At first glance, King 3 appears to be similar to the previous King 2 report. However, there are significant differences, many of them aspirational, which will have practical implications for boards, directors, management, assurance providers and stakeholders.

King 3 summary and implications
In this King 3 summary document, we have provided an interpretation of the significant changes as well as a quick reference guide. KPMG interprets some of the changes and related implications as follows:

Applicability
King 3 applies to “all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors.”

Implications: KPMG anticipates that entities and stakeholders will require a deeper understanding of governance in order to decide how governance principles and practices should be adopted and implemented in their particular entity – “the one size does not fit all” consequence. This will necessitate education, dialogue, decisions and disclosure.

‘Apply or explain’ versus ‘Comply or explain’
King 3 has opted for the more flexible ‘apply or explain’ approach to its principles and recommended practices. In the United Kingdom, the Combined Code, which is based on the ‘comply or explain’ principle, requires London listed companies to state their compliance with the principles and then explain if there is non-compliance to any of the detailed provisions supporting the principle. In South Africa, under King 3, entities are required to make a statement as to whether or not they apply the principles and then to explain their practices. It is relevant too that King 3 states “Each principle is of equal importance, consequently ‘substantial’ application of this Code and Report does not achieve compliance.”

Implications: South African entities will have to consider the recommended principles in King 3, state what theirs are, and explain if and why they differ from the King 3 recommendations. This softer approach to governance disclosure is more flexible, but may be open to abuse if entities fail to justify their deviations from the King 3 Report’s recommended principles. Only the sophisticated reader and those well-versed in governance will be able to discern deviations from the recommended principles in the disclosure. Potentially, this could expose a director to liability in the event that statements of adherence to principles are made but the best practices are not followed and are not explained.
Sustainability
There is increased emphasis on sustainability and its inseparable interface with strategy and control.
King 3 calls for integrated reporting (reporting of financial information with sustainability issues of social, economic and environmental impacts) and recommends that the audit committee engage an external assurance provider to provide assurance over material aspects of the sustainability reporting in the integrated report.

Implications: The skill set of the audit committee will have to include member/s proficient in sustainability. Furthermore, integrated reporting may require registered auditors and assurance providers who can provide assurance on both the financial components and the sustainability aspects of reporting. This is likely to impact the external audit engagement, opinion and associated costs, as well as director liability in the event of misrepresentation.

Stakeholder inclusive model
King 3 follows an inclusive approach to stakeholders, whereby the legitimate interests of stakeholders (e.g. employees, suppliers, customers, regulators, environment, community, etc) are considered and recognised over and above solely the shareholders’ interests, in a manner which befits the long term sustainability of the entity.

Implications: The board should identify important stakeholder groupings and management will have to engage with them to ascertain legitimate expectations. Communication with all stakeholders will be important and will be reflected in the integrated report. We anticipate the current common role of the ‘Investor Relations Manager’ to develop towards that of a ‘Stakeholder Relations Manager’.

Board composition
King 3 requires boards to be comprised of a majority of non-executive directors, of whom the majority should be independent. Every year the directors who are classified as independent should have their independence assessed by the board, particularly those that have been on the board for longer than nine years. The results should be reported.

Implications: Boards may encounter difficulty in having sufficient independent, suitably skilled and demographically acceptable directors. Another consequence will be the increased time required by non-executive directors to discharge their governance responsibilities e.g. reporting on the effectiveness of the companies system of internal controls. This will impact on both the cost of directors and management time.

Audit committee composition and duties
King 3 requires an independent and suitably skilled audit committee, appointed by the shareholders. This committee also has statutory duties in terms of the Companies Act 71 of 2008, apart from the board of directors. The duties of the audit committee are extensive and include overseeing integrated reporting, external audit, internal audit, the risk management process and the finance function effectiveness. Part of its function in relation to risk management is to oversee the IT risks and fraud risks as they relate to financial reporting and the internal financial controls, and this includes reporting to the board on the effectiveness thereof. The board in turn has to report on the effectiveness of the system of internal controls.

Implications: Whilst King 3 supports the unitary board principle, it could be argued that South Africa is moving towards a two-tiered governance structure with boards and audit committees both having statutory responsibilities. This is pertinent where, in the event of conflict, the audit committee’s decisions will prevail over the boards in areas where the former has legislative responsibility.

KPMG anticipates that audit committees will have to look carefully at their composition in order to have sufficient proficiency in all the areas of financial reporting, sustainability, risk management (including IT and fraud risks), internal financial controls, audit processes and corporate law. More specialists may be co-opted as attendees and advisors onto audit committees who, whilst not being directors, will have all the responsibilities and liabilities of being a director in terms of the Companies Act 71 of 2008.

We expect that many audit committees may need support in relation to the following:

- Integrated reporting and levels of independent assurance
- How the combined assurance framework addresses all significant risks
- The practicalities of how the risk committee works with the audit committee.
**Internal Audit**

King 3 requires companies to establish an internal audit function which provides assurance over the company’s governance, risk management and internal controls. Internal audit will be required to provide a written assessment of the system of internal controls and risk management to the board, as well as a written assessment of the internal financial controls to the audit committee. (King 3 differs from Sarbanes-Oxley in that no attestation is required from external auditors on internal controls on financial reporting).

**Implications:** Internal audit may require more resources to provide assurance on the system of internal control and risk management to the board. Currently in practice, many internal audit functions take care not to duplicate the work of external audit and thereby do not provide assurance on exclusively internal financial controls. Internal audit will have to determine the basis and methodology by which it can provide a written assessment on the internal financial controls to the audit committee going forward. The audit committee will have to ensure that internal audit is properly resourced and has sufficient budget.

**Risk management**

Under King 3, risk management remains important and more detailed guidance is given on how it is to be accomplished. The board is responsible for the governance of risk and disclosure, and management is responsible for the risk management design, implementation and monitoring of the risk management plan.

**Implications:** Boards will have to spend more time on risk management. Management will have to integrate risk management more fully into the running of business. The disclosure of key risks will require articulation and stakeholder management.

**IT governance**

King 3 highlights the role of IT governance and the board’s related responsibilities. The recommendations are extensive.

**Implications:** This is a new and expanded area for King. More resources, management and director time will be required to address IT governance and the related procedures and practices. IT governance will impact the risk management, assurance and reporting frameworks.

**Compliance**

King 3 states that compliance should form an integral part of the risk management function and that companies should consider establishing a compliance function.

**Implications:** There may be an increased demand for compliance officers and the role and positioning of the function will have organisational structure and reporting implications. Companies will also have to incorporate compliance methodologies into the risk management and combined assurance frameworks.

**Remuneration, disclosure and shareholders’ votes**

King 3 requires disclosure of the remuneration of each individual director and the top three most highly paid employees. Guidance is given on remuneration policy and practices, including that non-executive directors should not receive share options. King 3 recommends that the remuneration policy be put to the shareholders for a non-binding advisory vote, and that the board should determine the remuneration of the executive directors in line with the policy.

**Implications:** Companies may be concerned about the effect of disclosure on both executive remuneration negotiations in terms of staying competitive with global standards of remuneration for highly mobile executive talent, as well as the impact that it could have on labour relations locally.

**Alternate Dispute Resolution (ADR)**

There is advocacy of enforceable ADR clauses in contracts so as to efficiently resolve disputes according to parties needs, rather than just their legal rights and obligations.

**Implications:** The board will have to become involved in terms of appointing the appropriate person and there will be coordination costs.

**Director development and performance management**

King 3 recommends induction and ongoing training for directors. Performance assessments of the board, its committees and the individual directors are recommended every year.

**Implications:** Boards will have to consider whether to conduct evaluations inhouse or through independent service providers. An overview of results and action plans are recommended for disclosure. We anticipate that these recommendations will require more time commitments from directors and the company secretary.

**Conclusion**

King 3 is an aspirational code and it is likely that entities could take several years to achieve application of all the principles and best practice recommendations. The challenges will be in deciding the optimal level of application required, balancing the costs and benefits to all stakeholders, and then being able to disclose such principles and practices in a manner that is clear and understandable to stakeholders.
The third South African report on corporate governance (King 3) was released on 1 September 2009 and becomes effective on 1 March 2010. The quick reference guide that follows contains a summary and extracts of the salient details. However, the reader is encouraged to consult the full King Report and the Code of Governance Principles now available from the Institute of Directors.

Board and Directors
The board, director and company refers to the functional responsibility of those charged with governance in any entity.

Role of the board
The board should:

■ Be responsible for IT governance
■ Ensure the company complies with laws and considers rules, codes and standards
■ Ensure there is an effective risk-based internal audit function
■ Ensure integrity of the integrated report
■ Report on the effectiveness of internal controls
■ Act in the best interests of the company (including managing conflicts and dealing in securities)
■ Immediately consider business rescue proceedings should the company become financially distressed
■ Elect annually an independent, non-executive director as chairman. If the chairman is not independent or is executive, then a lead independent non-executive director should be appointed and justified in the integrated report. The CEO should not become chairman until after three years, the number of chairmanships should be considered and there should be a chairman succession plan
■ Appoint the CEO, define the board’s materiality, establish a delegation of authority, evaluate CEO performance and ensure a succession plan for the CEO and senior executives.

Structure and composition of the board
The board should comprise a balance of power with:

■ A majority of non-executive directors, of whom the majority should be independent
■ Knowledge, skills, resources, size, diversity and demographics of board to be considered
■ A minimum of two executive directors (CEO and Finance Director)
■ The CEO and chairman positions should be separate
■ One third of non-executives should rotate annually
■ Non-executive directors on the board for longer than nine years must be assessed annually for independence and this should be reported
■ Board should be able to remove any director without shareholder approval.

The King Report provides detailed guidance on the role of the chairman and the CEO.

Appointment, development and performance assessment of directors
■ A formal process should be established for appointment and development of directors
■ A nominations committee should assist with the identification and recommendation of potential directors to the board
■ Backgrounds and references should be checked before nomination
■ Letters of appointment should be provided to non-executive directors
■ Full disclosure of directors should be made to shareholders (King 3 has details of disclosure e.g. education, experience, age, other directorships, etc)
■ Directors should receive induction and ongoing training (including changes to laws, rules, standards and codes)
■ The performance of the board, its committees and individual directors should be evaluated every year by the chairman or an independent provider. Results should assist training and be disclosed in the integrated report
■ Performance evaluation results should inform the nomination for re-appointment of a director.

Company secretary
■ The board should appoint/remove, empower and be assisted by a competent, qualified and experienced company secretary (who is not a director and who is at ‘arms-length’)
■ The company secretary should assist the nominations committee, facilitate training, provide guidance to the board, keep the board and committee charters current, prepare
and circulate board papers, assist communication into and around board meetings, assist drafting workplans, keep minutes, and assist with evaluations of the board, committees and individual directors.

**Group boards of companies**

A governance framework should be agreed between the group and its subsidiary boards (subject to legal and fiduciary duties of subsidiary directors to the subsidiary company). Implementation and adoption of policies, processes or procedures of the holding company should be considered and approved by the subsidiary company and disclosed by the subsidiary company. Where the holding company of a South African subsidiary is listed on another exchange, King 3 principles should be applied to the subsidiary.

**Committees**

Audit, Risk, Nomination and Remuneration committees should be established.

Board committees should have:

- Terms of reference approved by the board that are reviewed annually
- Composition and terms of reference should be disclosed in the integrated report
- Composition should comprise a majority of non-executive directors of which the majority should be independent (risk committee may have a mixed composition – refer below)
- The chairman should not be a member of the audit committee. He/she should not chair the risk or remuneration committees but may be a member of these committees. The chairman should be a member of the nomination committee and may also be its chairman
- The CEO should not be a member of the remuneration, audit or nomination committees but should attend by invitation. CEO’s should recuse themselves when conflicts arise or when their performance and/or remuneration is discussed. CEO’s should not become a chairman of a company outside the group
- External advisors and executive directors may attend by invitation. Non-directors serving as members on committees of the board should be aware of sections 76 and 77 of the Companies Act 71 of 2008 which places the same standards of conduct and liability as if they were directors (but without the benefit of a committee vote)
- Committees should be able to take outside professional advice subject to following an approved process
- Committee chairmen should give at least an oral summary of their committee’s deliberations at the following board meeting.

**Remuneration committees and remuneration**

- Companies should remunerate directors and executives fairly and responsibly i.e. align remuneration policies to company strategy and individual performance. Detailed guidance is provided in the report as to what is considered fair and responsible remuneration practices
- The remuneration committee should assist the board with setting and administering remuneration policies (which should address base pay, bonuses, contracts, severance, retirement benefits, share and incentive schemes)
- Non-executive director fees should comprise a base and an attendance fee component. Non-executive directors and the chairman should not receive share options or other incentive awards. Non-executive director fees should be approved by shareholders in advance by way of special resolution at intervals of not more than two years
- The detail of each individual directors’ remuneration as well as that of the three most highly paid employees should be disclosed within the remuneration report in the integrated report. Other information to be disclosed should be base pay policy, participation in incentive schemes, benchmarks used, retention schemes, justifications for salaries above medians, material ex-gratia payments, executive employment policies, and maximum potential dilution from incentive awards
- Shareholders should vote a non-binding advisory vote on the company’s remuneration policy (including share schemes)
- The board should determine executive directors’ remuneration in accordance with the policy put to shareholders.

**Audit committees**

The board should ensure that it has an effective and independent audit committee, with approved terms of reference. The audit committee is an integral part of the risk management process with oversight of financial reporting risks, internal financial controls, and fraud and IT risks relevant to financial reporting.

The audit committee should:

- Consist of at least three independent members, all of whom should be independent non-executive directors. The chairman of the board should not be the chairman of, nor a member of, the audit committee. The audit committee chairman should be elected by the board, set the agenda and be present at the AGM
- Meet at least twice a year (at least once a year external and internal auditors should attend without management)
- Have sufficient qualifications and experience and be up-to-date with relevant developments
- Be able to consult with specialists subject to a board-approved process
Oversee integrated reporting (i.e. the integrity of the integrated report, its financial statements and the disclosure of sustainability for consistency with the financial information)

Recommend engaging an external assurance provider on material sustainability issues

Consider the need to issue interim results

Review summarised information and engage external auditors to provide assurance on summarised financial information

Ensure there is a combined assurance approach for assurance activities to address all significant risks

Monitor the relationship between external assurance providers and the company

Review annually and satisfy itself on the company’s finance function and disclose such in the integrated report

Oversee internal audit (including appointment/dismissal and performance management of the Chief Audit Executive (CAE), approve the internal audit plan, evaluate the document review of internal financial controls, assess internal audit performance and quality review the function, ensure properly resourced with sufficient budget)

Recommend the external audit appointment and oversee the external audit process (nomination, terms of engagement, remuneration, monitoring independence, defining non-audit services policy and pre-approval of non-audit services, be informed of Reportable Irregularities, and review quality and effectiveness of external audit process)

Report internally to the board and externally to shareholders on

- the discharge of its statutory duties
- independence of external auditor
- financial statements and accounting practices

- effectiveness of the internal financial controls
- its role, composition, meetings and activities

Recommend the integrated report for approval by the board.

Risk management

The board is responsible for the governance of risk (to be specified in the board charter). The board responsibilities include the following:

- Develop a documented risk management policy and plan, approved by the board, which policy is widely distributed
- Comment in the integrated report on the effectiveness of the risk management system and process
- Review implementation of the risk management plan at least annually, with continuous monitoring
- Determine levels of risk tolerance (annual risk tolerance to be set with risk limits and appetites)
- Appoint a risk committee which considers the risk policy, plan and monitoring. The risk committee may comprise a minimum of three members from executive, non-executive directors, senior management and independent risk experts. It should meet at least twice a year
- Evaluate the performance of the risk committee
- Delegate to management the responsibility for the risk management plan
- Ensure that risk assessments are performed on a continual basis at least once a year on a top-down approach
- Receive and review the company’s risk register (quantified where possible)
- Ensure a framework for anticipating unpredictable risks
- Ensure management continually implements appropriate risk management responses with risk monitoring
- Receive assurance on the effectiveness of risk management from management as well as a written assessment of the effectiveness of the system of internal controls and risk management from internal audit

Disclose in the integrated report its view on the effectiveness of the risk management process and any unusual risks.

IT Governance

The board is responsible for Information Technology (IT) governance.

The board should:

- Ensure IT is on the agenda, an IT charter exists, IT policies are in place, an IT internal control framework exists and independent assurance on effectiveness of IT controls is obtained
- Align IT to performance and sustainability objectives of the company
- Delegate responsibility for implementation of an IT governance framework to management (The board may appoint an IT steering committee. The CEO should appoint a suitably qualified Chief Information Officer)
- Monitor and evaluate significant IT spend in terms of value and return on investment
- Ensure protection of intellectual property, information management and security (including personal data) on IT systems
- Ensure compliance with IT laws and standards
- Obtain independent assurance on IT governance and controls on outsourced IT services.

Management should demonstrate adequate disaster recovery arrangements.

The risk committee should ensure that IT risks are adequately addressed and get appropriate assurance on controls.
The audit committee should consider IT in relation to financial reporting and the going concern.

**Compliance**
Compliance should form an integral part of the risk management process. The risk of non-compliance should be identified, assessed and responded to in the risk management process. The establishment of a compliance function should be considered.

The board should:
- Ensure the company complies with applicable laws and considers adherence to rules, codes and standards
- Delegate to management the implementation of an effective compliance framework and processes (this may include an approved compliance policy, code of conduct, structures, training, appointment of a compliance officer, key performance indicators, integration with risk management and ethics programmes)
- Monitor compliance and have it as a regular item on the board agenda
- Receive assurance on the effectiveness of compliance controls
- Disclose details on how it has established an effective compliance framework and processes, as well as disclose material or oft repeated instances of non-compliance.

**Internal audit**
The board should ensure that there is an effective risk based internal audit function which is governed by an internal audit charter approved by the board, and which adheres to the IIA Standards and code of ethics.

Internal audit should:
- Report functionally to the audit committee (CAE should report functionally to the audit committee chairman) and report at all audit committee meetings
- Evaluate the company’s governance processes
- Objectively assess the effectiveness of risk management and the internal control framework
- Analyse business processes and controls
- Provide information on fraud and unethical practices
- Have an internal audit plan that is informed by the strategy and risks
- Be independent from management and objective
- Provide a written assessment on the effectiveness of the company’s system of internal controls and risk management to the board
- Provide a written assessment of the internal financial controls to the audit committee (after formally documenting and testing internal financial controls annually).
- The CAE should be able to attend all executive committee meetings, and should develop a quality assurance and improvement programme.

**Stakeholder management**
The board should:
- Appreciate that stakeholder perceptions affect reputation and should seek to manage reputation risk
- Identify important stakeholders
- Delegate to management the responsibility to deal with stakeholder relationships
- Consider publishing stakeholder policies
- Oversee the mechanisms and processes for the constructive engagement of stakeholders
- Encourage shareholders to attend the AGM
- Disclose in the integrated report its stakeholder dealings
- Strive to achieve balancing of various stakeholders legitimate expectations in the best interests of the company
- Ensure equitable treatment of shareholders of the same class and protection of minority shareholders
- Adopt communication guidelines for stakeholder communication so that communication is clear, relevant, timely, honest and accessible to stakeholders
- Consider disclosing in the integrated report the number and refusals to information access in terms of the Promotion of Access to Information Act, 2000
- Adopt a formal dispute resolution process
- Select the appropriate individuals for Alternate Dispute Resolution (ADR) representation.

**Integrated reporting and disclosure**
The board should:
- Ensure integrity of integrated reporting. (There should be controls to ensure integrity of the integrated report. The report should be prepared annually, cover sufficient financial and sustainability performance, focus on substance over form, and describe how the company made its money)
- Delegate evaluation of sustainability disclosures to the audit committee
- Comment on the financial results
- Disclose if the company is a going concern
- Convey positive and negative impacts of operations and how these will be improved in the next year
- Delegate oversight and reporting of sustainability to the audit committee (who should ensure that sustainability reporting and disclosure is independently assured).
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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