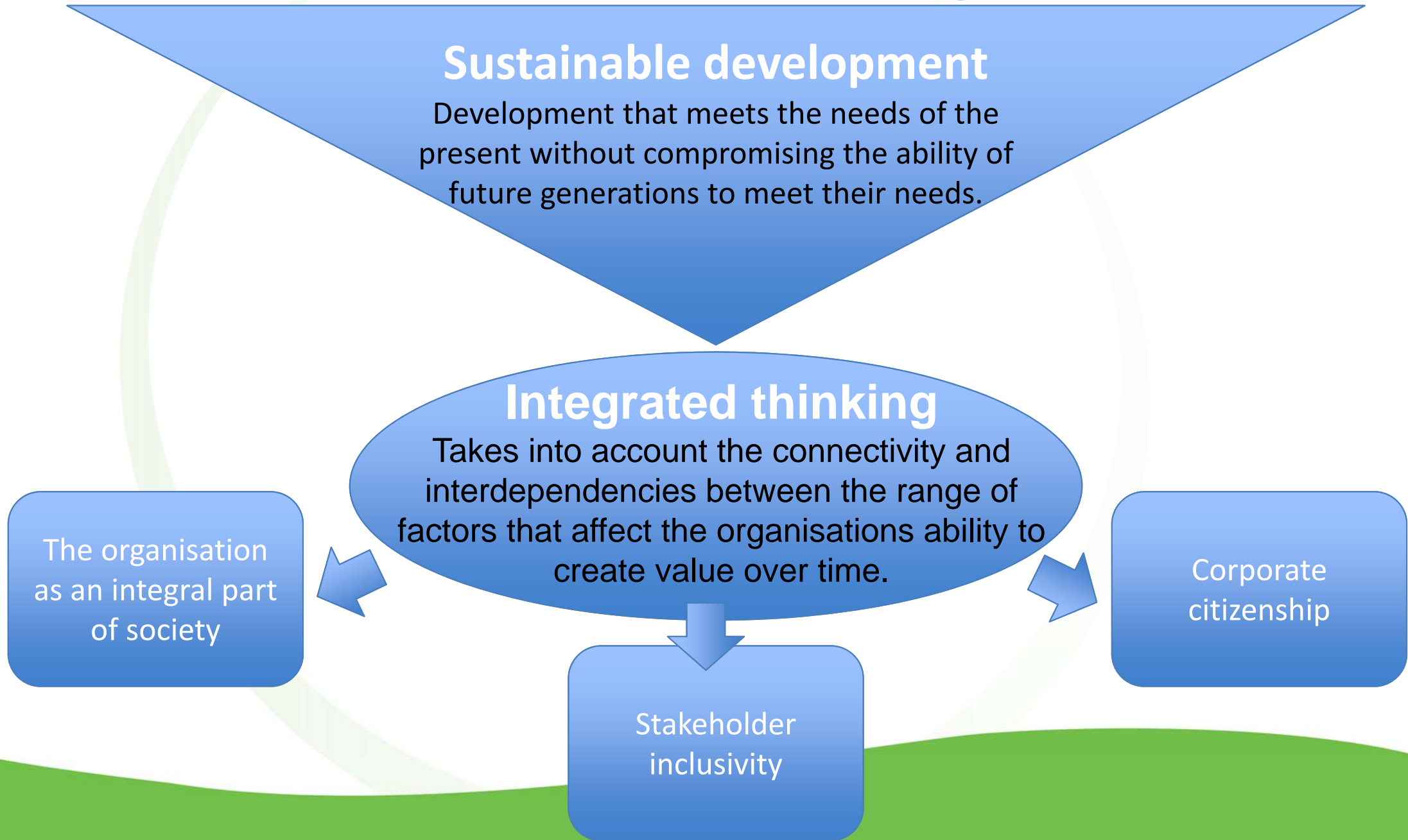
Integrated thinking

Takes into account the connectivity and interdependencies between the range of factors that affect the organisations ability to create value over time.

The organisation
as an integral part
of society

Corporate
citizenship

Stakeholder
inclusivity



Background to Corporate Governance

How has CG develop in South Africa

1. The King I Report issued in 1994
2. The King II Report issued in 2002
3. The King III Report effective in March of 2010
4. The King IV Report issued 1 November 2016, effective 1 April 2017

Note: King IV includes many of the ideas, principles and characteristics developed in King I, II and King III.

Background to Corporate Governance

Objectives of King IV

1. CG is integral to running an organisation and delivering governance outcomes e.g. ethical culture
2. Broaden acceptance of King IV – more accessible across variety of sectors and organisational types.
3. Reinforce CG as a holistic and interrelated arrangement to be understood and implemented in integrated manner.
4. Encourage transparent and meaningful reporting to stakeholders.
5. CG is concerned with structure, process, ethical consciousness and conduct.

Background to Corporate Governance

Are both King IV and the Companies Act legislated into South African Law?

The **King IV Report** is **not** legislated in South Africa. It provides **principles** and **recommendations** to all organisations in South Africa to ensure that they adhere to good corporate governance. However non-compliance to the principles of King IV is not contrary to the law.

One of the listing requirements of the JSE is compliance to the King IV Report.

The **Companies Act is legislated** into South African law, and thus if companies do not comply with the rules and laws in the Companies Act, are acting contrary to the law

Background to Corporate Governance

Study:

- The King IV Report (2016: 3-7, 20-38)
- Jackson & Stent (2016: 4/3 - 4/18)

Activities:

- Do all the activities related to this learning unit

Statutory Matters

- Always a **link** between good corporate governance and compliance with the law
- As **directors** play an important role in corporate governance, You need knowledge of the Companies Act sections which deal with directors
- These sections include: 76, 77, 78 and 94

Statutory Matters

Section 76: Standards of Directors Conduct

This section describes certain duties of directors such as:

1. Not to use the position of director

- Gain an advantage for director or any other person
- Knowingly cause harm to the company

2. Communicate to the board any information that comes to his attention

3. Exercise the powers and functions of director

- In good faith and for a proper purpose
- In the best interests of the company
- With a degree of care, skill reasonably expected of a director

Study: Companies Act S76 and Jackson & Stent (2016: 3/45 – 3/46)

Statutory Matters

Section 77: Liability of Directors and Prescribed Officers

This section can be broken down in two “sub sections”

Firstly a director may be held liable when:

- Breach of fiduciary duties
- Delict
- Acting for the company without authority
- Carrying on a business recklessly
- Etc.

Statutory Matters

Section 77: Liability of Directors and Prescribed Officers

Secondly: A director may be held liable to the company for **any loss, damage or costs arising as a direct or indirect consequence of the director:**

- Acting for the company despite knowing that he lacked authority
- Agreeing to carry on business knowing that to do so was “reckless”
- Etc...

Study: Companies Act S77 and Jackson & Stent (2016: 3/46 – 3/47)

Statutory Matters

Section 78: Indemnification and Directors Insurance

Any provision of an agreement, the MOI or rules or a resolution of a company, is void if it directly or indirectly seeks to relieve a director of any of that directors duties.

The section does allow certain protection of directors through indemnification (protection) and director insurance provided certain conditions are met.

Study: Companies Act S78 and Jackson & Stent (2016: 3/47-3/48)

Statutory Matters

Section 94: Audit Committees

States that a public company, state owned company or other company that is required by its MOI to have an audit committee, must elect an audit committee at each annual general meeting

- Study the membership of this committee (Members must or must not be)
- Study the duties of the audit committee

Study: Companies Act S94 and Jackson & Stent (2016: 3/53 – 3/54)

Old exam paper question for companies act sections.

- Do question 1.2 of May 2018 exam paper
- Do question 1.2 of May 2017
- Do question 1.3 of October 2017
- Do question 1.1 May 2016

King IV Report

Applies to all entities regardless of manner and form of incorporation, however compliance is **compulsory** for **public companies listed** on the **JSE**

- The size and nature of the company will determine how the recommendations are applied

King IV Report

The **significant matters** covered by the **King Report** include:

- Leadership, ethics and corporate citizenship
- Strategy, performance and reporting
- Governance structures and delegation
- The governance of risk
- The governance of information technology
- Compliance governance
- The governance of remuneration
- Assurance
- The governance of stakeholder relationships

King IV Report

Leadership, ethics and corporate citizenship

Responsible corporate citizenship is about:

- Building sustainable businesses
- Reflecting on the role of business in society
- Doing business ethically
- Not compromising the natural environment
- Treat employees fairly
- Embracing a shared future
- Promoting an inclusive approach to governance

Study: King IV Report (2016:43-46) and Jackson & Stent (2016: 4/19 – 4/24)

King IV Report

Strategy, Performance and Reporting

- An integrated report should be prepared, the value creation of the company should be reported on in terms of the “six capitals”
 - Financial capital
 - Manufactured capital
 - Intellectual capital
 - Human capital
 - Natural capital
 - Social capital

King IV Report

Strategy, Performance and Reporting


- Often referred to as “triple bottom line” reporting
- Triple bottom line reporting? A company should report on its performance with regard to **economic**, **social** and **environmental** issues.
- The board should ensure the **integrity** of the company’s integrated report
- Sustainability reporting and disclosure should be integrated with the company’s financial reporting
- Sustainability reporting and disclosure should be independently assured



King IV Report

Strategy, Performance and Reporting

Study: King IV Report (2016: 47 – 48) and Jackson & Stent (2016: 4/14 - 4/15; 4/24 – 4/26)



King IV Report

Governing Structures and Delegation

The governing body is responsible for the corporate governance of an organisation.

S66(1) of the Companies Act requires that the business and affairs of companies must be **managed** by or under the direction of a **board of directors**

King IV Report

Governing body and committees

Governing Body

Chair	Independent non-executive member
	CEO not fulfill the role of chair (CEO will not be an independent non-executive)
	The role of chair should be formalized
	The chair's performance should be assessed every alternate year
Membership	Comprise a balance of power, knowledge, skill, experience, diversity and independence
	Majority of non-executive members Majority of non-executive members should be independent
	Nominations committee to recommend the eligibility of prospective members
Members	Minimum of two executive members: one should be the CEO and the other may be the chief finance officer or other any executive as is appropriate
	Periodic, staggered rotation of members
Functions	Governing body should have a charter setting out its responsibilities, role, membership requirements and procedural conduct.
	Other functions listed under principle 6.1

King IV Report

Governing body and committees

Audit Committee

Chair	Independent non-executive member
	Chair of board should not chair audit committee
Membership	All members should be independent non-executive
Members	Minimum of three members
Meetings	Should meet with internal and external auditors at least once a year without management being present
Functions	Provide independent oversight of the effectiveness of the organisation's assurance functions and services
	Provide independent oversight of the integrity of the annual financial statements and other external reports
	May approve the annual financial statements (but the governing body remains ultimately accountable)
	The governing body may delegate the risk governance to the audit committee
	Oversee the management of financial and other risks that affect the integrity of external reports

King IV Report

Governing body and committees

Other Committees

	Remuneration Committee	Nomination Committee	Risk Committee	Social and Ethics Committee
Chair	Independent non-executive member	Not specified	Not specified	Not specified
Membership	All should be non-executive of which majority should be independent .	All should be non-executive of which majority should be independent .	Executive and non-executive of which majority should be non-executive	Executive and non-executive of which majority should be non-executive
Members	Minimum of three members	Minimum of three members	Minimum of three members	Minimum of three members

King IV Report

Governing body and committees

Other Committees continued...

	Remuneration Committee	Nomination Committee	Risk Committee	Social and Ethics Committee
Functions	Should assist the governing body in setting and administering remuneration policies.	The process for nominating, electing and appointing members of the governing body.	Should consider the risk management policy and plan and monitor the risk management process.	Oversight of, and reporting on organisational ethics, responsible corporate citizenship, sustainable development and stakeholder relationships.
		Succession planning iro governing body members.		
		Evaluation of the performance of the governing body.		

King IV Report

Governing body and committees

- Principle 8 state that the governing body should ensure that its arrangements for delegation within its own structures promote **independent judgement**, and assist with **balance of power** and the **effective discharge of its duties**. This means that the governing body **may delegate** some of its responsibilities to various committees as needed to **ensure the best interest** of the organisations is achieved.
- The governing body **remains ultimately responsible**.

King IV Report

Governing body and committees

Study: King IV Report (2016: 49 – 60) and Jackson & Stent (2016: 4/26 – 4/40)

When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. You will notice that marks are available for **applying** the information in the scenario to the requirements of the King IV Report.

King IV Report

Non-executive member

- A non-executive member is a member who is **not involved in the management** of the company.
- The role of the non-executive member is to **provide independent judgment, advice and opinions** on issues facing the company – “an outsiders’ view”
- Required to **attend governing body and committee meetings** to which they have been appointed.

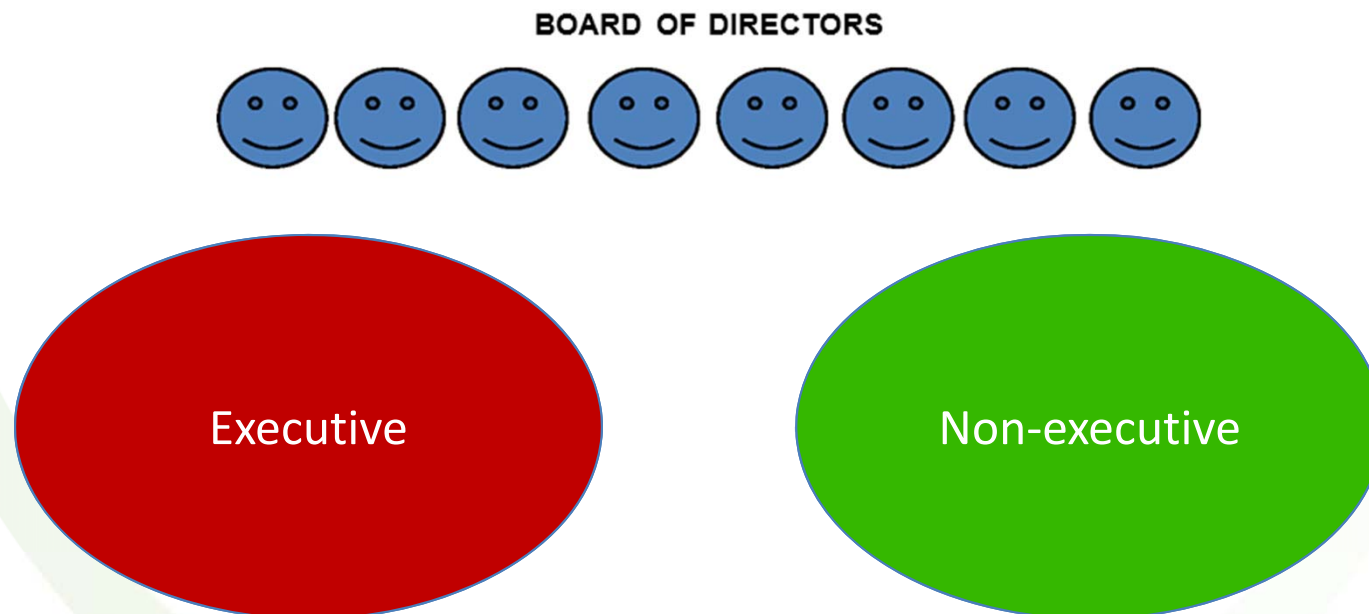
King IV Report

Independent non-executive member

- Is **not a representative of a shareholder** who has the ability to control or significantly influence management.
- Does **not have a direct or indirect interest** in the company which is material to the director or the company. (A holding of **5%** or more is considered material)
- Has not been **employed** by the company 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 during the **previous three financial years**, employed by the company in an executive capacity.
- Is **not a professional advisor** to the company
- Is **free from any business** or other relationship which could be seen to interfere materially with the individual's capacity to act independently.
- Does **not receive remuneration contingent upon the performance** of the company.

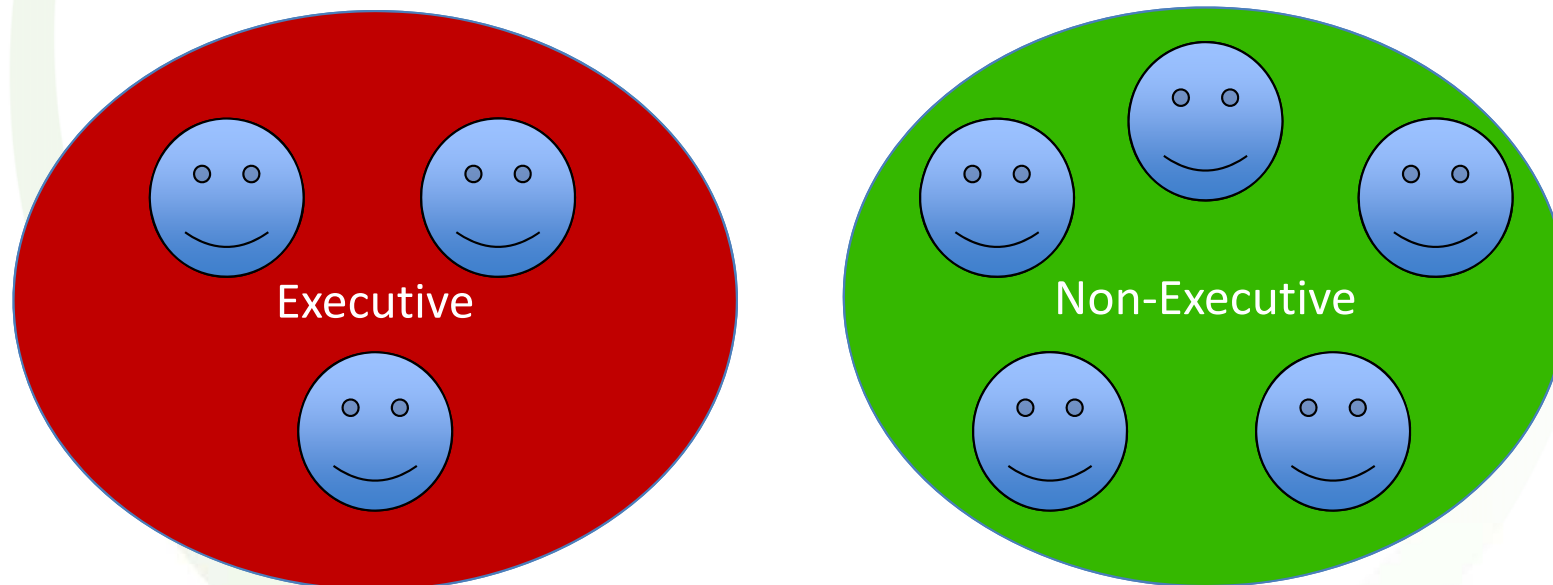
Example – Governing body composition

How should the governing body be structured in order to comply with the requirements of King IV?



Example – Governing body composition

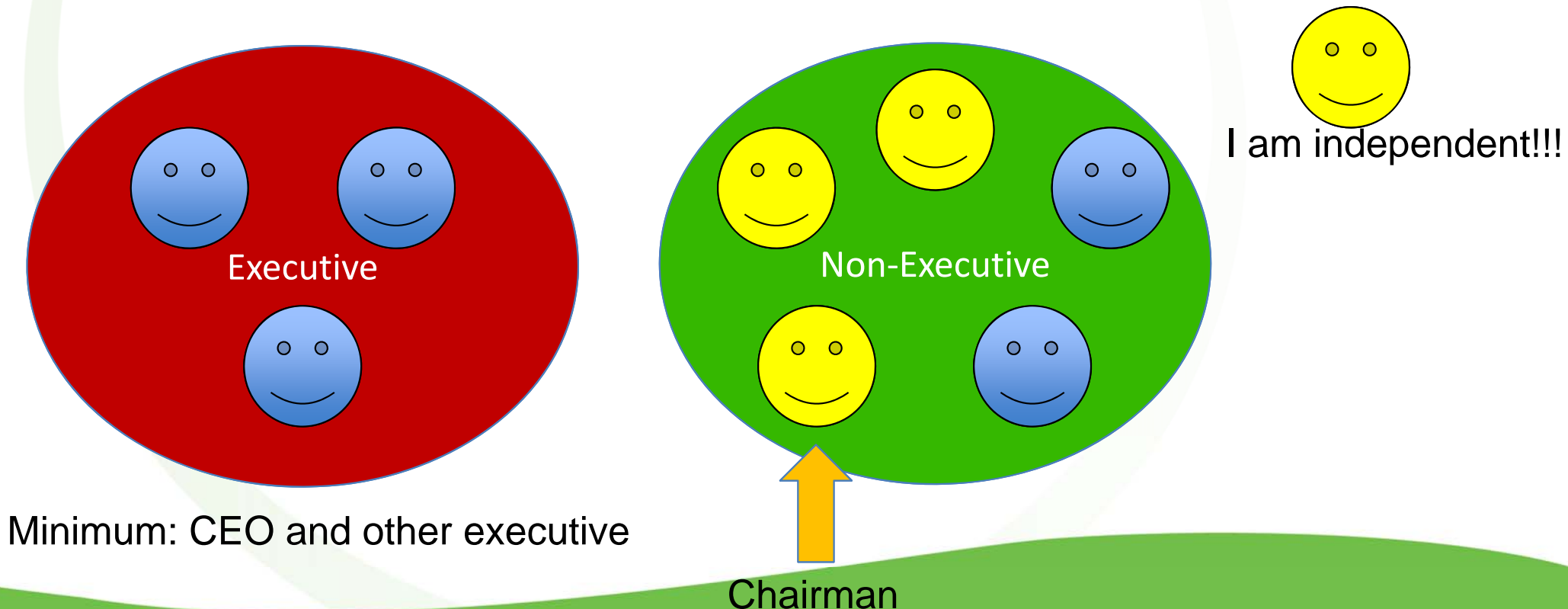
How should the governing body be structured in order to comply with the requirements of King IV?



Minimum: CEO and other executive

Example – Governing body composition

How should the governing body be structured in order to comply with the requirements of King IV?



Quick Quiz 1

Would the following individual qualify as an independent non-executive member in terms of the King IV Report? Justify your answer:

- A partner in the law firm that acts as legal advisors to the company
→ NO;
- The company's external auditor
→ NO;
- The company's recently retired CEO
→ NO;
- A shareholder who holds 3% of the company's shares
→ YES

Quick Quiz 2

State whether the following are true or false in terms of the King IV Report:

- The chair of the audit committee should be the chair of the board;
→ FALSE
→ Principle 7.36.a specifically states the Chair of the board may not be a member of the audit committee
- The CEO must chair the remuneration committee;
→ FALSE
→ The Chair of the remuneration & audit committee must be INED
- The nominations committee should consist of only non-executive directors.
→ TRUE
→ All members must be NEDs with majority being Independent

King IV Report

The Governance of Risk

The board should exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the companies business.

Who is responsible for what?

WHAT	WHO
Governance of Risk?	The governing body
Implement and execute the risk management plan	The governing body should delegate it to management
Monitor the risk management process?	The governing body, risk committee, audit committee
Performing an objective assessment of the effectiveness of risk management?	Internal audit



King IV Report

The Governance of Risk

Study: King IV Report (2016: 61 – 62) and Jackson & Stent (2016: 4/40 – 4/43)

King IV Report

The Governance of Information Technology

- The board should be responsible for IT governance
- The board should ensure that IT is aligned with the performance and sustainability of the company
- The board should delegate to management, the responsibility for the implementation of an IT governance framework
- The board should monitor and evaluate significant IT investments and Expenditures
- IT should form an integrated part of the company's risk management and the board should ensure that information assets are managed effectively
- The audit or risk committee should assist the board to carry out its responsibilities



King IV Report

The Governance of Information Technology

Study: King IV Report (2016: 62 – 63) and Jackson & Stent (2016: 4/43 – 4/46)

King IV Report

Compliance Governance

The board should ensure that the company complies with applicable laws, rules, codes and standards.

The governing body should delegate the responsibility for implementation and execution of effective compliance governance to management.

The governing body should **monitor and oversee compliance** and **disclose** details in the integrated report

King IV Report

Compliance Governance – Company Secretary

- Governing body should ensure it has access to professional and independent guidance on corporate governance and its legal duties.
- For some companies, the appointment of a company secretary is a statutory requirement.
- King IV recommends appointing a company secretary or other professional as appropriate for the organisation, to provide professional CG services.

King IV Report

Compliance Governance – Company Secretary

The Company secretary should:

- Be suitably qualified, competent and experienced
- Have an “arms’-length” relationship
- Not be a director
- Prepare and circulate governing body papers
- Elicit responses, input, feedback for governing body and its committee meetings
- Ensure preparation and circulation of minutes of governing body and committee meetings



King IV Report

Compliance Governance

Study: King IV Report (2016: 63 – 64) and Jackson & Stent (2016: 4/46 – 4/47)

King IV Report

The Governance of Remuneration

- Remuneration policies should be designed to:
 - Attract, motivate, reward and retain human capital
 - Promote the achievement of strategic objectives
 - Promote positive outcomes
 - Promote an ethical culture and responsible corporate citizenship

King IV Report

The Governance of Remuneration

- Elements of remuneration offered should be set out in the remuneration policy:
 - Base salary
 - Variable remuneration
 - Payments on termination of employment or office
 - Sign-on, retention and restraint payments
 - Commissions and allowances
 - Fees of non-executive members of the governing body
 - Etc



King IV Report

The Governance of Remuneration

Study: King IV Report (2016: 64 – 67) and Jackson & Stent (2016: 4/47 – 4/50)

King IV Report

Assurance

Principle 15 states:

“The governing body should ensure that assurance services and functions enable an effective control environment and that these support the integrity of information for internal decision-making and of the organisation's external reports.”

King IV Report

Assurance

Combined assurance model:

- Incorporates and optimizes all assurance services and functions to enable an effective control environment, support the integrity of info used for internal decision-making, and support the integrity of external reports.

King IV Report

Assurance

Internal Audit

- Board ensure an effective **risk based** internal audit
- Should follow an approved **risk based internal audit plan**
- Should provide an **overall statement annually** to the effectiveness of the organisation's governance, risk management and control processes.
- The audit committee should be **responsible** for overseeing internal audit
- Should be **strategically** positioned to achieve its objectives
- External, independent quality **review of internal audit function** should be conducted at least once every five years.

Quick Quiz 3

- Why should the internal audit function be independent and not partake in the day-to-day management or operations of the company?
→ To stay independent
- Who oversees the internal audit function?
→ The audit committee (principle 15.48)
- To whom does the Chief Audit Executive report to?
→ The chair of the audit committee on performance of duties and functions
→ Appointed member of executive management on other duties and administrative matters (principle 15.56)
- Who appoints the Chief Audit Executive?
→ The governing body (principle 15.52)
- Should the CAE be a member of the governing body?
→ No, the CAE is not a director, and for reasons of independence.

King IV Report Assurance

Study: King IV Report (2016: 68 – 70) and
Jackson & Stent (2016: 4/51 – 4/55)

King IV Report

Stakeholder Relationships

- King IV Report emphasizes a “Stakeholder inclusive” approach to governance
- **Stakeholder perceptions** affect a companies reputation
- Company to proactively manage relationships with stakeholders
- Achieve correct balance between various stakeholder groups
- Equitable treatment of shareholders
- **Transparent** and effective **communication** with stakeholders
- Governing body should ensure disputes are resolved effectively, efficiently and expeditiously as possible

King IV Report

Stakeholder Relationships

Main categories of stakeholders:

Suppliers	Creditors
Government (e.g. SARS)	Employees
External auditors	Consumers / Customers
Industry	Local Communities
Regulators	Media
Potential investors	Shareholders



King IV Report

Stakeholder Relationships

Study: King IV Report (2016: 71 – 73) and Jackson & Stent (2016: 4/55 – 4/59)

Corporate Governance

Activities:

- Do all the activities related to this Topic

Tutorial letter 102:

- Do all questions under topic 1 from the prescribed textbook, *Graded Questions on Auditing* (2017)

Assignments and past examination papers:

- Do the assignments (tut 101) and past examination questions (on myUnisa) to see how this topic could be examined
- Remember to read the scenario and the questions carefully, and answer what was asked!
- This is easy marks!

EXAM TECHNIQUE

- When doing the activities, tutorial 102 questions, assignments and past examination papers, take note of how the information is given in the scenario, as well as how the solution is presented. You will notice that marks are available for **applying** the information in the scenario to the requirements of the King IV Report.

Old exam paper question

- Do questions 1.1 and 1.2 of May 2017 exam paper
- Do questions 1.1, 1.2 and 1.4 of October 2017 exam paper
- Do questions 1.1 and 1.3 of May 2018 exam paper
- Do questions 1.1, 1.2 and 1.3 of October 2018 exam