



King III Summary

Department of Professional Practice

AUDIT





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Introduction

The “King Code and Report on Governance for South Africa” (King III) was released on 1 September 2009, with an effective date of 1 March 2010.

All entities incorporated in, or resident in South Africa, (irrespective of their manner or form of incorporation or establishment) should apply the principles in the Code. They should consider the best practice recommendations in the Report.

The Code and Report are drafted on an “apply and explain” basis – i.e. explaining how the principles and recommendations were applied, or if not applied, the reasons, results in compliance.

Practice Notes to King III will provide the necessary guidance to all entities on implementing the Code.

In reading the Code and Report, the word “must” indicates a legal requirement. The word “should” is used for aspects which will result in good governance and recommendations are indicated by the word “may”.

The Code and Report is split into the following chapters:

- 1 Ethical leadership and corporate citizenship
- 2 Boards and directors
- 3 Audit committees
- 4 The governance of risk
- 5 The governance of information technology
- 6 Compliance with laws, rules, codes and standards
- 7 Internal audit
- 8 Governing stakeholder relationships
- 9 Integrated reporting and disclosure

This document contains an overview of King III, focussing particularly on the chapters on boards and audit committees.

Ethical leadership, corporate citizenship and Boards and directors

Roles and responsibilities

King III requires the board to act in the best interests of the company and to act as a focal point for and custodian of corporate governance by:

- having a charter setting out its responsibilities
- meeting at least four times per year
- monitoring the relationship between management and the stakeholders of the company
- ensuring that the company survives and thrives.

In addition, the board should:

- provide effective leadership based on an ethical foundation
- ensure that the company is and is seen to be a responsible corporate citizen
- ensure that the company's ethics are managed effectively
- appreciate that strategy, risk, performance and sustainability are inseparable
- ensure that the company has an effective and independent audit committee
- be responsible for risk and IT governance
- ensure compliance with applicable laws and regulations
- ensure an effective risk based internal audit function
- appreciate that stakeholders' perceptions affect the company's reputation
- ensure integrity of the company's integrated report
- report on the effectiveness of internal controls
- consider business rescue proceedings as soon as the company is financially distressed
- appoint the CEO and establish a framework for the delegation of authority
- comment on the independence of the independent non-executive directors in the integrated report
- formalise a process for induction and ongoing training and development of directors
- be assisted by a competent, suitably qualified and experienced company secretary
- evaluate the performance of the board, its committees and the individual directors every year
- agree on a governance framework between the group and its subsidiary boards



- be remunerated fairly and responsibly
- ensure that the remuneration of each director and certain senior executives are disclosed
- determine the remuneration of executive directors in accordance with the remuneration policy put to shareholder's vote.

Composition

The board should be appointed through a formal process and comprise a balance of power, with a majority of non-executive directors, of which the majority should be independent. At least one-third of the non-executive directors should rotate every year. The board should review the independence of an independent non-executive director serving more than 9 years.

An independent non-executive director is a non-executive director who:

- is not a representative of a shareholder who has the ability to control or significantly influence management or the board
- does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue
- does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth
- has not been employed by the company or the group of which it currently forms part in any executive capacity, or appointed as the designated auditor or partner in the group's external audit firm, or senior legal adviser for the preceding 3 financial years
- is not a member of the immediate family of an individual who is, or has during the preceding 3 financial years, been employed by the company or the group in an executive capacity
- is not a professional advisor to the company or the group, other than as a director
- is free from any business or other relationships (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company
- does not receive remuneration contingent upon the performance of the company.

The chairman should be an independent non-executive director and not be the CEO of the entity. With regard to the chairman serving on other committees, he:

- should not be a member of the audit committee
- should not chair the remuneration or risk committee, but may be a member of it
- should be a member of the nomination committee and may also be its chairman.

Every board should have a minimum of 2 executive directors being the CEO and FD.

When determining the number of directors, the knowledge, skills and resources required for conducting business should be considered. The board should consider whether its size, diversity and demographics make it effective. Factors to be considered include:

- evolving circumstances, the needs of the company and the nature of its business
- the need to achieve an appropriate mix of executive and independent non-executive directors
- the need to have sufficient directors to structure board committees appropriately
- potential difficulties of raising a quorum with a small board
- regulatory requirements
- the skills and knowledge needed to make business judgement calls on behalf of the company.

The board, through its nomination committee, should recommend the eligibility of prospective directors and should be permitted to remove any director without shareholder approval.

Board committees

The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities. This includes risk, nomination, remuneration and audit committees, bearing in mind that audit committees also have legislative duties in terms of the Companies Act 2008.

The committees should have formal terms of reference, should be appropriately constituted and the composition disclosed in the integrated report. Other than the risk committee, they should comprise a majority of non-executive directors of which the majority should be independent.

The terms of reference of each committee should, as a minimum, cover:

- composition
- objectives, purpose and functions
- delegated authorities, including the extent of power to make decisions or recommendations or both
- tenure
- reporting mechanism to the board.

External advisors and executive directors should attend committee meetings by invitation; and committees should be free to take independent outside professional advice at the cost of the company, where necessary.

Audit committees

The Companies Act 2008 has transformed the audit committee from being a committee of the board to a separate statutory committee that is appointed by the shareholders. However, the audit committee still forms part of a unitary board even though it has specific statutory responsibilities over and above responsibilities assigned to it by the board.

An audit committee must be established by a public or state-owned company, and should be established by all other companies through incorporation in the Memorandum of Incorporation.

Roles and responsibilities

The audit committee must:

- nominate the external auditor for appointment
- approve the terms of engagement and remuneration of the external auditor
- monitor and report on the independence of the external auditor
- define a policy for non-audit services provided by the external auditor
- approve contracts for non-audit services by the external auditor
- report to the shareholders on:
 - how they carried out their duties
 - whether they are satisfied with the external auditors independence
 - their view on the financial statements and accounting practices
 - whether the internal financial controls are effective.

The audit committee should:

- have formal terms of reference approved by the board
- meet at least twice a year
- meet separately with internal and external audit at least once a year
- oversee integrated reporting, including:
 - considering all factors and risks that may impact on the integrated report
 - reviewing and commenting on the financial statements
 - reviewing the disclosure of sustainability issues
 - recommending to the board to appoint an external assurance provider on material sustainability issues
 - considering the need to issue interim results
 - reviewing the content of summarised information
 - engaging the external auditors to provide assurance on the summarised financial information



- ensure that the combined assurance model is applied to provide a coordinated approach to all assurance activities
- satisfy itself of the expertise, resources and experience of the company's finance function
- oversee the internal audit function
- be an integral component of the risk management process with regards to financial reporting risks
- be informed of any Reportable Irregularities identified and reported by the external auditor
- review the quality and effectiveness of the external audit process
- report to the board on its statutory duties and other duties assigned to it by the board
- provide the following, as a minimum, in the integrated report:
 - a summary of the role of the audit committee
 - a statement on whether or not the audit committee has adopted a formal terms of reference that have been approved by the board and if so, whether the committee satisfied its responsibilities for the year in compliance with its terms of reference
 - the names and qualifications of all members of the audit committee during the period under review, and the period for which they served on the committee
 - the number of audit committee meetings held during the period under review and members' attendance at these meetings
 - a statement on whether or not the audit committee considered and recommended the internal audit charter for approval by the board
 - a description of the working relationship with the chief audit executive
 - information about any other responsibilities assigned to the audit committee by the board
 - a statement on whether the audit committee complied with its legal, regulatory and other responsibilities
 - a statement on whether or not the audit committee recommended the integrated report to the board for approval.

Membership

The audit committee should consist of at least 3 independent non-executive directors and should have sufficient qualifications and experience to fulfil its duties. The chairman of the board should not be the chairman or member of the audit committee.

The chairman of the committee should be an independent non-executive director who should:

- be elected by the board
- participate in setting and agreeing the agenda
- be present at the AGM.

The members should keep up to date with developments and should consult with specialists or consultants where necessary. Such specialists or consultants should not be considered to be members of the committee and should not be entitled to vote on any matters.

There should be a basic level of qualification and experience for audit committee membership, therefore the nomination committee and the board should evaluate whether collectively the audit committee has an understanding of:

- integrated reporting, which includes financial reporting and standards
- internal financial controls
- external audit process
- internal audit process
- corporate law
- risk management
- sustainability issues
- IT governance as it relates to integrated reporting
- the governance processes within the company.

The collective skills of the members of the audit committee should be appropriate to the company's size and circumstances, as well as its industry.

The board must fill any vacancies on the audit committee, which will be ratified by the shareholders at the subsequent AGM.



The governance of risk

The board should be responsible for the governance of risk and set levels of risk tolerance and risk appetite annually.

The board should appoint a committee responsible for risk. This committee should:

- consider the risk management policy and plan
- monitor the risk management process
- convene at least twice per year
- be evaluated once a year by the board
- have a minimum of 3 members
- have as its members executive and non-executive directors, members or senior management and independent risk management experts to be invited in necessary.

With regards to risk, the board should:

- delegate to management the responsibility to design, implement and monitor the risk management plan
- ensure that risk assessments are performed on a continual basis
- ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks
- ensure that management considers and implements appropriate risk responses
- ensure continual risk monitoring by management
- receive assurance regarding the effectiveness of the risk management process
- ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.

The governance of IT

IT should form an integral part of the company's risk management. The board should be responsible for IT governance with the assistance of the risk and audit committees, and this should be aligned with the performance and sustainability objectives of the company.

In addition, the board should:

- delegate to management the responsibility for the implementation of an IT governance framework
- monitor and evaluate significant IT investment and expenditure
- ensure that information assets are managed effectively.





Compliance with laws, rules, codes and standards

The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards, through delegation to management of an effective compliance framework and processes.

The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business.

Compliance risk should form an integral part of the company's risk management process.

Internal audit

Companies should establish an effective risk based internal audit function that adheres to the IIA Standards and code of ethics and is mandated by a board approved internal audit charter.

The internal audit function should:

- be independent and objective
- report functionally to the audit committee
- have a standing invitation to attend executive committee meetings
- be skilled and resourced for the complexity and volume of risk and assurance needs
- develop and maintain a quality assurance and improvement programme

Internal audit should perform the following functions:

- evaluate the company's governance processes
- perform an objective assessment of the effectiveness of risk management and the internal control framework
- systematically analyse and evaluate business processes and associated controls
- provide a source of information regarding instances of fraud, corruption, unethical behaviour and irregularities
- provide a written assessment of the effectiveness of the company's system of internal controls and risk management.

The audit committee should be responsible for overseeing internal audit, including:

- approving the internal audit plan
- evaluating the performance of the internal audit function
- ensuring that the internal audit function is subjected to an independent quality review
- appointment, performance assessment and dismissal of the Chief Audit Executive
- ensuring that they are appropriately resourced and have an appropriate budget
- inviting internal audit to report at all audit committee meetings.

Governing stakeholder relationships

The board should:

- appreciate that stakeholders' perceptions affect a company's reputation
- delegate to management to proactively deal with stakeholder relationships
- strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company
- ensure equitable treatment of shareholders
- ensure transparent and effective communication with stakeholders
- ensure that disputes are resolved effectively, efficiently and expeditiously.

Integrated reporting and disclosure

The integrated report should:

- be prepared every year
- convey adequate information regarding the company's financial and sustainability performance
- focus on substance over form.

Sustainability reporting and disclosure should be integrated with the company's financial reporting and disclosure should be independently assured.

Disclaimer

This document covers certain aspects of King III and must not be read as a summary of the entire Code or Report. The information in this document is for general information purposes and does not constitute professional advice.

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