**Corporate governance summarised notes**

**Study Unit 1.1**

**Define corporate governance and briefly explain why is important to society that companies operate within the frame work of good corporate governance**.

Corporate governance is a system or process whereby companies are directed or controlled. It is about companies being good corporate citizens and all that this entails. Companies are integral part of the modern society and it therefore follows that healthy, honest, open, competently and responsible controlled companies will improve the quality of modern society

**Explain in your own words what the term “apply or explain” means. Do you think that allows directors to avoid adhering to principles of good corporate governance?**

“Apply or explain” means that the King III follows a non-legislated approach, which allows companies to explain if they choose not to apply the principle of King III. They may make this choice if they believe that it would be in the best interest of their company.

**Key aspects of the King III report**

1. **Leadership**-good governance is about effective leadership. Leadership is characterized by ethical values of responsibility, accountability, fairness and transparency and is based on moral duties that find expression in concept of Ubuntu
2. **Sustainability** - .to understand the term “ sustainability” we need to understand that companies don’t operate in a vacuum , they are part and parcel of the society and must address , and be part of , the social , ethical and environmental issues which arise out of society.
3. **Corporate citizenship** – the concept of corporate citizenship flows from the fact that the company is a person and should operate in a sustainable manner. It is about the ethical relationship between the company and the society it operates in.

**Three important aspects of sustainability**

1. **Inclusivity of stakeholders** – to achieve sustainability, the legitimate interest and expectations of all stakeholders must be taken into account in decision making strategy.
2. **Innovation, fairness and collaboration** – these are key aspects in achieving sustainability. Innovation provide new ways of achieving sustainability, fairness is vital because of social injustice is unsustainable and collaboration is required if business is going to embrace the principle of sound corporate gov proposed by King III.
3. **Social transformation** – to achieve sustainability, social transformation must be part and parcel of the company’s perfomance.This will benefit both company and society.

**Four important issues incorporated into the king III report**

1. **Alternative dispute resolution (ADR)-** it is an emerging trend in international business, that where disputes arise in business dealings, mediation/arbitration as opposed to going to court is an acceptable way of resolving the dispute.
2. **Risk-based internal audit-** King III favours risk based internal audit over compliance based internal audit. The latter has internal audit checking that the company has complied with its internal controls, legislation. The risk-based approach places more emphasis on internal audit understanding the risks associated with strategic direction of the company and determining whether internal controls, processes and procedures, adequately address these risks
3. **IT governance –** If you think about the international banking system, electronic banking, use of internet banking by business, it is very easy to understand that issues such as confidentiality, integrity, functionality of the system are paramount of importance in the management of the company.
4. **Business recue-** Rescuing a business means that the business has been sustained, and is clearly in the interest of all business’s stakeholders.
5. **STUDY UNIT 1.2**

**Explain and apply section 76 of companies Act.**

* A director of the company must not use the position of a director, or any information obtained whist acting as a director, to gain advantage for himself or knowingly cause harm to company
* Must communicate to the board unless he reasonable believes the information is
* Immaterial to the company or generally available to public or directors
* Or he is bound not to disclose the confidential information by legal or ethical obligation of confidentiality
* Exercise his or her powers in good faith and proper purpose, in the best interest of the company, with the degree of care, skill and diligence reasonably expected of a director.

**Explain and apply section 77 of companies Act**

* A director may be held liable :
* in terms of common law for a breach of fiduciary duty for any loss, damages or costs sustained by the company in respect of the director.
* In terms of the common law relating to delict for any loss damages or costs sustained by the company as a result of any breach of the director of the duty to act with necessary degree of care , skill and diligence.
* Damage or costs arising as a direct or indirect consequence of the director, acting for the company despite knowing that he lacked authority.

**Section 78 indemnity of insurance**

* Any provision of an agreement, the MOI or rules, or a resolution of a company, is void if it directly seeks to relieve a director of any of that director’s **duties** in respect of – Personal financial interest or the standard of director’s conduct or liability arising from sec 77.
* A company may indemnify (protect) a director in respect of any liability *except* where the director: Acted in the name of a company despite knowing he lacked the authority to do so or Committed wilful misconduct or wilful breach of trust, Acquiesced in the carrying on of the business recklessly, with gross negligence, with intent to defraud any person or trading under insolvent circumstances or Intended to defraud a creditor, employee or shareholder.

**Membership requirements for the audit committee according to section 94 by referring to what a member must and must not be**

* The audit committee must have at least 3 members
* Each member of the audit committee must :
* Be a director of the company
* Satisfy an minimum qualifications the minister may prescribe to ensure that the audit committee taken as a whole, comprises persons eith adequate financial knowledge and experience.
* Must not be:
* Involved in the day to day management of the company’s business or have been involved at any time during previous financial year or
* A prescribed officer , or full –time executive employee of the company or another related or inter-related company, or have held such post at any time during previous three financial years or
* A material supplier or customer of the company, such that a reasonable and informed third party would conclude that circumstances, the integrity , impartiality or objectivity of that member of the audit committee would be compromised.
* A related person to any person subject to the above prohibitions.

**Main duties of the audit committee sec 94**

* To nominate for appointment as auditor of the company, a registered auditor who, in the opinion of the audit committee, is independent of the company.
* To determine the fees to be paid to the auditor and the auditor’s terms of engagements.
* To ensure that the appointment of the auditor complies with the provisions of this act, and any other legislation relating to appointment of auditors.
* To determine the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company , or a related company.
* To pre-approve any proposed agreement with the auditor for the provision of non-audit services to the company.
* To prepare a report to be included in the annual financial statements for that financial year.
* To make submissions to the board on any matter concerning the company’s accounting policies, financial controls, records and reporting.
* To perform such other oversight functions as determined by the board.

**STUDY UNIT 1.3**

**List five responsibility of the board**

* The board is responsible for corporate governance and has two main functions:
* it is responsible for determining the company’s strategic direction and
* it is responsible for the control of the company
* The board is responsible to ensure that management actively cultivates a culture of ethical conduct and sets the values to which the company will adhere.
* The board is responsible to ensure that integrity permeates all aspects of the company and its operations and that the company’s vision, missions and objectives are ethically sound.
* The board is responsible to align its conduct and the conduct of management with the values that drive the company’s business.
* The board is responsible for considering the legitimate interest and expectations of the company’s stakeholders in its deliberations, decisions and actions.

**Four ethical values underpinning good corporate governance**

1. **Responsibility** – the board should assume responsibility for the assets and actions of the company and should take corrective action to keep the company on its correct path.
2. **Accountability** – the board should be able to justify its decisions and actions to all stakeholders.
3. **Fairness** – in its decisions and actions, the board should ensure it givs fair consideration to the interest of all stakeholders.
4. **Transparency** – the board should disclose information in a manner that enables all stakeholders to make informed analysis of the company’s performance.

**Moral duties that should be exercised by a director**

1. **Conscience** – a director should act with an intellectual honesty, in the best interest of the company, avoid conflicts of interest and remain independent in mind and action.
2. **Care** – a director should pay careful attention to affairs of the company, a carefree of careless attitude is not acceptable.
3. **Competence** – a director should have necessary knowledge and skills to exercise his/her duties and should continuously “upgrade” knowledge. keep abreast with IT development.
4. **Commitment** – a director should be diligent and prepared to put in necessary time and effort.
5. **Courage** – a director should have courage to act with integrity , even when there is pressure on him to act otherwise, or be unpopular.

**SHORT QUESTIONS: BOARD OF DIRECTORS**

1.    What is an executive director?

2.    What is a non-executive director?

3.    What is an independent, non-executive director?

4.    What are the recommendations of King III with regards to the chairman of the board?

5.    What are the recommendations of King III with regards to membership and the appointment process of the board?

6.    Briefly, what does it mean when we say the board must comprise ‘a balance of power’?

7.    How often should the board of directors meet?

**Answers**

1. **An executive director** is a director who is involved in the management of the company and/or is a full-time salaried employee of the company and/or its subsidiary.
2. **A non-executive director** is…the opposite of the above!
3. **An independent, non-executive director:**  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 (including its holding or subsidiary 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 (or group) 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 (or group) 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.
4. **The chairman of the board**:   Should be and independent non-executive director.  **CEO** of the company should not also fulfil the role of chairman of the board ·  The role of the chairman should be formalised. The chairman’s ability to add value, and his performance against what is expected of his role and function, should be assessed every year

**Note**: these are some of the main recommendations regarding the chairman. Refer to your King III Report for more detail.

1. **The board should**: Comprise a balance of power, Appointments should be a matter for the board as a whole, assisted by the nominations committee. minimum of two executive directors of which one should be the CEO and the other the financial director Note: these are some of the main recommendations regarding the chairman. Refer to your King III Report for more detail

6. The majority of directors should be non-executive directors. And of these non-executive directors, the majority should be independent. (This will ensure that all power does not invest in one person / small group, and who is involved in the business.)

7 .At least four times per year. Directors should ensure that they have the time available to attend. Note: Remember that a board should always appoint audit-, risk-, nomination- and remuneration committees.

Note: Remember that a company should always appoint a company secretary as well.

Note: These are some of the main recommendations of the King III Report. Refer to your King III Report for more detail.

**Board committees**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Remuneration committee** | **Nomination committee** | **Risk committee** |
| **Chairman** | Independent non-executive director | Independent non-executive director | Independent non-executive director |
| **Membership** | Majority of members should be non-executive directors of which majority should be independent. | Majority of members should be non-executive directors of which majority should be independent. | Executive & non-executive directors |
| **Members** | Not specified in king III. | Not specified in king III. | Minimum of three members |
| **Meetings** | Not specified in king III. | Not specified in king III. | Meet at least twice a year |
| **Functions** | Should assist the board in setting and administering remuneration policies. | Should assist with the process of identifying suitable members of the board. | Should consider the risk management policy and plan and monitor risk management process. |

**List functions of the CEO**

1. Recommending or appointing the executive team & ensuring proper succession planning & performance appraisals.
2. Developing the company’s for consideration and approval by the board.
3. Developing & recommending to the board yearly business plans and budgets that support the company’s long-term strategy.
4. Monitoring and reporting to the board the performance of the company and its conformance with compliance imperatives.
5. Establishing an organisational structure for the company which is necessary to enable execution of its strategic planning.
6. Setting the tone in providing ethical leadership and creating an ethical environment.
7. Ensuring that the company complies with all relevant laws and corporate governance principles, and
8. Ensuring that the company applies all recommended best practices and, if not, that the failure to do so is justifiable explained.

**Why should the CEO not fulfil the role of the chairman of the board?**

* Given the strategic and operational role of the CEO, and to prevent too much power vesting in one person, this appointment should be separate from that of the chairman of the board.

**Audit committee**

|  |  |
| --- | --- |
|  | **Audit committee** |
| **Chairman** | * Independent non-executive director * The chairman of the chairman of the board should not be chairman or member of the audit committee. |
| **Membership** | * All members should be Independent non-executive directos |
| **Members** | * Minimum of three members |
| **Meetings** | * Meet at least twice a year * Should meet with internal and external auditors at least once a year without management being present. |
| **Functions** | * Should oversee integrated reporting * Should ensure that a combined assurance model is applied * Should satisfy itself of the expertise, resources and experience of the company’s finance function. * Should oversee internal audit * Should be an integral component of the risk management process. * Should recommend the appointment of the external auditor and oversee the external audit process. * Should report to the board and shareholders on how it has discharged its duties. |

**1.3.4 The Governance of risk**

**The responsibility of Management and CEO in the risk management process.**

1. The board risk strategy should be executed by management in accordance with the board- approved risk management policy and plan.
2. The management is accountable to the board for designing, implementing and monitoring the system and process of risk management and integrating into day to day activities of the company.
3. The board’s delegation of authority to management should incorporate risk management requirements.
4. Although the CEO may appoint a chief risk officer to assist with the execution of the risk management process, the accountability to the board remains with the CEO.
5. The CRO should be a suitable experienced person who should have access to, and interact regularly on, strategic risk matters with the board and appropriate board committee and executive management.
6. The board should satisfy itself that insurance, indemnification and remuneration practices do not prejudice risk management decision-making.
7. Risk management should be intrusive: its methodology and techniques should be embedded within strategy setting, planning and business processes to safeguard performance and sustainability.

**1.3.5 The Governance of information technology**

**Explain the role information technology plays in the company’s risk management**

1. IT risks should form part of the company’s risk management activities and considerations.
2. Management should regularly demonstrate to the board that the company has adequate business resilience arrangements in place for disaster recovery.
3. IT legal risk arises from possession, ownership and operational use of technology that may result in the company becoming a party to legal proceedings.
4. When considering the company’s compliance with applicable laws, rules, codes and standards, the board should ensure that IT related laws, rules, codes and standards are considered.
5. The board should consider how IT could be used to aid the company in its managing of risk and its compliance with laws, rules, codes and standards.
6. The risk committee should ensure that IT risks are adequately addressed through its risk management, monitoring and assurance processes.
7. The risk committee should consider IT risk as a crucial element of the effective oversight risk management of the company.
8. Areas that are more dependent on IT are more exposed if IT risks are not appropriately governed.
9. IT as it relates to financial reporting and the going concern of the company should be the responsibility of the audit committee.
10. Audit committee should also consider the use of technology and related techniques to improve audit coverage and audit efficiency.

**Explain in your own words what the term “risk-based audit approach” means in the context of King III requirements for internal audit.**

* Risk – based internal auditing (RBIA) is the methodology which provides assurance that risks are being managed within the organisation’s risk appetite.

**Define the term “Stakeholder” according to King III**

* Stakeholders can be considered to be any group that can effect the company’s operations, or be effected by company’s operations. Stakeholders include shareholders, institutional investors, creditors, lenders, suppliers customers, regulators, employees, society in general, communities, auditors and potential investors.

**Discuss how frequently a company should report to its stake holders on sustainability and other issues.**

* Effective reporting should take place at least once a year, but there is no fixed number of times that it should take place. The objective is to keep all stakeholders informed in a manner that satisfies the needs the needs of each stakeholder groupings.

**Name an discuss each stakeholder:**

1. Suppliers of goods and services without whom the company cannot operate effectively.
2. Creditors arising from supply of goods, sevices and finance , for example loan porviders.These parties are owed money and therefore have direct stake in the company.
3. Employees are most important asset of the company, at all levels and in all activities- skilled, unskilled and administrative.
4. Government and important parties of in respect of other legislative matters, for example granting of forestry licences.
5. Customers, who may range from individual to large corporations to government and who are lifeblood of the company.
6. External auditors who require co-operations to fulfil their functions
7. Industry at large – The company does not operate in a vacuum. It is part of of the broader economic community. Co-operation and participation are key to sustainability of industry as a whole.
8. Local communities – Companies are part of the wider society .The company depends on these communities vice versa.
9. Media Financial, industrial and human interest journalists write about the company and can enhance or damage a company’s reputation and image as a good corporate citizen.
10. Regulators the King III defines a regulator as body which seeks compliance either on a mandatory or voluntary basis, with a set of rules ,regulations or codes.