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*PRESENTATION OF THE PAPER
“CORPORATE GOVERNANCE IN EURASIA: A COMPARATIVE OVERVIEW”*

AND

A REVIEW OF CORPORATE GOVERNANCE REFORMS IN UKRAINE

Kyiv, Ukraine
17 – 18 May 2004

*“Corporate Governance in South Africa – a Perspective from an
Emerging Market”*

by
Mr. Philip Armstrong



CORPORATE GOVERNANCE IN SOUTH AFRICA

- A PERSPECTIVE FROM AN EMERGING MARKET

PRESENTATION TO THE
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Prepared by

Philip Armstrong

Managing Director, ENF Corporate Governance Advisory Services, South Africa
Convenor and Editor of the King Report on Corporate Governance in South Africa
Advisor to the Pan-African Consultative Forum on Corporate Governance

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1. SOUTH AFRICA IN CONTEXT

1.1. Political System

- 1.1.1. South Africa was constituted a political democracy under its new Constitution established in 1996, following resolution to proceed to a political democracy in 1992 with the dismantling of the Apartheid political system and the introduction of a democratically-elected Parliamentary system in 1994 and interim Constitution.
- 1.1.2. The Constitution is the supreme law of the land. No other law or government action can supersede the provisions of the Constitution. South Africa's Constitution is regarded as one of the most progressive in the world and enjoys high acclaim internationally.
- 1.1.3. The fundamental rights of citizens is entrenched in the Bill of Rights contained in the Constitution which aims, *inter alia*, to heal the divisions of the past and establish a society based on democratic values, social justice and fundamental human rights.
- 1.1.4. Government is established along the lines of a federal system of governance constituted at the national, provincial and municipal levels within distinctive, interdependent and interrelated structures. The powers of the law makers [legislative authorities], governments [executive authorities] and courts [judicial authorities] are separate from one another.
- 1.1.5. The President of South Africa is the Head of State and leads the Cabinet. The first President of a democratic South Africa was President Nelson Mandela, who was succeeded by President Thabo Mbeki in 1999 (recently re-elected to a second and final term of office to 2008).

1.2. Demographic Information

- 1.2.1. South Africa is a demographically diverse country in nearly every respect, comprising a population of approximately 45 million people. Of

these, 79% are classified as African, 9,6% as white (of European origin), 8,9% as coloured (of mixed race origin) and 2,5% as Asian (mainly from the South Asian sub-continent).

1.2.2. Reflecting this diversity, the South African Constitution provides for 11 official languages. However, for the most part, business is conducted in the English language.

1.2.3. Almost 80% of South Africa's population follows the Christian faith. Other major religious groups include the Hindus, Muslims and Jews. Freedom of worship is guaranteed by the Constitution, and the official policy is one of non-interference in religious practices.

1.2.4. South Africa occupies the southern most part of the African continent, occupying a land surface area of 1,2 million km².

1.2.5. South Africa is well known for its rich diversity of animal wildlife and natural resources. This comprises in the main, gold, diamonds, coal, platinum group metals, iron ore, manganese, titanium metals, copper, etc. In fact, it is this mineral wealth which has been largely instrumental for the development of the South African economy along with its diverse agricultural industry.

1.3. **Economic System**

1.3.1. While South Africa's gross domestic product ("GDP") is by far the largest on the African continent, at US\$126 billion¹, this is a fraction of the global GDP of approximately US\$31 000 billion – making South Africa the 30th largest global economy in GDP terms.

1.3.2. In respect of the African continent, 53 countries constitute a total GDP of US\$460 billion – which is largely made up by South Africa, Egypt and Algeria. This presents a number of challenges and obligations to South Africa in relation to the continent, represented by South Africa's

¹ 2002

prominent role in The New Partnership for Africa's Development ("NEPAD") and the conduct of South African business interests operating in countries on the continent outside of South Africa.

- 1.3.3. Notwithstanding South Africa's prominence and the relative recognition of its advanced economic system by emerging markets standards, it has been an insignificant recipient of foreign direct investment ("FDI") which remains a cause for concern among the authorities and business sector. With the exception of 2001, when South Africa received approximately US\$6,5 billion in FDI on account of an unbundling of cross-share holdings involving London-listed Anglo American and its subsidiary, De Beers, this figure has remained at around US\$1 billion or less annually. This is a fraction of the total global FDI flows reported in 2002 of US\$735 billion.²
- 1.3.4. While historically the bedrock of the South African economy has been the export of commodities derived from the mining and agricultural sectors, the manufacturing sector through active official policy has become increasingly significant. The secondary sector, buoyed by the strong growth in construction spending, has also been a more recent factor in the South African economy.
- 1.3.5. As with most emerging markets, the South African economy remains vulnerable to international events particularly in the financial markets as it affects its currency (known as the "Rand") against the hard currencies of its major trading partners in Western Europe and North America.
- 1.3.6. Africa forms the focus of South Africa's global economic strategy and its economy is inextricably linked to that of the southern African region. Hence the recovery of the African continent through the NEPAD initiative is an important criteria.
- 1.3.7. However, Western Europe is the largest source of investment for South Africa and accounts for almost half of South Africa's total foreign trade.

² World Investment Report 2002, United Nations Conference on Trade and Development

In fact, seven of South Africa's top 10 trading partners are located in Western Europe. The largest of these is the United Kingdom, given its historic political and colonial links, followed by Germany. The United States is another major source of trade for South Africa, mainly in unprocessed and semi-beneficiated material, as has been Japan.

- 1.3.8. Following its advent to a fully fledged democracy in 1994, South Africa is a member of a number of major trading blocs and important multilateral arrangements. In some of these areas, it plays a significant role particularly in representing the interests of the emerging markets and specifically Africa.

2. CORPORATE STRUCTURE AND OWNERSHIP

2.1. Legal and Institutional Framework

- 2.1.1. The legal system in South Africa is based on Roman-Dutch law and the Constitution formally introduced in 1996. It draws much of its reference from the English legal system in the commercial sector, constituted by the Companies Act promulgated in 1973 and the common law system of judicial precedent.
- 2.1.2. The institutional framework in South Africa is constituted by *primary law* represented by statute promulgated by the national Parliament, which in the commercial sphere is generally subject to criminal sanction in the event of breach, and a disparate *regulatory oversight* framework of institutional structures designed to enforce compliance.
- 2.1.3. Given the weak enforcement of these rules and regulations, in part due to availability of skills and resources and budgetary constraints and also because of a heavy burden on the judicial system dealing with conventional criminal prosecution, there is a relatively heavy reliance on *self-regulatory* measures.

- 2.1.4. All incorporated bodies in South Africa are required to register with the Registrar of Companies, which administers the Companies Act. The Registrar has limited capacity for enforcement.
- 2.1.5. In addition to the Companies Office, the banking sector is regulated by the Registrar of Banks falling under the South African Reserve Bank. While the financial markets sectors, covering long- and short-term insurances, collective investment schemes, pension and retirement funds, etc., is regulated by the Financial Services Board (“FSB”) which in turn is accountable to the Minister of Finance. The institutions falling into the banking and financial markets sectors are also regulated by international developments and conventions, which are closely followed by the regulators for these sectors.
- 2.1.6. South Africa’s principal, and sole, stock exchange falls under the supervision of the FSB. This is known as the JSE Securities Exchange South Africa (“JSE”), which is the 14th largest stock exchange in global terms.
- 2.1.7. The Insider Trading Act, introduced in 1998, forms an important backbone to the regulatory environment, particularly in relation to companies quoted on the JSE. It falls under the FSB, and has powers to institute criminal prosecution and civil proceedings, and also follows a “name and shame” policy in disclosing miscreants that have fallen foul of this legislation.
- 2.1.8. Another significant regulatory instrument, is the Securities Regulation Panel, which supervises mergers and takeovers. While it is a statutory body, it is essentially self-regulatory in nature and applies the Securities Regulation Code based on the takeover code in London. This institution falls under the Minister of Trade and industry.
- 2.1.9. The Public Accountants’ and Auditors’ Act provides for statutory regulation of the audit profession and is funded by fees and levies paid by the registered accountants and auditors. An investigation has

recently presented a report to the Minister of Finance in regard to recommendations for the reform of the institutional framework governing the accounting sector. The accounting profession in South Africa has a long history, with a highly skilled membership, which reciprocal arrangements in Australia, Canada, England and Wales, Ireland, Scotland and others.

2.2. **Public Sector Institutional Framework**

- 2.2.1. A significant factor in the South African economy is the public sector. State-owned enterprises in South Africa control about a quarter of the country's capital stock, which makes this sector significant in the overall context of the South African economy.
- 2.2.2. Some SOEs rank among the largest of their kind globally, including Eskom (electricity utility serving not just South Africa but much of Africa) and Transnet (transport utility responsible for South Africa's ports, railway system, national airline, etc.).
- 2.2.3. Notable in this construction, is that the SOEs are responsible for generating approximately a third of all savings in the country (on a gross basis). This means that they play a critical role in the allocation of capital in the South African economy.
- 2.2.4. The standard of corporate governance in this sector, therefore, plays an important role in the South African economy. This sector is also regulated by some of the most advanced, and onerous, public finance legislation internationally under the Public Finance Management Act. This is administered by the National Treasury, falling under the Minister of Finance, and the Office of the Auditor-General (an independent Constitutional oversight authority).
- 2.2.5. This extends to the provincial and municipal government sectors and any commercial enterprise established at these levels.

2.3. **Capital Market Framework**

- 2.3.1. In general terms, there are marginally under 7 000 active public companies incorporated under the Companies Act, of which 415 are currently listed on the JSE. Approximately 290 000 active private companies are incorporated and there exist approximately another 16 types of companies that are recorded as “active”.
- 2.3.2. An interesting feature of the JSE, is that its market capitalisation stands at 1,65 times GDP (excluding cross-holdings). This is higher than many developed countries such as the United Kingdom, France, Germany and the United States.
- 2.3.3. Historically, the corporate sector was dominated by mining finance houses but following the opening of the economy to global forces with the advent of democracy, mining houses as they were originally constructed have largely unbundled their stakes in non-core holdings or bought out minority shareholding interests. The restructuring has significantly transformed the control structures of South Africa’s economy and broadened ownership.
- 2.3.4. This has also been led, more recently, by strong motivation at the official policy level to diversify control holdings in the corporate sector to “historically disadvantaged” ethnic groups (otherwise more commonly known as “black economic empowerment”). This provides, perhaps, an interesting dimension to corporate governance issues that are unique to South Africa and it is too early to anticipate the impact.
- 2.3.5. Outside of the banking and financial services sectors, though, many of South Africa’s larger companies still have considerable interests owned by the founding families of these companies.
- 2.3.6. South Africa has a large private retirement funds sector and long-term insurance industry. Domestic institutional investors dominate the JSE and account for around 40% of the total market capitalisation. Since

exchange control restrictions regulate the investment of domestic funds to a large extent, issuers quoted on the JSE essentially operate in a captive market for domestic institutional investors.

2.3.7. The level of foreign institutional investment is difficult to ascertain with accuracy, as it is usually deployed through local intermediaries as part of their overall funds invested, but is deemed to be low. However, this is not necessarily out of line with the withdrawal of global investors from the emerging markets on account of a number of financial crises that occurred during the latter part of the 1990s.

2.3.8. The dismantling of the racially based Apartheid political system in the early 1990s has brought about a profound transformation in the socio-economic fabric of South Africa. Prior to this, the proper functioning of market mechanisms and a sound corporate culture of transparency and disclosure was largely stifled and accompanied by excessive rent seeking on the part of government and management often at the expense of employees and shareholders generally.

2.3.9. A significant feature of the democratic period since 1994 has been successive political reforms, admission to the World Trade Organisation, rejuvenation of foreign capital inflows and a series of domestic regulatory initiatives designed to foster a policy of economic liberalisation with special emphasis on capital market development and corporate reform.

3. CORPORATE GOVERNANCE IN SOUTH AFRICA

3.1. Background

3.1.1. Corporate governance has been a reasonably well developed concept in South Africa since the establishment of the King Committee on Corporate Governance (“King Committee”) in 1992, at the instigation of

the Institute of Directors of Southern Africa (“IoD”), and the release of the first King Report in November 1994.

- 3.1.2. The IoD is a voluntary membership organisation that was established in South Africa nearly 50 years ago to promote director professionalism and interests. It is affiliated, loosely, to the IoD in the United Kingdom and enjoys a close affiliation with its well established counterparts in Australia and New Zealand as well. Some 2 000 directors and professionals are members of the IoD in South Africa.
- 3.1.3. The King Committee, chaired by former judge and businessman Mervyn King, is also a voluntary body with a wide range of institutional and professional representative interests serving on the Committee (at the invitation of the IoD). This covers businessmen, lawyers, accountants and auditors, corporate secretaries, regulators, civil society and others.
- 3.1.4. A further, and notable, feature of the activities of the King Committee is that it carries no government sanction or instruction. Its activities are primarily designed to promote good practices in corporate governance in the corporate sector in South Africa.
- 3.1.5. Another relevant feature, is that this embraces both the private and public sectors and is not specifically directed to companies quoted on the JSE only. This is in recognition of the significance of the public sector commercial activities to the South African economy, which is not exclusively or significantly dominated only by companies quoted on the JSE.
- 3.1.6. The first King Report drew attention to the importance of a properly functioning board of directors as a key ingredient of good corporate governance. It was not stimulated by any significant crisis in the corporate sector at that time, but was generated by similar developments in other Commonwealth countries following the Cadbury Report in the United Kingdom and also concerns with the competitiveness of the South African private sector following the re-

admission of South Africa to the global economy in 1994 with the advent of the new democratic dispensation.

- 3.1.7. The second King Report came about following an assessment of developments that had taken place in the South African economy and the global markets since 1994. Again, it was not driven by any major crisis in the corporate sector. However, coincident with this review a number of crises did come to light, that has stimulated attention to corporate governance practices in the corporate sector – both private and public.
- 3.1.8. The JSE had in this period comprehensively revised and updated its listings requirements in line with international standards, a number of important changes had been made to the South African Companies Act as a result of the recommendations contained in the first King Report, new insider trading regulations had been introduced, public sector finance reporting and accountability had been significantly strengthened, and a range of other legislation addressing social and labour priorities was increasingly impacting on existing governance standards and practices.

3.2. **Nature of Review Process**

- 3.2.1. The King Committee, under guidance of the IoD, initiated its second review in August 2000.
- 3.2.2. Four primary guiding principles were established:
 - 3.2.2.1. to review the first King Report and to assess its currency against developments locally and internationally since 1994;
 - 3.2.2.2. to review and clarify the approach taken in the earlier review to extend the investigation beyond the financial and regulatory aspects of corporate governance in

advocating an integrated approach to embrace the interests of a wide range of stakeholders (not only shareholders);

3.2.2.3. to consider requirements facing boards and directors in relation to matters of risk and internal controls assurance that extended to also include non-financial issues (the so-called “triple bottom line” approach); and

3.2.2.4. to recommend provisions for effective enforcement of good corporate governance standards and existing rules and regulations.

3.2.3. The review was structured into five task teams, as follows:

3.2.3.1. *Boards and Directors* which looked at a wide range of issues in the area of board governance and director conduct with particular reference to international developments and institutional investor requirements.

3.2.3.2. *Accounting and Auditing* which considered developments surrounding auditing and non-audit services, accounting standards in relation to international developments, and auditor skills around the issues associated with non-financial reporting.

3.2.3.3. *Internal Audit, Control and Risk Management* which reviewed and updated guidelines in this field as they related to boards and companies and the processes of assurance and reporting.

3.2.3.4. *Integrated Sustainability Reporting* which investigated recommendations for integrating matters of a non-financial nature into the overall governance and reporting framework of companies in South Africa. This covered

the aspects of health, safety, environment, public interest and community issues and their economic impact or relevance.

3.2.3.5. *Compliance and Enforcement* which considered the supervision and enforcement of existing rules and regulations governing companies in South Africa and recommendations to improve compliance with governance guidelines.

3.2.4. The task teams were deliberately structured to embrace a wide range of interests from the private and public sectors, institutional and investor interests, civil society, government and regulators. This was to ensure a wide reference for investigation and consideration of the recommendations arising out of the review.

3.2.5. A co-ordinator and convenor of this process was appointed, on a voluntary basis, to set the programme, its objectives and to provide expert guidance to the process.

3.2.6. Extensive consultation took place locally and internationally from the inception of the review in August 2000 until the public consultation document was released in South Africa and overseas in July 2001. Considerable comment was received from both sources.

3.2.7. The final report was approved by the King Committee in early 2002 and released on 26 March 2002.

3.3. **Substance of King Guidelines**

3.3.1. The second King Report (“King II”) was designed to elaborate on the practices of good governance as required in law, and was not intended to substitute or in any way replace legal deficiencies. To the extent that legal deficiencies were identified, certain recommendations were made by the King Committee for consideration by the relevant authorities.

- 3.3.2. A particular emphasis in King II, having regard to a well established (albeit ineffectively supervised in some cases) regulatory environment, was on the qualitative aspects of good corporate governance. In other words, a number of the guidelines were structured to encourage greater board effectiveness and did not merely set out procedural requirements. For this reason, a number of the guidelines (certainly in the area of non-financial reporting) were considered aspirational at the time of the introduction of King II and perhaps remain so for many companies two years hence.
- 3.3.3. A further feature of the guidelines contained in King II, was to align international standards with domestic practices and circumstances.
- 3.3.4. Given the difficulties of applying these guidelines across the South African economy, King II instead applies specifically to the following “regulated” sectors:
- 3.3.4.1. All companies quoted on the JSE (with dispensation granted to companies having a dual listing on a stock exchange with more rigorous requirements).
- 3.3.4.2. All banks and financial institutions, whether quoted on the JSE or not.
- 3.3.4.3. All entities falling under the public sector regulations at both the national and local government levels.
- 3.3.5. Any other companies not falling within the above categories are encouraged to adapt King II, as appropriate, to their particular circumstances.
- 3.3.6. King II comprises the following:
- 3.3.6.1. Detailed guidelines constituting the “King Code”.

- 3.3.6.2. Recommendations for legislative/regulatory intervention.
- 3.3.6.3. Samples of various charters, guidelines and international conventions relevant to various aspects of the guidelines.
- 3.3.7. Companies were, effectively, given one year within which to align their practices accordingly. This meant, therefore, that King II for these purposes came into effect from 1 April 2003 for applicable companies.

3.4. **Main Components of King II**

3.4.1. *Primary Focus of Principles*

- 3.4.1.1. The principles of discipline, transparency, independence and accountability enshrined in the OECD Principles were reiterated.
- 3.4.1.2. However, King II went further to embrace the concepts of responsibility, fairness and corporate citizenship in providing a wider perspective on the role of companies in society. This is particularly relevant to circumstances in South Africa and the role that companies are expected to play in the social and economic transformation taking place in the country.

3.4.2. *Board Structure*

- 3.4.2.1. King II emphasises the board as the focal point of the corporate governance system and that it is ultimately accountable and responsible for the performance and affairs of the company.
- 3.4.2.2. Regarding the composition of the board, guidelines recommend a proper balance of executive and non-

executive directors, preferably with a majority of the non-executive directors being independent.

- 3.4.2.3. Independence has a wide definition in King II, largely driven by the more rigorous tests used by international investors, requiring a non-executive director to be free from any business relationship which could be seen to materially interfere with the individual's capacity to act in an independent manner. In practice, the tight knit nature of the South African business community raises questions about the true independence of directors and this is a constant source of tension among boards seeking to comply with this requirement.
- 3.4.2.4. The requirement for boards to give greater consideration to issues of diversity, both in terms of gender and ethnicity, is highlighted as a strategic imperative. Allied to the requirements for independence and the need to broaden the pool from which non-executives are drawn, emphasis has also been placed on a more effective induction process and ongoing development of directors.
- 3.4.2.5. This leads to the requirement for directors and boards to undergo regular evaluation, preferably from an independent facilitator, to validate board effectiveness and continuing suitability of individual directors standing for re-election. Given the shortage of skills within the economy, it was not considered appropriate to prescribe age limits and constraints on the length of service on boards – although this is a problem but difficult to address among the many other demands facing boards at this time.
- 3.4.2.6. Size of boards was not regulated by King II, but has drawn the attention of institutional investors and

regulators with the result that a number of boards have sought to reduce their size to a more acceptable level. While the frequency of board meetings was recommended to be at least once a quarter, many of South Africa's prominent quoted companies meet much more frequently as circumstances require.

3.4.2.7. King II advocates that the roles of chairman and chief executive officer should be separated, which has since been reinforced by the JSE, banking and financial markets regulators and the public sector regulations. The position of chairman should be held by an independent non-executive director, and steps have been taken by companies across a wide spectrum to address this requirement.

3.4.2.8. Meetings of the non-executive directors, without management present, are encouraged. The concept of a so-called "lead independent" non-executive director is put forward for consideration where circumstances might require.

3.4.2.9. The length of executive director service contracts is restricted to a maximum term of three years and should be the subject of shareholder confirmation, while extensive disclosure of individual director (executive and non-executive) remuneration and benefits is now enforced by all of the regulators mentioned in 3.4.2.7 above.

3.4.2.10. King II states that board committees are for the purpose of assisting the board and its directors in discharging their duties and responsibilities, and should not assume any executive authority that should be retained by the board as a whole. Furthermore, guidelines are provided in relation to the requirements for audit, remuneration and

nomination committees with a strong emphasis on the role of independent non-executive directors in this process. Board committees should also undergo regular independent evaluation.

3.4.2.11. Extensive disclosure is called for by King II in respect of these issues, including detailed information on board and committee attendance (which has been a particular problem among South African companies). On this latter point, disclosure of attendances has had a remarkable effect on directors and has seen a significant improvement.

3.4.3. *Risk Management and Internal Control Assurance*

3.4.3.1. Risk management and internal control systems are essential in a successful corporate governance system. On this score, King II provides clear-cut guidelines stating that the board is responsible for the total process of risk management and internal control.

3.4.3.2. The guidelines further assign to the board the requirements to develop risk strategy policies, setting the company's risk tolerance level, and assessing the company's risk profile on the basis of various risk categories including credit risk, market risk, operational risk, human resources risk, regulatory and legal risk, etc.

3.4.3.3. Further, King II requires the board to consider the need for a confidential reporting process to guard against fraud and corporate malfeasance ("whistleblowing"). On this point, legislation has recently been introduced to provide for whistleblowing protections and mechanisms.

- 3.4.3.4. Quoted companies are now required to provide a comprehensive annual statement on risk and internal controls, while this has been a feature of the banking and financial sectors for some time these requirements have been further enhanced and in the public sector rigorous provisions are now in force.
- 3.4.3.5. Given the complexity of these processes, it is still in many cases very much work in progress for companies but some sophisticated responses have been forthcoming from both the private and public sectors.
- 3.4.3.6. King II is also noteworthy in emphasising the importance of organisation integrity. Each company is required to demonstrate its commitment to organisation probity by codifying its standards in the form of an ethical code that should be widely implemented and monitored by the board.

3.4.4. *Accounting and Reporting*

- 3.4.4.1. South African statements of GAAP (Generally Accepted Accounting Practices) are broadly comparable with the International Accounting Standards (now known as International Financial Reporting Standards (“IFRS”)).
- 3.4.4.2. Deliberate steps have been taken by the accounting regulators in South Africa to ensure that South African standards are compatible with international reporting standards. This includes the commitment to align South Africa’s accounting standards with updated IFRS by 2005.
- 3.4.4.3. In addition to the self-regulatory mechanisms for accounting and auditing in South Africa, the listing rules of the JSE require all quoted companies to comply with

South African GAAP. To ensure appropriate compliance, in the absence of an effective official regulatory mechanism, the JSE has established a GAAP Monitoring Panel to review all financial statements issued by JSE-quoted companies and to take appropriate actions against companies failing to meet this requirement.

- 3.4.4.4. King II makes a number of recommendations in regard to accounting and auditing, specifically around the role of the audit committee and disclosure issues associated with consulting services provided by the same audit firm.
- 3.4.4.5. The guidelines in King II require that the audit committee should be chaired by an independent non-executive director and that the majority of audit committee members should be financially literate. Furthermore, the board chairman should not be a member of this committee nor necessarily present in its deliberations.
- 3.4.4.6. In cases where there is a departure from relevant accounting standards, the board (through the audit committee) should not only disclose and explain the nature of this issue but also quantify the magnitude of the financial impact in the annual report.
- 3.4.4.7. An effective internal audit function is emphasised (see also 3.4.3 above) and the need to co-ordinate, efficiently, this process with that of the external audit. Furthermore, separate meetings between the audit committee and the internal audit on the one hand and the external auditors on the other is encouraged.
- 3.4.4.8. King II fully endorses the Standards for the Professional Practice of Internal Auditing promulgated by the international body for internal auditing.

- 3.4.4.9. With regard to the annual independent audit, there is no statutory definition of “independence” and it is not unusual currently in the South African environment for the same auditor to perform both internal and external audit functions for the same company. This issue has been highlighted for attention generally, but to some extent is determined by limited skills availability and economics for the smaller companies. There is an outright prohibition on this taking place in the public sector.
- 3.4.4.10. Under guidance of the audit committee, boards are required to consider the assumptions and basis on which the company is considered to be a “going concern” for the year ahead. This should be recorded in the board minutes accordingly.

3.4.5. *Integrated Sustainability Reporting*

- 3.4.5.1. Stakeholder rights (outside of those enshrined in the Companies Act for shareholders) are observed through laws providing for affirmative action in addressing historic ethnic imbalances in the workplace, employee skill development, labour and employee rights, prevention of discrimination and harassment across a broad spectrum of issues and circumstances, etc.
- 3.4.5.2. However, King II goes further to require that 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. This contemplates companies going beyond merely regulated requirements and to treat these aspects of their activities as issues of strategic implication.

3.4.5.3. This aspect, probably, most distinguishes the South African guidelines from similar codes worldwide. What should be understood, is that these requirements should take the form of an integrated approach to the overall business strategy of companies and should be designed as part of its economic profile. They are also recognised as another dimension of risk (see 3.4.3 above).

3.4.5.4. This extends to guidelines providing for organisation integrity and ethics as mentioned in 3.4.3.6 above.

3.4.6. *Relations with Shareholders*

3.4.6.1. This was not dealt with extensively within the King II guidelines, given the rights contained in the Companies Act relating to shareholders. However, it is recognised that this remains a serious area for concern and probably requires a level of regulatory intervention to give greater effect to these legal provisions.

3.4.6.2. Companies are encouraged to enter into dialogue with institutional investors, based on constructive engagement and the mutual understanding of objectives. Clearly this should take place with regard to regulatory and other directives governing the dissemination of information by companies and their directors and officers (which is another area fraught with pitfalls and largely falls on the insider trading regulations which are insufficient in themselves for this purpose).

3.4.6.3. Proxy voting without significant restrictions or constraints is permitted, and it is more the inefficiency of the system that gives rise for concern. While King II makes no explicit reference to the issue of one share, one vote this is largely presumed under the terms of the Companies

Act and disproportionate voting rights (which was a practice at one time in South Africa) are prohibited for companies quoted on the JSE.

3.4.6.4. Various transactions are regulated by the Companies Act and the JSE requiring specified voting thresholds and thus were not the subject of King II, although the low threshold for the constitution of a quorum for a shareholders' meeting was highlighted as a possible area for further investigation by the regulators.

3.5. **Impact of King II and the Regulatory Environment**

3.5.1. It would be unrealistic to anticipate that King II on its own, given its voluntary nature, would generate a significant transformation of corporate governance standards and practices in South Africa.

3.5.2. It was recognised that other interventions would be necessary to create the necessary climate for adherence to these guidelines, led by the regulators without unnecessarily imposing restrictive requirements that would inhibit commercial and entrepreneurial enterprise. This, clearly, represents a challenging dimension to corporate governance reform in any country, not just South Africa.

3.5.3. The King Committee identified 24 issues for regulatory or other official intervention. In response, legislation has been formulated with the intention of introducing rigorous provisions relating to delinquent directors and for the introduction of provisions that will give legal backing to accounting standards in South Africa.

3.5.4. King II came to the conclusion that insofar as principles of corporate governance co-exist with established legal principles, no new sanctions or remedies were necessary. Nevertheless, the King Committee recorded its concerns at the lack of enforcement of existing rules and regulations and has called for urgent dialogue between the business

community and the authorities to enhance the resources and capacity of the State to handle more effectively breaches and offences of these rules and regulations. Given the many other priorities facing the economy and government, little progress has taken place in response to this call.

- 3.5.5. Of concern, controversially in South Africa certainly, has been the country's ranking under the so-called Corruption Perception Index developed by Transparency International with ranked South Africa 38 out of 91 countries. Steps at the official level continue to be taken to address this issue, resulting recently in new legislation with draconian consequences for acts of corruption. The main problem, as exists throughout the commercial sector, is the available capacity of the regulators and the judiciary to enforce this and a plethora of other important legislation.
- 3.5.6. Added to this, has been the introduction of advanced legislation regulating money laundering and other similar activities.
- 3.5.7. An interesting dimension to corporate governance in South Africa more recently, has been the growing number of South African companies that have shifted their stock exchange listings to a foreign bourse – primarily London and New York. This has had positive spillover effects in the domestic environment.
- 3.5.8. Through an active and free media, corporate governance has been closely observed by the press and has given considerable attention to the conduct of directors, boards and companies that has in turn stimulated a level of shareholder activism not previously observed in the South African market. Nonetheless, the level of public activity of institutional investors remains low key despite some well publicised events of poor governance.
- 3.5.9. King II made a number of recommendations, among which included public disclosure by institutions of their voting policies and decisions, but

little apparent response has been noted to date. Another area identified by the King Committee for attention, was the role of pension and retirement fund trustees and their own obligations in this regard but again little response has taken place thus far. It is in this area, apparently, that international investors are most concerned in relation to the governance environment in South Africa.

3.5.10. Notwithstanding these various issues, the regulators have responded in various ways:

3.5.10.1. The JSE listing rules were again comprehensively updated (for the third time in seven years) to incorporate certain elements of King II as mandatory requirements for quoted companies. The JSE continues to enforce its existing requirement for companies to “comply or explain” their adoption of the King II guidelines.

3.5.10.2. The banking regulator has introduced, arguably, extremely rigorous provisions around director accountability in amendments to the Banks Act that reflect a number of principles enshrined in King II. Greater powers have been conferred on the banking regulator to intervene on matters such as director and executive appointments.

3.5.10.3. The FSB continues to give attention to enhancing the financial markets legislation that falls under its supervision, embracing a number of the King II guidelines. It is also reviewing a number of pieces of securities legislation, including the Insider Trading Act and Stock Exchanges Control Act, to give more integrated consistency to these provisions and with enhanced enforcement powers.

- 3.5.10.4. The Protocol for State-owned Enterprises on Corporate Governance was comprehensively updated in line with King II and adopted by Cabinet in 2003, which forms the basis of corporate governance standards at all levels of public sector institutions and agencies. This supplements the already onerous requirements of the Public Finance Management Act and updated National Treasury regulations (to align with King II).
- 3.5.10.5. A formal review of the existing corporate laws in South Africa is in the process of being commissioned by government and a strong foundation for this review will rest on the recommendations and guidelines contained in King II, taken against international developments as well.
- 3.5.10.6. A major response in all of this to the King II guidelines, has been the surge in director development and corporate governance training led by the IoD, private consultants, large auditing and accounting firms, and higher education institutions including business schools. Interactive e-learning courses on corporate governance have also been developed in order to make specialised education on this topic accessible to many more people.

4. CONCLUSION

- 4.1. Following the advent of the democratic dispensation, that is now well established following three national elections, the authorities in South Africa remain under pressure to rapidly improve the standard of living of the general population through higher employment and expanded social services. There is a clear recognition that in order to achieve higher economic growth, South Africa will need to increase both domestic and foreign capital and use it more efficiently.
- 4.2. By promoting sound governance practices in both the private and public sectors, the authorities hope to attract and assure investors in such a way as to promote the

use of equity and bond markets as capital-raising alternatives to the highly leveraged balance sheets of the major banks which are regarded as noticeably susceptible to macro-economic shocks.

- 4.3. South Africa's approach to corporate governance going forward is likely to be as sophisticated as its approach to the development of domestic financial markets. The authorities, however, see a need to address more than just the financial aspects of corporate governance as was highlighted in the emphasis given to integrated sustainability reporting contained in King II. For this reason, companies and boards are presently pre-occupied with settling industry "charters" that give recognition to these wider objectives to address historic socio-economic imbalances, although this aspect is not well understood in the international markets in relation to both its political and economic significance to South African corporate enterprise.
- 4.4. An interesting aspect of corporate governance in South Africa has not so much been the role of the regulators and the private sector, but the emphasis given to corporate governance within the State-owned corporate sector and the pressure this has placed on the private sector to some extent to match these standards. This has added to the impetus brought to bear on the market through the spillover effect of foreign listings of South African companies referred to in 3.5.7 above.

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