King II Report on Corporate Governance 2002

SUMMARY OF CODE OF CORPORATE PRACTICES AND CONDUCT

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1. **APPLICATION OF CODE**

1.1. The code applies to:

- All listed companies.
- Financial institutions.
- Public sector enterprises, agencies and government (local, provincial and national) departments.

1.2. All companies and their stakeholders should apply the relevant principles.

1.3. National Treasury will issue “Good Practice Guides” for the public sector.

1.4. The code will be **effective** for financial years commencing on or after 1 March 2002.

2. **BOARDS AND DIRECTORS**

2.1. **THE BOARD**

2.1.1. The Board is accountable for the performance and affairs of the company.

2.1.2. Authority should be delegated to management and board committees, but it remains the responsibility of directors.

2.1.3. The unitary board with executive and non-executive directors is appropriate for S.A. companies.

2.1.4. The Board shall:

(a) Provide **strategic direction;**

(b) Retain full and **effective control;**

(c) Comply with **laws** and **regulations;**

(d) Define levels of materiality;

(e) **Delegate** certain **powers to management;**

(f) If material, **reserve powers** to itself;

(g) Have **access** to company information and **records;**

(h) Agree a procedure to allow directors to **obtain independent professional advice;**

(i) Decide on the **number of directors** required to make the Board effective;

(j) Identify and monitor **key risk and key performance** areas;

(k) Identify and monitor **non-financial aspects;**

(l) Record **facts** and assumptions which lead it **to conclude** that the business will be a **going concern** in the next financial year (if not: what steps it is taking);

(m) Explain the **effect of all proposed resolutions** to be passed at shareholders meetings;

(n) Encourage shareowners to attend general meetings;

(o) Ensure the **Chairperson of the Audit and Remuneration** Committees and as many directors as possible attend shareholders meetings;

(p) Provide **CV's of all directors** who are to be appointed;

(q) Have a board **charter** setting out its responsibilities. This should be published in the annual report. This should, at least, make the board responsible for:

- Strategic plans;
- Monitoring operational performance;
- Monitoring performance of management;
- Determining policies and procedures;
- Risk management;
- Internal controls;
- Communications policy;
- Director selection;
- Induction of directors;
- Evaluation of directors.

(r) Determine a **balance** between **governance** constraints and **entrepreneurial** performance.

2.2. BOARD COMPOSITION

- ➢ A balance of **executive** and **non-executive** directors;
- ➢ Non-executive directors should comprise the **majority**;
- ➢ Sufficient non-executive directors should be **"independent" directors**.
- ➢ A nomination committee, consisting entirely of non-executive directors, **with the majority independent directors** and chaired by the board chairman, is to select directors in a transparent manner.
- ➢ Rotation of directors, to ensure continuity, is important.
  [See 2.4.3 (iii) for description of "independent director"]

2.3. CHAIRPERSON AND CEO

2.3.1.

- A **division of responsibilities** between CEO and Chairperson is necessary.
- This is to ensure **no one has unfettered power or authority.**
- **When CEO and Chairperson roles are combined**:
  - a deputy Chairperson who is an independent director should be appointed; or
  - there shall be a strong independent director component of the board.
  - the combined roles shall be **justified** in each year's **annual report.**
- The **performance** of the Chairperson should be **evaluated annually** or on any other basis agreed by the board**.**
- If the role of Chairperson and CEO are combined, an **independent deputy Chairperson** should lead the evaluation.
- **CEO's performance** to be evaluated by Chairperson or a sub-committee appointed by the board, not less than once a year.
- The remuneration committee shall take the performance appraisal into account when setting the CEO's remuneration.

2.4. DIRECTORS

2.4.1. No one block of individuals should dominate the Board: this can only be controlled by a **division of power.**

2.4.2. Non-executive directors shall have the skill and experience to bring to bear on:

- Strategy;
- Performance;
- Standards of conduct;
- Resources

2.4.3. The annual report shall categorise directors as:

- **Executive Director:** who is involved in day-to-day management or are employed by the company or its subsidiaries.
- **Non-executive Director:** who is not an executive director.
- **Independent Directors:** being a non-executive director who:
  - Does not represent or was not nominated by a major shareholder;
  - Was not employed by the group in the past 3 financial years;

- Is not an immediate family member of a person who is, or was in the past 3 financial years, employed in an executive capacity;
- Is not a professional advisor;
- Is not a significant supplier to, or customer of the group;
- Has no significant contractual relationship with the group;
- Is free from any business or other relationship, which could materially interfere with his/her ability to act independently.

2.4.4. A "shadow director" is a person whose directions the directors follow. The practice of using "shadow directors" is discouraged.

2.4.5.
- Executive directors should be encouraged to hold non-executive directorships in other companies;
- Non-executive directors: should consider the **number of directorships** they should hold, in order that they are able to **perform effectively.**

2.4.6.
- An **orientation programme** should be held to:
  - introduce new directors to the company;
  - brief them on their fiduciary duties.
- Directors should be briefed on new laws and regulations, from time to time.

[N.B. These are normally services to be rendered by the Company Secretary.]

2.5. REMUNERATION

2.5.1. To retain quality executives: **sufficient payment** should be made.

2.5.2. A **remuneration committee** should be appointed to consider **executive remuneration**. This should:

- Consist preferably entirely (but at least mainly) of **independent** directors;
- Make recommendations to the board;
- The CEO may attend, by invitation, for most business, but should recuse himself/herself while his/her remuneration is considered.
- An **independent** non-executive director shall be the **Chairperson** of the remuneration committee.

2.5.3. **Annual report: to disclose membership of remuneration committee.** The Chairperson of the remuneration committee to attend Annual General Meetings, to answer questions from shareowners.

2.5.4. **Annual report** to contain a declaration of individual director's remuneration, share options and other benefits.

2.5.5. Performance-related elements: to **constitute** a large portion of each executive's package.

2.5.6. Any **share options granted to non-executive directors** shall be **approved by shareowners**, usually at the Annual General Meeting and be in accordance with the provisions of the Companies Act. It is **preferable to issue shares** to directors, as part of their remuneration, rather than grant share options: because of the loss of independence by following the option route.

2.5.7. **For share options**:

- A **vesting period** is required for options to non-executive directors: to avoid short-term decision-making. The consequences of resignation and removal and the impact on independence should be evaluated by the board.
- **Re-pricing** of options: requires **shareholder approval**;
- Any **discount to ruling price**: requires **shareholder approval**.

2.5.8. **Full disclosure** is required, for each director in respect of options and other share issues.

2.5.9. An executive director's **contract** should not be for **more than 3 years**: otherwise **shareholder approval is required**.

2.5.10. The annual report should contain a "Statement of **Remuneration Philosophy"**.

2.5.11. **Succession planning** is necessary for CEO and executive management.

2.5.12. Remuneration committee is to recommend pay for non-executive directors on:

- A **merit** basis;
- Accordingly, each non-executive director will be paid an appropriate rate, which may be different to that of other non-executive directors.

2.6. BOARD MEETINGS

2.6.1.
- Board should meet at least once every three months.
- The **annual report** should **record:**
  - **Number** of meetings;
  - **Attendance** of each director at meetings.

2.6.2. Board members should be **briefed** prior to each board meeting.

2.6.3.
- Non-executive directors should have **access** to **management**, without executive directors being present.
- The whole board to set the **policy and procedure** for such access.

2.6.4. The **Board** should regularly:

- **Review processes** and procedures;
- Ensure the effectiveness of **internal controls.**

2.6.5. Board to ensure it receives **non-financial** information, to address broader stakeholder issues and measures.

2.7. BOARD COMMITTEES

2.7.1. Board **committees to assist** the board in its performance of duties. **Directors** however remain **responsible** notwithstanding delegation to a committee.

2.7.2. A **formal procedure for delegation** should exist to discharge the Board's duties and to facilitate decision-making.

2.7.3. **Board committees** require:

- Written **terms of reference/**mandates;
- Set **lifespan**.

2.7.4. **Transparency** and full disclosure of committee matters should exist.

2.7.5. All companies should have, at least:

- An **Audit Committee**;
- A **Remuneration Committee**

2.7.6. Non-executive directors should play an important part in committees.

2.7.7. Board committees, with the exception of operational committees, should be **chaired** by an **independent** (non-executive) director.

2.7.8. Independent **outside professional advice** may be sought by board committees.

2.7.9.
- The Annual Report to state:
  - Members of board committees;
  - Number of meetings held.
- Chairpersons of board committees should attend the **AGM.**

2.7.10. Board committees' performance should be regularly evaluated.

2.8. BOARD AND DIRECTOR EVALUATION

2.8.1. The board, through the nominations committee or other board committee should regularly, through **self-evaluation** by all directors, review the board's effectiveness and its consist by:

- Mix of skills;
- Experience;
- Demographics;
- Diversity.

2.8.2. The evaluation should be done **not less than once a year**.

2.9. DEADLINES IN SECURITIES

2.9.1. Board to have a **practice**:

- **prohibiting** directors and officers from **trading** in the period between the end of an accounting period and the date on which results are published; and
- The Company Secretary should implement.

2.10. COMPANY SECRETARY

The Company Secretary:

2.10.1. Has a **pivotal** role in the corporate governance;

2.10.2. Should be **empowered** by the board to enable him/her to properly perform his/her duties.

2.10.3. Is to provide directors individually and collectively with **detailed guidance** on discharging their responsibilities.

2.10.4.
- Should **induct** or participate in the induction of directors.
- Assist the Chairman and CEO in setting the annual **board plan**.
- **Administer** other **strategic** board level **matters**.

2.10.5. Provide a central source of **guidance** on:

- **Ethics**;
- Good **governance.**

2.10.6. Should be subject to a **fit and proper test**, as should directors.

3. <u>RISK MANAGEMENT</u>

3.1. RESPONSIBILITY

3.1.1.
- **Board** is responsible for the total **process of risk**.
- **Management** is responsible to the board in respect of **risk management processes** for:
  - Designing;
  - Implementing;
  - Monitoring.

3.1.2. Board, in liaison with management, to:

- **Set risk management policies**;

- Ensure these **policies are communicated** to and implemented by all **employees.**

3.1.3. The board is required:

- To decide on the **risk tolerance levels**;
- Implement an **ongoing process** to:
  - **Identify** risk;
  - **Measure** risk;
  - Proactively **manage** risks.

3.1.4. The board should use **recognized** models to provide **reasonable assurance** that risk management and internal controls are serving objectives to:

- Provide effective and efficient operations;
- Safeguard assets;
- Comply with laws and regulations;
- Ensure business is sustainable;
- Reliable reporting.
- A **responsible attitude to stakeholders**.

3.1.5. In order to make an **annual statement on risk management** in the company a systematic, **documented assessment** of key risks should be undertaken. The **board should regularly receive report on risk management** on the following risks:

- Physical and operational;
- Human resources;
- Technology;
- Business continuity;
- Credit;
- Market;
- Compliance.

Disaster recovery plans, which often involve insurance and risk funding planning, should be addressed.

3.1.6. The risk management process and evaluation of risks should be addressed by a special **committee**, or a board committee, which shall **report to the board.**

3.1.7. Risk management and internal controls should be **embedded** in day-to-day **activities.**

3.1.8. A **"whistle blowing"** process, which allows protected reporting, should be considered, to enable employees and others to report misdemeanors.

3.2. APPLICATION AND REPORTING

3.2.1. Controls, including **ethical value**, should be in place to reduce risk and attain objectives.

3.2.2. **Risk** should be **assessed in a continuous manner** and controls instituted to respond to risk.

3.2.3. Risk management systems should manage risks and protect and **enhance** the **interests** of shareholders and stakeholders.

The systems should deliver:

- Risk identification;
- A management commitment to the process;
- Risk mitigation activities;
- Documented risk communications;
- Documentation of the costs of non-compliance and losses;
- Documented internal control and risk management processes;
- Assurance of efforts to risk profile;
- A register of key risks.

3.2.4. **Key risk areas and key performance** indicators must be **identified** by the board.

3.2.5. **Management** should **report** to the board on**:**

- Effectiveness of internal controls;
- Significant control weaknesses identified;
- Action taken to reduce control weaknesses and to reduce risk;

3.2.6. The **board** should **disclose:**

- That it is **responsible for internal control** systems and risk management, which are regularly reviewed;
- That an **ongoing process for identifying, evaluating** and **managing significant risks** is and has been in place.
- An **adequate system** of internal control provides reasonable, but not absolute, assurance exists to manage risk and to achieve business objectives;
- A documented and tested **disaster recovery plan exists;**
- Material joint ventures have been:
    - dealt with as part of the group risk management; or
    - by other means: details of which should be provided.
- Any **additional appropriate information** on the risk management process should be provided.

Should the board not be able to make any of the aforementioned disclosures, this should be **explained.**

3.2.7. The review of processes may identify areas in which **risk management can be turned to competitive advantage.**

4. INTERNAL AUDIT

4.1. STATUS AND ROLE

4.1.1. When the board decides **not to implement internal audit:**

- Annual report: to **explain why;**
- Annual report: to explain **how** effectiveness of processes and systems will be **tested.**

4.1.2. An **internal audit charter** to be authorized by the board.

4.1.3. Refer Institute of Internal Auditors "Standards for the Professional Practice of Internal Auditing" for code of ethics and definition of internal auditing.

4.1.4. **Internal Audit** to **report** at an appropriately **senior level.**

4.1.5. Internal audit to:

- **Report to all audit committee meetings**;
- Have **access to Chairperson of audit committee**;
- Have **access to Chairperson of Board**;
- **Report to the CEO**.

4.1.6. The **audit committee to concur** with any decision **to appoint or dismiss** the head of internal audit.

4.1.7. When internal and external audit is provided by the same auditing firm, segregation between the functions to ensure independence, should be agreed by the:

- Board, and
- Audit committee.

4.2. SCOPE OF INTERNAL AUDIT

4.2.1. Internal audit is an independent **objective assurance** activity. It brings a disciplined approach to evaluate risk management, control and governance.

4.2.2. Effective internal audit should **provide assurance** that:

- **Risk is adequately identified** and monitored;
- **Internal** control systems are effective;
- Feedback on risk matters is effective;
- **Management** generated **information** is reliable.

4.2.3. ➢ Internal audit plan to be based on a **risk assessment** and to include emerging and existing risks;

➢ The risk assessment to be formally **reviewed** not less than once a year.

4.2.4. Internal audit **work plan** to be approved by the **audit committee.**

4.2.5. Internal audit should ensure that comprehensive assurance reviews are conducted by expert functions, without any duplication.

5. <u>INTEGRATED SUSTAINABILITY REPORTING</u>

5.1. SUSTAINABILITY REPORTING

5.1.1. A company shall report on its **policies and procedures and systems and commitments** to the following:

- ➢ Social:
- ➢ Ethical;
- ➢ Safety;
- ➢ Health;
- ➢ Environment.

5.1.2. **Stakeholder reporting** requires an integrated approach.

Issues should be **categorized** into the following reporting levels.

- ➢ First level: matters arising from documents.
- ➢ Second level: implementation of practices and the steps taken to implement.
- ➢ Third level: demonstrate the benefit of changes.

5.1.3. Boards should consider:

- ➢ **Nature** of the organization;
- ➢ **Performance expectations** consequent upon the **going concern** concept.
- ➢ Extent to which the company's action, or lack of action led to the reported matter.
- ➢ Non-financial information should be:
    - Reliable;
    - Relevant;
    - Clear and unambiguous;
    - Verifiable;
    - Timeless.

- ➢ Guidelines for **materiality** should be developed, to ensure consistent reporting.

5.1.4. The following matters require specific consideration:

- ➢ **Safety and occupational** health objectives issues, including HIV/AIDS.
- ➢ **Environmental** reporting and following the option with the least impact on the environment.
- ➢ **Social investment** policies, including black economic empowerment (including procurement and investment).
- ➢ **Human capital development**, including:
  - Number of staff;
  - Progress towards equity targets;
  - Training;
  - Opportunities for women and the previously disadvantaged.

5.2. ORGANISATIONAL INTEGRITY/CODE OF ETHICS

5.2.1. Need to set a code of ethics, for all stakeholders.

5.2.2. Commitment to the **code of ethics** to be shown by:

- ➢ **Procedures** to **implement**, monitor and enforce code of ethics at a high level;
- ➢ **Assessing integrity** when promoting;
- ➢ **Training** on company values.

5.2.3. Disclosure to include the **directors' opinion** as to the extent to which ethical standards are met.

5.2.4. Continuing **relationships** with those with lower ethical standards should be **re-evaluated.**

6. <u>ACCOUNTING AND AUDITING</u>

6.1. AUDITING AND NON-AUDIT SERVICES

6.1.1. Auditors' **independence should not be impaired.**

6.1.2. **Internal and external audit** services should **supplement** one another through good audit processes.

6.1.3. Internal and external auditors should **consult** and co-ordinate effort**.**

6.1.4. ➢ Audit committee should set the principle for the use of external **auditors for non-audit services.**

➢ Separate **disclosure** should be made to **members** of non-audit services provided by the external auditor.

6.2. REPORTING OF FINANCIAL AND NON-FINANCIAL INFORMATION

6.2.1. Audit committee: to determine whether or not **interims** should be **audited.**

6.2.2. ➢ **If** interims are **not audited:** audit committee shall report to board on the **reasons**;

➢ Interims to be adopted by board.

6.2.3. **Going concern:** The board to **minute assumptions** for its decision;

6.2.4. Internal/External audit consultation: Board to encourage.

6.2.5. Non-financial reports: Any **external validation** to be reported in annual report.

6.2.6. Communicate reports via **broad range of media** and **communication channels.**

6.3. AUDIT COMMITTEE

6.3.1. Majority of members to consist of **independent directors.**

6.3.2. **Chairperson** of audit committee:

➢ **Independent**;

➢ Board Chairperson should not be a member of the audit committee

6.3.3. **Written terms of reference** should be given to the audit committee to deal with:

➢ Membership;

➢ Authority;

➢ Duties.

6.3.4. **Annual Report**: to indicate:

➢ If written terms of reference are given;

➢ If the committee **has complied with its terms** of reference.

6.3.5. ➢ Annual report: to **disclose membership;**

➢ **Chairperson** of the Audit: to attend AGM: to answer relevant questions.

7. RELATIONS WITH SHAREOWNERS

7.1. **Dialogue with institutional investors** by constructive engagement will assist in understanding objectives.

7.2. Institutional investors should take all relevant factors into account.

7.3. **Notices** of general meetings shall **explain the effect of all items** of special business.

Reasonable time should be allowed for discussion at general meetings.

7.4. **Use of a poll** at general meetings should be considered for contentious issues.

The results of decisions should be published.

8. COMMUNICATION

8.1. It is the board's responsibility to **report**, on significant and relevant matters, in a balanced and understandable manner.

8.2. Reports should be:

- Transparent;
- Reflect accountability;
- Objective;
- Comprehensive.

8.3. **A balance between positive and negative** is required to ensure a full, fair and honest account of performance.

8.4. The **directors' report** should contain:

- Directors' responsibility to report fairly.
- An auditor's report on financial statements.
- Adequate:
  - Accounting records kept;
  - Internal control;
  - Risk Management
- Consistent and appropriate accounting policies and prudent judgments have been applied.
- Accounting standards were followed with **departures quantified and explained.**
- A statement that there is no reason to believe that the company will not be a **going concern** in the year ahead.
- The provisions of the Code of Corporate Practice and Conduct followed.

9. IMPLEMENTATION OF THE CODE

All boards and individual directors are responsible to ensure that the principles contained in the Code are observed.