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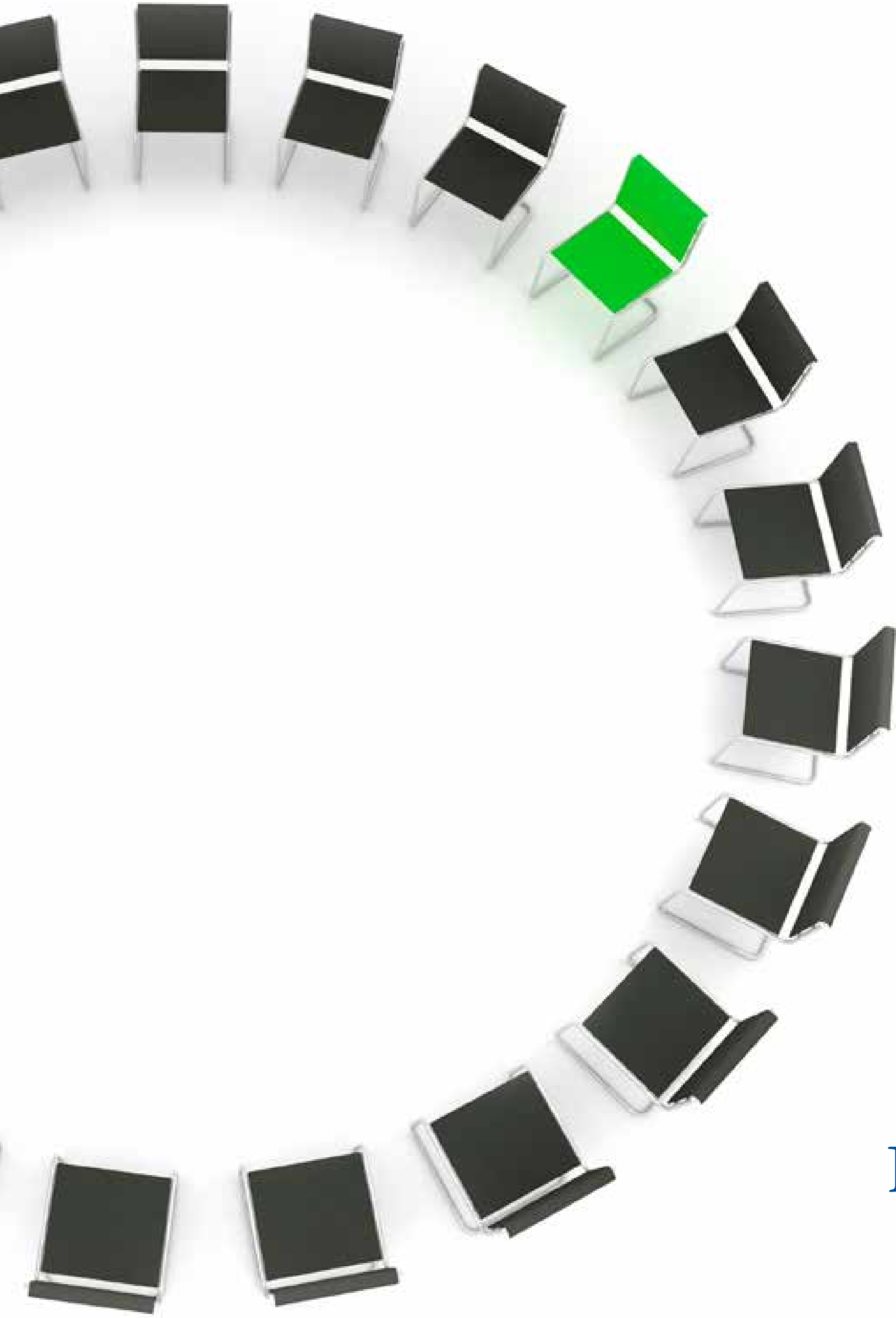

Duties of Directors

April 2013

The question of corporate governance as it pertains to directors is a very wide-ranging topic. This booklet is intended to provide general guidance in this regard only, and does not purport to cover all possible issues relating to the topic. For specific guidance, we suggest you contact Deloitte & Touche.

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Preface

A key feature of the Companies Act, 2008 (the Act) is that it clearly emphasises the responsibility and accountability of directors.

Recent international and local jurisprudence also underline the demanding standard of conduct that is expected of company directors, all of which South African company directors would do well to take very thorough notice of.

The Act reduces the company's reliance on the regulator, the Companies and Intellectual Property Commission (CIPC). Although companies still have to comply with various administrative processes to inform the CIPC of its decisions (for example the appointment of directors, changing of auditors, change of year end, amendment of the Memorandum of Incorporation, etc.), the validity of these decisions are generally not dependent on the approval of the CIPC. In most instances, the company's decision is effective immediately and it merely needs to inform the CIPC of decisions or actions. However, in a few instances the effect of the decision is delayed until the necessary Notices have been 'filed' with the CIPC. 'Filing' in terms of the new Act simply means that the Notice had been received by the CIPC (recorded in the CIPC's computer system, or the date on which registered or other mail is received by the CIPC). The CIPC is not required to approve or vet any decisions or actions of the company.

The counter balance to the diminished role of the regulator is greater emphasis on the role of the directors of the company. The construction is that by accepting their appointment to the position, directors tacitly indicate that they will perform their duties to a certain standard, and it is a reasonable assumption of the shareholders that every individual director will apply his or her particular skills, experience and intelligence appropriately and to the best advantage of the company. In this regard, the Act subscribes to the "enlightened shareholder value approach" – which requires that directors are obliged to promote the success of the company in the collective best interest of shareholders. This includes, as appropriate, the company's need to take account of the legitimate interests of other stakeholders including among others, the community, employees, customers and suppliers. Also, the social responsibility of the company (and the directors) was noted in Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and others 2006 (5) SA 333 (W), emphasising the broader responsibility of the directors and the company. In this case the court made direct reference to the King Code, which is interpreted by some as evidence that the King Code has de facto become part of the duties of directors.

The Act codifies the standard of directors' conduct in section 76. The standard sets the bar very high for directors, with personal liability where the company suffers loss or damage as a result of the director's conduct not meeting the prescribed standard. The intention of the legislature seems to be to confirm the common law duties and to encourage directors to act honestly and to bear responsibility for their actions - directors should be accountable to shareholders and other stakeholders for their decisions and their actions on behalf of the inanimate company. With the standard set so high, the unintended consequence may be that directors would not be prepared to take difficult decisions or expose the company to risk. Since calculated risk taking and risk exposure form an integral part of any business, the Act includes a number of provisions to ensure that directors are allowed to act reasonably without constant fear of personal exposure to liability claims. In this regard, the Act has codified the business judgement rule, and provides for the indemnification of directors under certain circumstances, as well as the possibility to insure the company and its directors against liability claims in certain circumstances.

The Act makes no specific distinction between the responsibilities of executive, non-executive or independent non-executive directors (in order to understand the distinction between different types of directors we turn to the King Report of Governance for South Africa, 2009 (King III) for guidance). The codified standard applies to all directors. In CyberScene Ltd and others v iKiosk Internet and Information (Pty) Ltd 2000 (3) SA 806 (C) the court confirmed that a director stands in a fiduciary relationship to the company of which he or she is a director, even if he or she is a non-executive director.

In terms of this standard a director (or other person to whom section 76 applies), must exercise his or her powers and perform his or her functions:

- in good faith and for a proper purpose;
- in the best interest of the company; and
- with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions and having the general knowledge, skill and experience of that particular director.

In essence, the Act combines the common law fiduciary duty and the duty of care and skill. This codified standard applies in addition to, and not in substitution of the common law duties of a director. In fact, the body of case law dealing with the director's fiduciary duty and the duty of care and skill remains applicable.

All directors are bound by their fiduciary duty and the duty of care and skill. The codified standard of conduct applies equally to all the directors of the company. Of course, it is trite that not all directors have the same skill and experience, and not all directors have a similar understanding of the functioning of the company. This raises the question as to what is expected of different types of directors when it comes to their duties. In this regard, the court, in *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd 1980 (4) SA 156 (W)* made it clear that the test is applied differently to different types of directors. The court concluded that the extent of a director's duty of care and skill depends on the nature of the company's business, that our law does not require a director to have special business acumen, and that directors may assume that officials will perform their duties honestly.

The test for the duty of care and skill as contained in the Act provides for a customised application of the test with respect to each individual director – in each instance both the objective part of the test (measured against a person carrying out the same functions as that director), as well as the subjective element of the test (measured against a person having the same knowledge, skill and experience as that director) will be applied. Thus, even though all directors have the same duties, the measurement against the standard of conduct will account for the personal circumstances of each director.

As stated above, the Act also codifies the business judgment rule. In terms of this rule a director will not be held liable if he or she took reasonable diligent steps to become informed about the subject matter, did not have a personal financial interest (or declared such a conflicting interest) and the director had a rational basis to believe that the decision was in the best interest of the company at the time.

In discharging any board or board committee duty, a director is entitled to rely on one or more employees of the company, legal counsel, accountants or other professional persons, or a committee of the board of which the director is not a member. The director, however, does not transfer the liability of the director imposed by this act onto such employee, nor can a director blindly rely on the advice of employees or advisors.

In a recent *Australian judgment, Australian Securities and Investments Commission v Healey [2011] FCA 717*, commonly referred to as the Centro case, the court re-emphasised the responsibility of every director (including non-executive directors) to pay appropriate attention to the business of the company, and to give any advice due consideration and exercise his or her own judgment in the light thereof. This case is relevant to directors of South African companies, because the new Act indicates that a court, when interpreting or applying the provisions of the Act, may consider foreign company law.

In this case the non-executive Chairman, six other non-executive directors and the Chief Financial Officer of the Centro Property Group ("Centro") faced allegations by the Australian Securities and Investments Commission that they had contravened sections of the Corporations Act 2001 *arising from their approval of the consolidated financial statements of Centro, which incorrectly reflected substantial short-term borrowings as "non-current liabilities"*. Similar to our Companies Act, the Australian Corporations Act also requires the board to approve the financial statements.

The relevant detail facts are that the 2007 financial statements of Centro Properties Group failed to disclose, or properly disclose, significant matters. The statements failed to disclose some AUS$1.5 billion of short-term liabilities by classifying them as non-current liabilities, and failed to disclose guarantees of short-term liabilities of an associated company of about US$1.75 billion that had been given after the balance sheet date, but before approval of the statements.

The central question in those proceeding were whether directors of substantial publicly listed entities are required to apply their own minds to, and carry out a careful review of, the proposed financial statements and the proposed directors' report, to determine that the information they contain is consistent with the director's knowledge of the company's affairs, and that they do not omit material matters known to them or material matters that should be known to them. In short, the question was to what extent reliance may be placed on the audit committee and the finance team.

In analysing the director's duty of care and skill, the court commented that:
"all directors must carefully read and understand financial statements before they form the opinions which are to be expressed ... Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director. These include the following:

- a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged;
- a director should keep informed about the activities of the corporation;
- whilst not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies;
- a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements;
- a director, whilst not an auditor, should still have a questioning mind."

Several statements were made in which it became apparent that every director is expected to apply his or her own mind to the issues at hand. Even though directors may rely on the guidance and advice of other board committees, employees and advisors, they nevertheless need to pay attention and apply an enquiring mind to the responsibilities placed upon him or her.

"…. a director is not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside the area of the director's expertise."

"… Whether, for instance, a director went through the financial statements 'line by line', he is not thereby taking all reasonable steps, if the director in doing so is not focussed for himself upon the task and considering for himself the statutory requirements and applying the knowledge he has of the affairs of the company".

A key statement made by the judge is as follows:
"Nothing I decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her."

The court concluded that in the Centro case each director failed to exercise the degree of care and diligence required by law in the course of their review of the financial statements, and as such can be held liable for the losses suffered by that company as a result of their failure to comply with their duties.

South African case law echoes the findings of the Centro judgment. In *Fisheries Development Corporation of SA Ltd v AWJ Investments* (Pty) Ltd 1980 (4) SA 156 (W) the court stated that: "Nowhere are [the director's] duties and qualifications listed as being equal to those of an auditor or accountant. Nor is he required to have special business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company... He is nevertheless expected to exercise the care which can reasonably be expected of a person with his knowledge and experience... a director is not liable for mere errors of judgment. In respect of all duties that may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgment, information and advice of the management, unless there are proper reasons for querying such. Similarly, he is not expected to examine entries in the company's books... Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof".

How do these judgments affect the position of directors (especially non-executive directors) where the audit committee considered complex financial reports? Are non-executive directors nevertheless expected to review such reports and vote on applicable resolutions? The answer seems to be 'yes'. The obligation to approve the financial statements of the company rests equally on each director. As such, every director has to study the relevant reports, and ensure for himself that the content of the report confirms and coincides with his view of the business. No director is entitled to blindly rely on the conclusions of the audit committee, the finance team or other experts.

These judgements emphasise the fact that the decision to accept appointment to the board of a company should not be taken lightly. A director cannot uncritically rely on the officials of the company, or on the other members of the board for the decisions of the company, but needs to be confident that he or she is able to pay adequate personal attention to the business of the company. Even though directors are entitled to rely of the guidance and advice from employees, advisors and other board committees, each director is obliged to apply their own mind (i.e. bring their own skill and experience to bear) to the facts at hand. They are not entitled to blindly rely on advice. What each director is expected to do is to ensure that they make a concerted effort to understand the business of the company and the information placed in front of them, and to apply an enquiring mind to such information.

1. What is a Director?

> "At common law, once a person accepts appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf."

Howard v Herrigel 1991 2 SA 660 (A) 678

The term "director" has been defined in law. The Companies Act, 2008 (the Act) defines a director as: "A member of the board of a company..., or an alternate director of a company and includes any person occupying the position of director or alternate director, by whatever name designated".

In terms of section 66 of the Act, the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company. The powers of the board may be limited by specific provisions of the Act or by the company's Memorandum of Incorporation.

It is interesting to note that the definition of a director includes not only those individuals that are appointed to the board of the company (as well as alternate directors), but also "any person occupying the position of director or alternate director, by whatever name designated". The effect of this wide definition is that the provisions will apply not only to members of the board, but also to "de facto" directors.

> *"A de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person is a de facto director of a company, it is necessary to plead and prove that he undertook the functions in relation to the company which could properly be discharged only by a director."*
>
> ***Re Hydrodam (Corby) Ltd [1994] 2 BCLC (Ch); [1994] BCC 161 at 183***

The Act requires private companies and personal liability companies to appoint at least one director, whereas public companies, state owned companies and non-profit companies are required to appoint at least three directors. This number would be in addition to the number of directors required where an audit committee and/or social and ethics committee is required (see 2.2 below).

It should be noted that this is the minimum requirement. Given the complexities of running a corporate, it may be necessary to appoint more directors. Furthermore, where companies apply the governance principles set out in the King Report on Governance for South Africa (King III), it may be necessary to have more than the minimum number of directors.

In general terms, the directors of a company are those individuals empowered by the Memorandum of Incorporation of that company to determine its strategic direction. As a consequence of the nature of a company, being a lifeless corporate entity, human intervention is required to direct its actions and therefore determine its identity.

The directors are entrusted by the shareholders of the company with the ultimate responsibility for the functioning of the company. While some of the day-to-day running of the company is generally delegated to some level of management, the responsibility for the acts committed in the name of the company rests with the directors.

1.2 Prescribed officers

Prescribed officers include every person, by whatever title the office is designated, that:

- exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
- regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

Most of the provisions in the Act pertaining to directors apply equally to prescribed officers. The Act determines that prescribed officers are required to perform their functions and exercise their duties to the standard of conduct as it applies to directors. Prescribed officers will be subject to the same liability provisions as it applies to directors. As is the case with directors, the remuneration paid to prescribed officers must be disclosed in the annual financial statements. The following provisions, inter alia applicable to directors, will also apply to prescribed officers:

- Section 69 – Ineligibility and disqualification of persons to be directors or prescribed officers;
- Section 75 – Directors' personal financial interest;
- Section 76 – Standards of directors' conduct;
- Section 77 – Liability of directors and prescribed officers;
- Section 78 – Indemnification and directors' insurance; and
- Section 30(4) and 30(5) – Disclosure of remuneration.

A person will be a prescribed officer regardless of any title or office they are designated.

Although it is not a legislative requirement, it is recommended that the board records the names of all those individuals which are regarded as prescribed officers. The list of names will be necessary, among other requirements, when the company has to disclose the remuneration paid to or receivable by its prescribed officers in the annual financial statements.

Note that regardless of whether a company has officially identified a particular individual as a prescribed officer or not, that person may nevertheless be classified as a prescribed officer to the extent that the person's role in the company meets the definition.

In order to determine who the prescribed officers of the company are, one will have to apply a certain degree of judgment. Management will have to consider all the relevant provisions of the definition, such as "general executive management" and "control" and "significant portion of the business and activities" in the context of their specific company in order to identify the prescribed officers of the company.

The meaning of *general executive control and management* needs to be determined in view of the organisational and governance structure of the company. *Executive control and management* should be distinguished from ordinary control and management carried out in the day to day functioning of the company. Where a person is responsible for implementing specific decisions of the board, he will in all likelihood not be regarded as a prescribed officer, as the exercise of those functions will not be equated with *executive* management or control. Further, the company will have to determine, in its particular circumstances and in view of the company's structure, which parts of the company, if any, are regarded as a *significant* portions of the company.

Not every division or business unit will necessarily be regarded as a significant portion of the business, and only persons that exercise general executive control over or management of a significant portion of the company are regarded as prescribed officers.

A person does not have to be employed by a particular company to be classified as a prescribed officer of the company.

The intention of the legislature seems to be to classify as prescribed officers those individuals that are not appointed to the board of the company (thus, they are not directors) but nevertheless act with the same authority as that of a director (executive management and control). In an earlier draft of the Regulations, a prescribed officer was defined as anyone that has a significant impact on the management and administration of the company. This definition was much wider and included most of the (senior) management of a company. However, the definition in the final Regulations limits the scope to only those individuals that exercise "executive" management and control – this would limit the prescribed officers to only those individuals that have executive authority in the company, and it would exclude ordinary managers, even senior managers (depending of course on the organisational and governance structure of the company). Persons may be classified as prescribed officers under the following circumstances:

- A member of a company's executive committee
- The senior financial manager in a company that does not have a financial director
- A chief executive officer
- Regional manager (eg "Africa manager: Sales")

A company secretary that performs the role contemplated in King III (i.e. advising the board but not taking decisions on behalf of the board) would generally not be classified as a prescribed officer. Also, persons that perform an important operational role, but not general executive management and control functions, would not be prescribed officers.

1.3 The legal status of a director

The Act assigns to directors the authority to perform all the functions and exercise all the powers of the company. It sets out the minimum standard of conduct, and provides for personal liability where a director does not perform to the said standard. The Act does not specifically comment on the legal status of a director.

Where no express contract has been entered into between the company and its directors, the provisions contained in the Act and the company's Memorandum of Incorporation are generally viewed as guiding the terms of the relationship that the director has with the company.

Directors have been alternately viewed as trustees, agents, managers and caretakers of the companies they serve. Whatever the view taken, a director occupies a position of trust within the company.

1.4 The different types of directors

In law there is no real distinction between the different categories of directors. Thus, for purposes of the Act, all directors are required to comply with the relevant provisions, and meet the required standard of conduct when performing their functions and duties.

It is an established practice, however, to classify directors according to their different roles on the board. King III has provided definitions for each type of director.

The classification of directors becomes particularly important when determining the appropriate membership of specialist board committees, and when making disclosures of the directors' remuneration in the company's annual report.

Executive director

Involvement in the day-to-day management of the company or being in the full-time salaried employment of the company (or its subsidiary) or both, defines the director as executive.

An executive director, through his or her privileged position, has an intimate knowledge of the workings of the company. There can, therefore, be an imbalance in the amount and quality of information regarding the company's affairs possessed by executive and non-executive directors.

Executive directors carry an added responsibility. They are entrusted with ensuring that the information laid before the board by management is an accurate reflection of their understanding of the affairs of the company.

King III highlights the fact that executive directors need to strike a balance between their management of the company, and their fiduciary duties and concomitant independent state of mind required when serving on the board. The executive director needs to ask himself "Is this right for the company?", and not "Is this right for the management of the company?"

Non-executive director

The non-executive director plays an important role in providing objective judgement independent of management on issues facing the company.

Not being involved in the management of the company defines the director as non-executive. Non-executive directors are independent of management on all issues including strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and evaluation of performance.

The non-executive directors should meet from time to time without the executive directors to consider the performance and actions of executive management.

An individual in the full-time employment of the holding company is also considered a non-executive director of a subsidiary company unless the individual, by conduct or executive authority, is involved in the day-to-day management of the subsidiary.

King III Report Annex 2.3

Independent director

An independent director is defined in detail in King III. In essence, an independent 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 or her 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 three financial years
- is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity
- is not a professional adviser to the company or the group, other than as a director
- is free from any business or other relationship (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, or
- does not receive remuneration contingent upon the performance of the company.

King III suggests that it may be useful to appoint a lead independent director who, as a result of his or her senior status, has the authority to facilitate any issues that may arise between executive and non-executive directors of the board. Such a function is noted as being especially relevant where the chairperson is an executive director.

1.5 Personal characteristics of an effective director

The role of a director, whether executive or non-executive, is a particularly challenging one. While all appointments have their own unique demands, there are a number of characteristics that can contribute to the effectiveness of a director.

Some such characteristics may include:

- Strong interpersonal and communications skills
  Increasingly, directors are being expected to represent the company at shareholders' meetings and in discussions with third parties such as analysts and the media. An obvious advantage is therefore the ability to clearly and definitively present the company's position.
- Energy
  Directors typically have a number of competing commitments and priorities. Where critical decisions are being made on a daily basis, directors are constantly challenged to maintain their energy levels and enthusiasm.
- Of independent mind
  A director is expected to apply his or her independent judgment to all issues presented to the board. Directors are increasingly required to take a stand when, in his or her mind, the company's long term future is not being prioritised, no matter what the consequences.
- A strategic thinker
  The primary duty of the director is to guide the company to long-term prosperity. This often requires the individual to be able to assess the long-term consequences of decisions taken.
- Analytical
  Directors are often presented with problems that have a number of potential solutions, and the ability to sift through data to find an answer is a valuable personality trait.

In addition to personal characteristics, a number of experiential factors may contribute to the effectiveness of a director. Such factors are not mandatory for all directors, but can often be persuasive in evaluating an individual for appointment.

- International exposure
  South African firms are increasingly competing on the world stage. This competition brings with it a number of unique challenges. A director that brings to the board an international focus and an exposure to global benchmarks and processes is becoming more and more valuable.
- Industry expertise
  The board is enriched by any individual that can contribute knowledge of the particular industry when evaluating issues and decisions made at the company.
- Financial knowledge
  All businesses are becoming increasingly driven by financial and accounting considerations. Having the ability to evaluate the financial implications of an action or decision is definitely an advantage as a director.

2. Appointment of a director

Shareholders are ultimately responsible for the composition of the board and it is in their own interests to ensure that the board is properly constituted from the viewpoint of skill and representivity.

King III Principle 2.19 par 80

Certainly one of the most important responsibilities of shareholders is the appointment of directors. While the Act and the company's Memorandum of Incorporation may prescribe the required qualifications and disqualifications for appointment as a director, it is vitally important that the existing directors assess the qualitative characteristics necessary in an individual to effectively perform their functions and integrate with the culture and style of the organisation.

From a legal perspective, it is important to ensure that the required procedures of the appointment as set out in the Act and the company's Memorandum of Incorporation are carried out correctly. This amy avoid any unwanted ramifications in the future.

In practice, companies may encounter difficulties in identifying suitable individuals to approach as potential directors. The directors of small companies are often hampered by the fact that they do not possess the extensive network of contacts that the directors of larger companies have.

In such instances it is often best to enquire of the company's auditors or other professional advisors, or to contact a professional organisation such as the Institute of Directors to identify suitable individuals. Further, companies could make use of executive search agencies to identify suitable individuals for consideration.

2.1 Who qualifies as a director?

With a few specific exceptions, anyone can be appointed as a director of a company.

Legal qualities required to be a director

The Act is the primary determinant of who may or may not be appointed to be a director. A company's Memorandum of Incorporation may provide additional grounds for ineligibility or disqualification, or minimum qualifications to be met by directors.

Section 69 of the Act in essence provides that any person is ineligible for appointment as director, if that person is a juristic person, an unemancipated minor (or is under a similar legal disability), or does not satisfy the qualifications as per the company's Memorandum of Incorporation. Also, a person is disqualified from being a director, if the person:

- has been prohibited to be a director by the court
- has been declared by the court to be delinquent in terms of this Act or the Close Corporations Act
- is an unrehabilitated insolvent
- is prohibited in terms of any public regulation to be a director of the company
- has been removed from an office of trust, on the grounds of misconduct involving dishonesty, or
- has been convicted and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence under the Companies Act, the Insolvency Act, the Close Corporations Act, the Competition Act, the Financial Intelligence Centre Act, the Securities Services Act, or the Prevention and Combating of Corruption Activities Act.

It is interesting to note that the Act provides the courts with wide discretion to either extend any disqualification for no longer than a period of five years at a time, or to exempt any person from the disqualifications as set out above.

The Act determines that the appointment of an ineligible or disqualified person as director is null and void.

Register of Directors

The Act requires the Commission to maintain a public register of persons who are disqualified from serving as a director, or who are subject to an order of probation as a director, in terms of an order of a court.

2.2 The legal mechanics of appointment

Directors are either appointed or elected. The Act provides that the company's Memorandum of Incorporation may provide for:

- the direct appointment and removal of directors by any person who is named in, or determined in terms of, the Memorandum of Incorporation (e.g. shareholder representative)
- ex officio directors (e.g. the CEO), and
- the appointment of alternate directors.

The Act makes it clear that, in the case of a profit company other than a state-owned company, the Memorandum of Incorporation must provide for the election by shareholders of at least 50% of the directors, and 50% of any alternate directors.

The first directors of the company

The Act determines that each incorporator of a company will also be a first director of that company. This directorship will be temporary and will continue until a sufficient number of directors have been first appointed or first elected in terms of the requirements of the Act.

The first appointment of directors should be done in terms of the provisions of the company's Memorandum of Incorporation (e.g. the Memorandum of Incorporation may permit the majority shareholder to appoint a certain number of directors). The first election of directors should be done in accordance with the provisions of section 68 (see below).

The required number of directors may be determined either in terms of the Act (private companies and personal liability companies to appoint at least one director, whereas public companies, state owned companies and non-profit companies are required to appoint at least three directors) or the company's Memorandum of Incorporation. It should be noted that the number of directors as prescribed by the Act is in addition to the directors that must be appointed to serve on the audit committee or social and ethics committee.

If not enough directors are either first appointed or first elected to meet the required number of directors as required in terms of the Act or the company's Memorandum of Incorporation, the board must call a shareholders' meeting within 40 days of incorporation to elect a sufficient number of directors.

Election of directors by the shareholders

While it is usually the directors themselves who identify and nominate a new director to be elected to their number, it is the responsibility of the shareholders to evaluate and legally appoint each new director.

In terms of section 68 of the Act each director must be voted on by a separate resolution at a general meeting of the company. Once elected, the person will become a director only once written consent to serve as a director was delivered to the company. The company's Memorandum of Incorporation may prescribe a different process for the election of directors by the shareholders. However, it should be noted that this must still amount to an 'election'.

If a vacancy arises on the board, other than as a result of an ex officio director ceasing to hold that office, it must be filled:

- by a new appointment, if the director was appointed by a person identified in the Memorandum of Incorporation, or
- by a new election conducted at the next annual general meeting of the company (in the case of a public company and a state owned company), or
- in any other case, within six months after the vacancy arose at a shareholders meeting called for the purpose of electing the director. In the latter instance, the election may be conducted by means of a written poll of the persons entitled to exercise voting rights in an election of the director.

King III proposes that a formal and transparent board appointment process be implemented. The JSE Listings Requirements require listed companies to have a policy detailing the procedures for appointments to the board of directors. The board, assisted by a nominations committee, should identify potential candidates and ensure that all such candidates will be in a position to contribute to the combined skill and experience of the board. The nominations committee (or the board) has to perform a background check on candidates. When considering candidates, cognisance should be taken of the following:

- the knowledge and experience required to fill the gap on the board
- the apparent integrity of the individual, and
- the skills and capacity of the individual to discharge these duties to the board.

Notwithstanding the consideration and evaluation of candidates, the onus is on the individual candidate to determine whether or not they have the time, skill, experience, and capacity to make a meaningful contribution to the company. They should consent to serve as a director only if they are of the opinion that they meet the requisite requirements and would be in a position to commit the time necessary to discharge their duties.

This is especially true for non-executive directors. Prior to accepting an appointment as director, they should consider the time and dedication required, and they should not accept an appointment if they would not be able to exercise the necessary care, skill and diligence. King III does not prescribe a maximum number of directorships for non-executive directors.

The appointment of a non-executive director should be formalised in an agreement between the director and the company.

Even though executive directors may accept non-executive directorships, they should consider their responsibilities and only accept such appointment in consultation with the CEO and chairman.

It is important when identifying new directors to consider the balance of power and authority at board of directors' level, to ensure that no one director has unfettered powers of decision-making.

The JSE Listings Requirements require that the company inform the JSE of any new appointments of directors (including the change of important functions on the board, or change of executive responsibilities of a director) by the end of the business day following the decision, or receipt of notice of the change. This information must also be disclosed on the JSE's news service SENS.

Where a director retires by rotation and is re-appointed, no notice needs to be given to the JSE.

The minimum number of directors

The Act requires private companies and personal liability companies to appoint at least one director, whereas public companies, state owned companies and non-profit companies are required to appoint at least three directors. This prescribed number of directors is in addition to the number of directors appointed to the audit committee and/or the social and ethics committee.

All public companies and state-owned companies need to appoint an audit committee comprising at least three directors that meet the prescribed criteria. All listed public companies and state-owned companies (as well as those other companies that would have scored at least 500 public interest points in any two of the last five financial years) must appoint a social and ethics committee comprising at least three directors or prescribed officers, of which one director must be an independent non-executive director. It is, however, permitted for committee members to serve on more than one committee. Thus, the members of the audit committee may also serve on the social and ethics committee. As such, the minimum prescribed number of directors for a public company is six (i.e. three directors as required by the Act, plus three committee members). Note: the obligation to appoint an audit committee and/or a social and ethics committee does not apply where the company in question uses the said committee of its holding company. In such an instance, the minimum number will be one director for private companies and personal liability companies, whereas public companies, state owned companies and non-profit companies are required to have at least three directors.

Any failure by a company at any time to have the minimum number of directors required by the Act or the company's Memorandum of Incorporation, does not limit or negate the authority of the board, or invalidate anything done by the board or the company.

Where the company is listed, Schedule 10 to the JSE Listings Requirements states that the company should have at least four directors.

The Register of Directors

The Act requires every company to keep a record of its directors. This record should be in written form, or other form as long as the information can be converted into written form within a reasonable time. The register of directors of a company must be open to inspection by any person who holds a beneficial interest in any securities issued by a profit company, or who is a member of a non-profit company, as well as any member of the public.

A record of its directors should comprise details of any person who has served as a director of the company, and include:

- full name
- identity number or date of birth
- nationality and passport number
- occupation
- date of their most recent election or appointment as director of the company
- name and registration number of every other company or foreign company of which the person is a director, and in the case of a foreign company, the nationality of that company, and
- any other information as required by Regulations.

These records should be kept for a period of seven years after the person ceases to serve as a director.

One of the details required by the Act to be entered is that of the other companies for which the individual also serves as a director. In practice, these details are often insufficient as the company secretary may struggle to obtain the information from the director, and to keep it current. The information does, however, serve as an important record in distinguishing between independent and non-executive directors.

2.3 What a new director should be told

King III recommends that when a new director is appointed to the board, he or she should receive the necessary induction to familiarise themselves with the duties and responsibilities of a director generally (where the individual has not performed the role previously), and with the issues specific to the company such as operations, business environment and general sustainability matters.

A formal programme should be designed to increase the awareness and effectiveness of each director appointed (both new and existing director). While the responsibility for this process lies with the chairperson, it is suggested that the company secretary is the best person to actually perform the induction and development programme.

Orientation of inexperienced directors

The functions and responsibilities of a director are unlike any other management position. Therefore, even when an individual has served for a considerable period of time as a member of senior management, the responsibilities assumed on the appointment as a director are unique to that position.

There are certain critical issues that should be communicated to a new, inexperienced director:

- **The time horizon of any decisions made**
  Most individuals, certainly when acting in a managerial capacity, become accustomed to dealing with a short time horizon. This arises due to the numerous deadlines imposed, and the importance ascribed to accounting results.

  The director's role is not to maximise short-term returns, but should rather attempt to safeguard the sustainable development of the company in the long-run. Decisions should therefore be taken that are in the long-term interests of the company, and not to boost the next earnings statement.
- **The independent frame of mind required**
  Managers in the business world are often accused of not being "team-players" when they criticise a decision made by their peers or superiors.

  It should be stressed that the director's role is to take a step back and critically assess the motivation and consequences of a decision, and where necessary, to put forward a reasoned view.
- **Personal liability of directors**
  Directors are often surprised by the high level of personal risk that they bear through their position.

  The legal framework in South Africa (which extends far beyond the Companies Act) is increasingly looking to make directors liable in their personal capacity for actions of the company.

It is only fair that an individual be given the opportunity to weigh up any risks against the rewards from serving as a director.

Each company and industry has its own unique issues. It is therefore vital for all directors to understand what these issues are and what their impact on the company is.

It may be beneficial for an experienced member of the board to introduce the new director to these issues, which may include:

- **Specific risks and the management thereof**
  The pertinent risks present in the industry, and those specific to the company, as well as the ways in which the board manages these risks.
- **Key members of senior management**
  New directors should be introduced to the various members of management on whom the directors depend for information.
- **Pertinent accounting issues**
  With accounting decisions driving a company's share price to a greater extent than ever before, it is important that all directors are aware of the material choices that have been made, and the extent to which these choices influence the company's results.
- **Quality of information and internal controls**
  Directors should satisfy themselves of the veracity of the information received from management, and the state of the internal control environment at the company.
- **The board's relationship with internal and external audit**
  The directors make certain assertions in the annual report, including:
  - the accounting results are free from misstatement, and that the internal controls at the company are operating effectively
  - the company will be a going concern in the foreseeable future, and
  - the risk management framework and processes within the company are adequate to manage the risks inherent in the business.

In order to make such statements, the directors rely to an extent on assurances provided to them by the internal and external audit functions. It is therefore important for a director to understand the sources and reliability of this assurance.

3. Director conduct

"It is unhelpful and even misleading to classify company directors as "executive" and "non-executive" for purposes of ascertaining their duties to the company or when any or specific or affirmative action is required of them. No such distinction is to be found in any statute. At common law, once a person accepts appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf. That is the general rule and its application to any particular incumbent of the office of director must necessarily depend on the facts and circumstances if each."

Howard v Herrigel 1991 (2) SA 660 (A)

3.1 The standard of directors' conduct

By accepting their appointment to the position, directors imply that they will perform their duties to a certain standard, and it is a reasonable assumption of the shareholders that every individual director will apply his or her particular skills, experience and intelligence to the advantage of the company.

The Act codifies the standard of directors' conduct in section 76. The standard sets the bar very high for directors. The intention of the legislature seems to be to encourage directors to act honestly and to bear responsibility for their actions - directors should be accountable to shareholders and other stakeholders for their decisions and their actions. However, with the standard set so high, the unintended consequence may be that directors would not be prepared to take difficult decisions or expose the company to risk. Since calculated risk taking and risk exposure form an integral part of any business, the Act includes a number of provisions to ensure that directors are allowed to act without constant fear of personal exposure to liability claims. In this regard, the Act has codified the business judgement rule, and provides for the indemnification of directors under certain circumstances, as well as the possibility to insure the company and its directors against liability claims in certain circumstances.

It should be noted that the duties imposed under section 76 are in addition to, and not in substitution for, any duties of the director of company under the common law. This means that the courts may still have regard to the common law, and past case law when interpreting the provisions of the Act.

The codified standard applies to all directors, prescribed officers or any other person who is a member of a board committee irrespective of whether or not that the person is also a member of the company's board. Also, it should be noted that no distinction is made between executive, non-executive or independent non-executive directors. The standard, and consequent liability where the standard is not met, applies equally to all directors.

In terms of this standard a director (or other person to whom section 76 applies), must exercise his or her powers and perform his or her functions:

- in good faith and for a proper purpose
- in the best interest of the company, and
- with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions and having the general knowledge, skill and experience of that director.

The Act prohibits a director from using the position of director, or any information obtained while acting in the capacity of a director to gain an advantage for himself or herself, or for any other person (other than the company or a wholly-owned subsidiary of the company), or to knowingly cause harm to the company or a subsidiary of the company.

Directors have a fiduciary duty to act in the best interest of the company as a whole. Directors owe this duty to the company as a legal entity, and not to any individual, or group of shareholders – not even if the majority shareholder appointed the director. Directors are obliged to act in good faith in the best interest of the company. They should act within the bounds of their powers, and always use these powers for the benefit of the company. Where a director transgresses his or her powers, the company might be bound by his or her action, although he or she can be held personally liable for any loss suffered as a result.

The fiduciary duty of directors includes (but not limited to):

- the duty to individually and collectively exercise their powers bona fide in the best interest of the company
- the duty not to exceed their powers
- the duty not to act illegally dishonestly, or ultra vires
- the duty to act with unfettered discretion
- the duty not to allow their personal interests to interfere with their duties
- a director is accountable to the company for secret profits made by virtue of the fiduciary position or from the appropriation of a corporate opportunity
- the duty not to compete with the company
- the duty not no misuse confidential information

When determining whether a director complied with his or her fiduciary duty, the court may consider whether, in the circumstances, a reasonable person could have believed that the particular act was in the best interest of the company. This is typically known as an objective test.

> *"… and the directors as occupying a fiduciary position towards the company must exercise those powers bona fide in the best interest of the company as a whole, and not for an ulterior motive …"*
>
> ***Treasure Trove Diamonds Ltd v Hyman 1928 AD 464 at 479***

The codified standard for director conduct combines "care, skill and diligence" in one single test. The test to measure a director's duty to exercise a degree of care, skill and diligence provides for an objective assessment to determine what a reasonable director would have done in the circumstances. However, the objective assessment contains subjective elements in that it takes into consideration the, skill and experience of that particular director. In applying the test, a distinction is made between different types of directors.

> *"the extent of a director's duty of care and skill depends to a considerable degree on the nature of the company's business and on any particular obligations assumed by him or assigned to him.... In that regard there is a difference between the so-called full-time or executive director, who participates in the day to day management of the company's affairs or of a portion thereof, and the non-executive director who has not taken on any special obligation. The latter is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodical board meetings, and at any other meetings that may require his attention."*
>
> ***Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd 1980 (4) SA 156 (W)***

In a recent Australian case (Centro case) the duty of care and skill was considered with respect to the duty of directors to approve the financial statements of the company. In this case that court found that all non-executive directors were in breach of their duty of care and skill. The failure to notice certain omissions may well be explicable – but here the directors clearly looked solely to management and external advisors. However, if they had acted as the final filter, taking care to read and understand the financial accounts, the errors may have been discovered.

"All directors must carefully read and understand financial statements before they form the opinions which are to be expressed … Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director.

These include the following:
- a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged;
- a director should keep informed about the activities of the corporation;
- whilst not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies;
- a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements;
- a director, whilst not an auditor, should still have a questioning mind."

"…. a director is not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside the area of the director's expertise."

Australian Securities and Investments Commission v Healey [2011] FCA 717 at 17 and 18

As stated above, the Act also codifies the business judgment rule. In terms of this rule a director will not be held liable if he or she took reasonable diligent steps to become informed about the subject matter, does not have a personal financial interest (or declared such a conflicting interest) and the director had a rational basis to believe that the decision was in the best interest of the company.

In discharging any board or committee duty, a director is entitled to rely on one or more employees of the company, legal counsel, accountants or other professional persons, or a committee of the board of which the director is not a member. The director, however, does not transfer the liability of the director imposed by this act onto such employee.

> *"In respect of all duties that may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgment, information and advice of the management, unless there are proper reasons for querying such. Similarly, he is not expected to examine entries in the company's books... Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof".*
>
> ***Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty)Ltd 1980 (4) SA 156 (W)***

> *"Nothing I decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her."*
>
> ***Australian Securities and Investments Commission v Healey [2011] FCA 717 at 20***

Directors of a company may be held jointly and severally liable for any loss, damage or costs sustained by the company as a result of a breach of the director's fiduciary duty or the duty to act with care, skill and diligence. The Act sets out a range of actions for which directors may be held liable for any loss, damage or costs sustained by the company. These actions include:

- acting in the name of the company without the necessary authority
- being part of an act or omission while knowing that the intention was to defraud shareholders, employees or creditors
- signing financial statements that was false or misleading in a material respect, or
- issuing a prospectus that contained an untrue statement.

In certain instances companies are allowed to indemnify directors in respect of any liability, or companies may purchase insurance to protect a director against liability (but only for those instances for which the company may indemnify the director), or to protect the company against expenses or liability for which the company may indemnify a director. A company may indemnify a director in respect of any liability, except for:

- any liability arising from situations where the director:
  - acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so
  - acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a reckless manner
  - been a party to an act or omission by the company despite knowing that the intention was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose
- any liability arising from wilful misconduct or wilful breach of trust, or
- incurred a fine as a result of a conviction on an offence in terms of national legislation.

Unless the company's Memorandum of Incorporation provides otherwise, a company may purchase insurance to protect a director against any liability or expenses for which the company is permitted to indemnify a director or to protect the company against any expenses or liability for which the company is permitted to indemnify a director. The company may, however, not directly or indirectly pay a fine imposed on the director of the company or of a related company as a consequence of that director having been convicted of an offence unless the conviction was based on strict liability.

3.2 Conflicts of interest

One of the fundamental duties of a director is to avoid any possible conflict of interests with the company. It is an accepted principle in South African law that, as a result of the trust placed in the director, he or she is bound to put the interests of the company before their own personal interests.

Section 75 of the Act makes clear provision for dealing with a director's use of company information and conflict of interest. Where a director has a conflicting personal financial interest (where his or her own interests are at odds with the interests of the company), he or she is prohibited from making, participating in the making, influencing, or attempting to influence any decision in relation to that particular matter. This provision seems to impose a strict duty on directors not to allow their personal financial interest to impact, in any way, on their dealings with the company. In addition, where a director has a conflicting personal interest in respect of a matter on the board agenda, he or she has to declare that personal interest and immediately leave the meeting. A director is also prohibited from any action that may influence or attempt to influence the discussion or vote by the board, and is prohibited from executing any document on behalf of the company in relation to the matter, unless specifically requested to do so by the board.

It should be noted that section 75 of the Act extends the application of the conflict of interest provisions to prescribed officers and members of board committees (even if those persons are not directors).

The conflict of interest provisions apply equally to persons related to the director. Thus, where a director knows that a related person has a personal financial interest in a matter to be considered at a meeting of the board, or knows that a related person has acquired a personal financial interest in a matter, after the board has approved that agreement or matter, the director should disclose that fact to the board. In this regard, it should be noted that for purposes of section 75 the definition of a ''related person'', when used in reference to a director, not only has the ordinary meaning as set out in the Act, but also includes a second company of which the director or a related person is also a director, or a close corporation of which the director or a related person is a member.

The conflict of interest provisions do not apply to a company or its director, if the company has only one director, and that director holds all the beneficial interest in all the issued securities of the company. However, where that one director does not hold all the beneficial interest in the issued securities, he or she may not approve or enter into an agreement, or determine any other matter, in terms of which a person related to him may have a personal financial interest. In these instances, the director has to obtain shareholder approval by ordinary resolution.

The provision makes it clear that conflict of interest is taken seriously by the legislature, and one may assume that the Commission and the Takeover Regulation Panel will enforce these provisions strictly.

The provisions will potentially have an impact on the way in which members of boards are selected and appointed, as membership of a number of different boards might lead to possible conflicts, which in turn means that those directors will not be able to participate in or contribute to discussions and decisions related to such matters.

"It is an elementary principle of company law, that (apart from explicit power in the articles of association) a director cannot vote for the adoption of a contract or on a matter in which he is an interested party".

Gundelfinger v African Textile Manufacturers Ltd 1939 AD 314

Where a director somehow acts in competition with the company, a fundamental conflict of interest is inevitable. There are a number of ways in which such a situation could occur. One is where a director takes an opportunity that could have been taken by the company, in his or her personal capacity. Another is where the director holds directorships on rival companies.

Where an opportunity arises that could have been acted upon by the company, the director is precluded from acting upon it in his or her individual capacity. The director has a fiduciary duty to pass this opportunity on to the company. The courts have held that even where the company did not have the resources to pursue the opportunity, the director who came across it was not at liberty to pursue it personally.

It is debatable whether the holding of directorships on the boards of rival companies in itself constitutes a breach of the director's fiduciary duties. However, it would be almost impossible for the director not to prejudice one of the two or more companies that he or she serves.

"It would be a most unusual situation which allowed directors... of one company to act in the same or similar capacity for a rival without actual or potential conflict situations arising with frequent regularity".

Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 2 SA 54 (T)

Of course, the provisions of the Act relating to conflicts of interest (as discussed above) will prevent a director from such a position.

3.3 Liability of directors

The Act makes it clear that a person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, unless where the Act or the company's Memorandum of Incorporation provides otherwise. The directors of a company may only incur liability in specific instances. In terms of the Act, a director of a company may be held liable for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in the standard of directors conduct, failure to disclose a personal financial interest in a particular matter, or any breach by the director of a provision of the Act or the company's Memorandum of Incorporation.

In addition, the Act determines that a director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having -

- acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the he or she had no authority to do so
- persisted and went along with any action or decision despite knowing that it amounts to reckless trading
- been a party to any action or failure to act despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company
- signed, consented to, or authorised the publication of any financial statements that were false or misleading, or a prospectus that contained false or misleading information
- been present at a meeting, or participated in the making of a decision, and failed to vote against a decision to issue any unauthorised shares or securities, to issue options for unauthorised shares or securities, to provide financial assistance to a director or any person without complying with the requirements of the Act and the Memorandum of Incorporation, to approve a distribution that was contrary to the requirements of the Act, or for the company to acquire any of its own shares, or the shares of its holding company, or make an allotment despite knowing that the acquisition or allotment was contrary to the requirements of the Act.

The Act makes it clear that a director is jointly and severally liable with any other person who is or may be held liable for the same act. Also, any claim for loss, damages or costs for which a person is or may be held liable in terms of the Act prescribes after three years after the act or omission that gave rise to that liability.

Delinquency and probation of directors

The Act determines that directors may be declared delinquent or placed on probation as a result of certain conduct. This can be achieved by an application to court by the company, a director, a shareholder, the company secretary, a registered trade union or representatives of employees of the company. The grounds for the application for delinquency and probation are set out in the Act, but in general terms, directors could be:

- declared delinquent if they grossly abused their position or if they caused intentional harm to the company, and
- placed on probation if they improperly supported a resolution in contravention of the solvency and liquidity test or otherwise acted in a manner which is inconsistent with the duties of directors.

Delinquency usually lasts for 7 years from date of the order or a longer period as determined by the court order. A person who has been declared delinquent may apply to court after 3 years, for suspension of the delinquency order and substitution thereof with a probation order. A probation order will lapse automatically after 5 years.

Personal liability company

The Act allows for the inclusion in the Memorandum of Incorporation of a private company the provision that all directors (both present and past) are jointly and severally liable, together with the company, for the past and present debts and liabilities of the company that were incurred during their term of office. Such a company is classified as a personal liability company, and the name of the company will end with the expression 'Incorporated' or the abbreviation 'Inc'.

While all private companies are able to include such a provision, it is usually those within certain professions such as companies of attorneys or auditors where personal liability is a necessity in terms of their professional standards. The advantage of such a corporate structure over a partnership would be perpetual succession of the legal entity.

3.4 Apportionment of damages

The Apportionment of Damages Act makes it easier for an aggrieved party to sue more than one party at a time. In the case of company failures, it has become common practice for the aggrieved creditors and shareholders to sue those parties with the "deepest pockets" namely the auditors, and occasionally the directors (although most directors of failed companies manage to alienate their assets prior to being sued).

In such instances, it will become more likely that the directors, together with any other relevant party, will be sued jointly under this Act.

3.5 Insider trading

Insider Trading and Closed Periods

The Financial Markets Act 19 of 2012 replaces the Securities Services Act which has governed the regulation of securities services in South Africa since 2005. With the purpose of maintaining the integrity of South African financial markets, aligning the regulatory framework with relevant local and international developments and standards and mitigating the potential impacts of any possible future financial crisis, the Financial Markets Act refines its predecessor's provisions regulating insider trading. The revisions further extend the liability of directors and their proxies, mainly through the amendment of allowable defences, in dealing with unpublished price-sensitive information within their companies.

Given the Financial Services Board and Legislature's continued focus on market abusive transactions as well as the criminal and civil sanctions envisaged by the Financial Markets Act, this piece of legislation is very relevant to directors who receive and trade in their company's securities.

Inside information

Inside information is defined by the Financial Markets Act as specific or precise information which has not been made public and which is obtained or learned as an insider and, if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market.

Insider

An insider, as defined by the Financial Markets Act, is an individual who "has inside information:

(a) through
   (i) being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates; or
   (ii) having access to such information by virtue of employment, office or possession; or her employment, office or possession; or

(b) where such person knows that the direct or indirect source of the information was a person contemplated in paragraph (a)"

The definition, borrowed from the Security Services Act (Act 36 of 2004), stretches a far-reaching net to include not only directors as insiders, but also those that have direct or indirect exposure to inside information.

The offences

Similar to its predecessor, the Financial Markets Act makes it an offence for an insider to deal directly, indirectly or through an agent for his or her own account or for any other person, in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it. The disclosure of inside information to another person, encouragement of another person in dealing in securities of the company or discouragement of another person from dealing in the securities of the company by an insider who knows that he or she has inside information, similarly remains an offence in terms of the Financial Markets Act.

The Financial Markets Act, however, for the first time extends liability to any person dealing for an insider who knew that such person is an insider. Insider's proxies are hereby included within the realm of liability and are treated as insiders themselves if acting for another insider of the company.

The defences

An insider, dealing for his or her own account, may no longer utilise the defence that insider trading was performed in pursuit of an affected transaction as defined in section 440A of the Companies Act 1973. The only defence available to such an insider is where he or she only became an insider after having given the instruction to deal to an authorised user (i.e. licensed security services provider) and the instruction was not changed in any manner after he or she became an insider. A similar defence is given to the authorised user acting on the insider's behalf.

Where an insider deals for another person's account, the Financial Markets Act has amended the defence available to the authorised user acting on the instruction of the insider and now places the onus on that authorised user to prove that he or she did not know the client was an insider at the time that the instruction was given. The defence previously available to public sector bodies in pursuit of monetary policy was completely removed in the Financial Markets Act. A new defence has been added, known as the "safe harbour defence", for bona fide commercial transactions amongst insiders that are not designed to benefit from the price sensitive information. This defence requires that all parties to the transaction have possession of the same inside information and that trading is limited to these parties. An authorised user acting on the instruction of the insider(s) may also utilise this defence.

Lastly, disclosure of insider information by an insider to another person is defensible where the insider can prove that such disclosure was made pursuant to the proper performance of his or her employment, office or profession in circumstances unrelated to dealing and that he or she at the same time disclosed that the information was inside information.

The table below summarises the available defences:

The Defence	Available to
I only became an insider after having given the instruction to deal to an authorised user (i.e. licensed security services provider) and the instruction was not changed in any manner after I became an insider.	• An insider dealing for own account. • The authorised user dealing on instruction of the insider
I am an authorised user acting on the instruction of the insider. The onus is on me to prove that I did not know the client was an insider at the time that the instruction was given.	• The authorised user dealing on instruction of the insider.
I entered into a *bona fide* commercial transaction amongst fellow insiders. The transaction was not designed to benefit from the price sensitive information. All parties to the transaction had possession of the same inside information and the trading was limited to these parties.	• An insider dealing for another person's account. • An authorised user dealing on instruction of the insider.
I disclosed insider information to another person. I can prove that such disclosure was made pursuant to the proper performance of my employment, office or profession in circumstances unrelated to dealing and that I at the same time disclosed that the information was inside information.	• An insider dealing for own account. • An insider dealing for another person's account. • An authorised user dealing on instruction of the insider.

The Penalty

Any director responsible for contravening the Financial Markets Act's provisions regulating insider trading will be liable to pay an administrative sanction not exceeding the profit on insider trading or loss avoided as a result thereof, an amount of up to R1 million, interest on any amount payable as well as the costs of suit, including any investigation costs incurred by the Enforcement Committeee. In addition, the Financial Services Board has wide-ranging powers to investigate allegations of insider trading, including the search of premises and examination of any documentation related to their investigation on authority of a warrant.

Publication

The insider trading provisions do not apply to public information. The Financial Markets Act has amended the definition of public information to ensure that such information be more widely available before insiders may deal. This was done by removing information obtained by persons exercising diligence or observation, information only communicated on the payment of a fee or information only published outside South Africa, from the definition of public information in the Financial Markets Act.

Closed periods

Regulators commonly utilise "closed period" provisions to curb insider trading practices of directors and management. The provisions prohibit trading in company securities by designated persons during closed periods which commonly coincide with periods during which the persons might be privy to price sensitive information.

The JSE Listing Requirements ("the JSE") defines a "closed period" as:

(a) the date from the financial year end up to the date of earliest publication of the preliminary report, abridged report or provisional report;
(b) the date from the expiration of the first six month period of a financial year up to the date of publication of the interim results;
(c) the date from the expiration of the second six month period of a financial year up to the date of publication of the second interim results, in cases where the financial period covers more than 12 months;
(d) in the case of reporting on a quarterly basis, the date from the end of the quarter up to the date of the publication of the quarterly results; and
(e) any period when an issuer is trading under a cautionary announcement.

The director of a company and company secretary (of the issuer company or a major subsidiary of the issuer) as well as associates of the director, which include immediate family, are prohibited from trading in the securities of a listed company during a closed period or any period when there exists any matter which constitutes unpublished price sensitive information in relation to the issuer's securities (whether or not the party has knowledge of such matter).

As it is quite possible that unpublished price sensitive information might already exist prior to the end of a financial period, the closed period could, applying the definition above, result in extended periods during which no trading is allowed. Even during periods of allowed trading, the director or company secretary (excluding his or her associates) require written authorisation to trade in the securities from the issuing company's chairman or another director designated for the purpose.

A director is expected to notify his or her immediate family and other associates as well as his or her investment manager of periods during which no trading is allowed and such communication should include the names of the issuer(s) of which he or she is a director. The investment manager of a director should be instructed by the director that no trades should be entered into on his or her behalf without prior written consent. Similarly, immediate family and associates of the director have to inform the director of their trading activities in the securities of the issuer to allow the director to comply with the disclosure requirements set by the JSE.

Disclosure

Trading in the securities of a listed company requires disclosure on Stock Exchange News Service (SENS) when trading is entered into by or on behalf of:

(i) a director and company secretary (held beneficially, whether directly or indirectly) of the issuer;

(ii) a director and company secretary (held beneficially whether directly or indirectly) of a major subsidiary company of the issuer; or

(iii) any associate of the company or a major subsidiary of the company.

The SENS disclosure shall include all details of the transaction, including off-market transactions.

In terms of the JSE Listing Requirements, a company must, without delay, unless the information is kept confidential for a limited period of time as allowed by the JSE, release an announcement providing details of any development(s) in such company's sphere of activity that is/are not public knowledge and which may, by virtue of its/their effect(s), lead to material movements of the reference price of such company's listed securities.

Immediately after a listed company acquires knowledge of any material price sensitive information and the necessary degree of confidentiality of such information cannot be maintained or if the company suspects that confidentiality has or may have been breached, the company must publish a cautionary announcement on SENS in terms of the JSE Listing Requirements. The company is required to update the cautionary statement at least every 30 business days after issuing the initial cautionary statement.

4. The workings of the board of directors

Directors should be individuals of integrity and courage, and have the relevant knowledge, skills and experience to bring judgement to bear on the business of the company. In situations where directors may lack experience, detailed induction and formal mentoring and support programmes should be implemented.

King III Principle 2.18 par 72

4.1 Composition of the full board

The three different types of directors each bring a different area of focus to the board of directors. Executive directors have an intimate knowledge of the workings of the company. Non-executive directors may have a better understanding of the issues facing the group as a whole. Independent directors bring a totally unclouded, objective viewpoint to the board, as well as experience gained at other enterprises.

The challenge lies in establishing the appropriate balance. Each company faces different issues, and will require a unique combination of skills to meet those challenges. King III suggests that every board should consider whether its size, diversity and demographics make it effective. In this regard, a number of factors may be taken into account, including academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and gender. When determining the number of directors to serve on the board, the collective knowledge, skills, experience and resources required for conducting the business of the board should be considered.

Factors determining the number of directors to be appointed are:

- 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, and
- the skills and knowledge needed to make business judgement calls on behalf of the company.

King III Report Principle 2.18 Par 70

King III has re-affirmed the view that the South African business environment lends itself to having a single (unitary) board of directors that takes ultimate responsibility for the direction of the company. Having a single board makes it essential to achieve the appropriate balance of power between the different categories of directors. In South Africa, best practice dictates that the majority of directors should be non-executive, of which the majority should be independent. At least two executive directors (the CEO and the director responsible for the finance function) should be appointed to the board.

King III proposes staggered rotation for non-executive directors, while ensuring continuity of skills and experience. Rotation also allows for the introduction of new directors with different skills and experience from which the board may derive benefit. It is proposed that at least one third of non-executive directors be rotated every year. Rotating directors may be re-appointed, if eligible.

The chairman and the board should re-assess the independence of independent directors on an annual basis. King III suggests that the re-appointment of an independent director after a term of nine years should be seriously considered. A statement on the outcome of such assessment should be included in the Integrated Report. It is suggested that the director's independence may be impaired after nine years.

4.2 The implicit duties of the board

The Practice Note on the Board Charter issued with King III advocates that the board has a number of duties, with the following being the most fundamental:

- The board has to act as the focal point for, and custodian of, corporate governance and as such the board should manage its relationship with management, the shareholders and other stakeholders of the company along sound corporate governance principles.

  As the focal point for, and custodian of, corporate governance the board should exercise leadership, integrity, enterprise and judgment when it directs, governs and controls the company. The most important function of the board is to ensure value creation, and in doing so, it should account for the interest of all stakeholders.

- The board has to appreciate that strategy, risk, performance and sustainability are inseparable and to give effect to this by:
  - informing and approving the strategy
  - satisfying itself that the strategy and business plans are not encumbered by risks that have not been thoroughly assessed by management
  - identifying key performance and risk areas
  - ensuring that the strategy will result in sustainable outcomes, and
  - considering sustainability as a business opportunity that guides strategy formulation.

- The board has to provide effective leadership that stands on an ethical foundation.

  Effective leadership is built on four pillars, namely responsibility, accountability, fairness and transparency. This entails doing business ethically and sustainably by having regard to the company's economic, social and environmental impact on the community.

- The board must ensure that the company is a responsible corporate citizen.

  Responsible corporate citizenship is closely related to ethical leadership. As a responsible corporate, the board has to ensure that the company should have regard to not only the financial aspects of the business of the company but also the impact that business operations have on the environment and the society within which it operates.

- The board should ensure that the company's ethics is managed effectively.

  The board should set the tone for ethical behaviour within a company, and is responsible for creating and sustaining an ethical corporate culture, both formal and informal. The ethical culture should be reflected in the company's vision, mission, strategies, operations, decisions, conduct and its stakeholder relationships. Ethical risks and opportunities should be identified and managed. It is advisable to articulate ethical standards in a code of conduct, which provides guidance and rules to avoid unethical behaviour. The board should further ensure that ethics are integrated into all the company's strategies and policies, and that its ethics performance is assessed, monitored, reported and disclosed.

- The board must ensure that the company has an effective and independent audit committee.

  Although the Act prescribes the composition and functions of the audit committee for state owned and public companies, King III proposes that all companies should appoint an audit committee. The audit committee should comprise at least three members and all members should be independent non-executive directors. The committee as a whole should have sufficient qualifications and experience to fulfil its duties, and should be permitted to consult with specialists or consultants after following an agreed process. The terms of reference of the audit committee should be approved by the board.

The functions of the audit committee in relation to the external auditor include:
- the nomination of the external auditor for appointment and to verify the independence of the auditor
- determining the audit fee and the scope of the appointment
- ensuring that the appointment complies with the requirements of the Act
- determining the nature and extent of non-audit services, and
- pre-approving any contract for non-audit services.

The board may delegate certain aspects of risk management and sustainability to the audit committee. King III introduces the concept of integrated reporting (which combines financial and sustainability reporting) and allows for the board to delegate the review of integrated reporting to the audit committee. In this regard, the audit committee should recommend to the board the need to engage external assurance providers to provide assurance on the accuracy and completeness of material elements of integrated reporting.

King III adopts a wide approach to the audit committee's responsibility for financial risk and reporting to include:
• financial risks and reporting
• review of internal financial controls, and
• fraud risks and IT risks as it relates to financial reporting.

King III further introduces the combined assurance model. In terms of this model, assurance should be done on three levels, i.e. management, internal assurance providers and external assurance providers. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities.

• The board is responsible for the governance of risk.

King III emphasises the fact that risk management should be seen as an integral part of the company's strategic and business processes. The board's responsibility for governance of risk should be set out in a risk management policy and plan. The board should consider the risk policy and plan, and should monitor the whole risk management process.

While the board remains responsible for the risk management policy and the determination of the company's risk appetite and risk tolerance, management is responsible for the design, implementation and effectiveness of risk management.

The board should receive combined assurance regarding the effectiveness of the risk management process. The board may assign its responsibility for risk management to the risk committee. Membership of this committee should include executive and non-executive directors. Where the company decides to assign this function to the audit committee, careful consideration should be given to the resources available to the audit committee to adequately deal with governance of risk in addition to its audit responsibilities.

A director is "bound to take such precautions and show such diligence in their office as a prudent man of business would exercise in the management of his own affairs".

Trustees of the Orange River Land & Asbestos Company v King (1892) 6 HCG 260 285

• The board is responsible for information technology (IT) governance.

As information and technology systems have become such an integral part of doing business, King III provides specific guidelines to ensure effective IT governance. It is necessary for directors to ensure proper IT governance, the proper alignment of IT with the performance and sustainability objectives of the company, and the proper management of operational IT risk, including security. The risk committee may be assigned responsibility to oversee the management of IT risk. In addition, the audit committee should consider IT as it relates to financial risk and reporting.

- The board should ensure that the company complies with applicable laws and consider adherence to non-binding rules and standards.

  The board is responsible for overseeing the management of the company's compliance risk. The board should ensure awareness of and compliance with laws, rules, codes and standards throughout the business. In turn, management is responsible for the implementation of an effective compliance framework and processes, and for the effective management of the company's compliance risk. The board may mandate management to establish a compliance function to implement measures and procedures to ensure that the board's policy on compliance is implemented.

- The board has to ensure that there is an effective risk-based internal audit function.

  King III advocates a risk based approach to internal audit. In order for internal audit to contribute to the attainment of strategic goals, the internal audit function should be positioned at a level within the company to understand the strategic direction and goals of the company. It should develop a programme to test the internal controls vis-a-vis specific risks. The internal audit function should provide assurance with reference to the adequacy of controls to identify risks that may impair the realisation of specific goals as well as opportunities that will promote the achievement of the company's strategic goals.

  As an internal assurance provider internal audit should form an integral part of the combined assurance model. It should provide a written assessment of internal controls and risk management to the board, and specifically on internal financial controls to the audit committee.

- The board should appreciate that stakeholder's perceptions affect the company's reputation.

  King III proposes that companies institute measures to ensure that they are able to proactively manage the relationships with all their stakeholders, including shareholders. The board should encourage constructive stakeholder engagement, and strive to achieve the correct balance between the interests of all its various stakeholder groupings and promote mutual respect between the company and its stakeholders.

- The board should ensure the integrity of the company's integrated report.

  King III proposes integrated reporting to ensure that all stakeholders are able to assess the economic value of the company. This entails the integration of the company's financial reporting with sustainability reporting and disclosure. The board should ensure that the positive and negative impacts of the company's operations, as well as plans to improve the positives and eradicate the negatives, are conveyed in the integrated report. The board should review the integrated reporting and disclosure to ensure that it does not contradict financial reporting.

- The board must act in the best interests of the company and in fulfilling this responsibility individual directors:
  - must adhere to legal standards of conduct
  - should be permitted to take independent advice in connection with their duties following an agreed procedure
  - must disclose real or perceived conflicts to the board and deal with them accordingly, and
  - deal in securities only in accordance with the policy adopted by the board.

- The board must commence business rescue proceedings as soon as the company is financially distressed.

  The Act sets out the processes and procedures to be followed when a company is financially distressed. The board has the responsibility to ensure that all stakeholders are consulted in the preparation of the business rescue plan.

- The board must elect a chairman of the board that is an independent non-executive director.

  King III emphasises the fact that the chairman should be independent and free of conflicts. The chair has to set the ethical tone for the board and the company, provide leadership to the board and the company, and act as link between the board and company.

- The board must appoint and evaluate the performance of the chief executive officer.

  Arguably the most important function of the board is to identify and appoint a suitable chief executive officer. The collective responsibility of management vests in the chief executive officer, and as such the chief executive officer bears ultimate responsibility for the decisions and actions of management.

4.3 Meetings of directors

The directors may meet as often as required. Generally, boards meet quarterly, but more meetings may be scheduled, depending on circumstances.

A director authorised to call a board meeting is obliged to do so if 2 or more directors (or 25% of directors where the board comprises more than 12 members) ask him or her to call a meeting.

In terms of the Act, board meetings may be conducted by electronic communication so long as the electronic communication facility employed ordinarily enables all persons participating in that meeting to communicate concurrently with each other without an intermediary, and to participate effectively in the meeting. Directors that participate in the meeting via electronic communication are regarded as being present at the meeting – both for quorum and voting purposes.

The majority of directors must be present at a board meeting before a vote may be called, in other words, the quorum for the meeting to commence is 50% plus one.

Decisions taken at the meetings are generally on a majority vote. In this regard, it should be kept in mind that a resolution will be passed by a majority of the directors that participate in the meeting. Where there is a tie, the Act allows the chairperson to have the deciding vote (but only if the chair did not participate in the initial vote). The Act allows a decision that could be voted on at a meeting of the board to be adopted by written consent of a majority of the directors, given in person, or by electronic communication, provided that each director has received notice of the matter to be decided (round-robin). This allows for a handy alternative to a physical meeting.

The information relating to the business to be conducted at the meeting is generally distributed ahead of time within a board "pack" to enable each director to digest the information prior to the meeting. This is usually the responsibility of the company secretary. Given the strict standard of director conduct, and the requirement for directors to take reasonably diligent steps to become informed on any matter on the agenda, it is important that the company secretary ensures that directors are provided with relevant and accurate information.

Section 73 of the Act requires that the minutes of the directors' meetings be kept, including any declaration of a conflict of personal financial interest, as well as every board resolution adopted by the board. Again, given the strict standard of director conduct, it is important for all directors to carefully read the minutes, and ensure that it provides a clear reflection of the proceedings and decisions taken at that particular meeting. Directors may have to rely on the minutes, should their decisions or actions ever be challenged.

The chairperson of the meeting (usually also the chairperson of the board) should sign the minutes as evidence that they are correct. Any minutes of a meeting, or a resolution, signed by the chair of the meeting, or by the chair of the next meeting of the board, is evidence of the proceedings of that meeting, or adoption of that resolution, as the case may be. If the chairperson of the meeting does not sign the minutes, the chairperson of the following meeting should sign them.

4.4 Important roles of the board

The board comprises a number of important individuals, each with a different role to play. The functions of these significant individuals are discussed below.

The Chairperson

The Memorandum of Incorporation of a company generally allow for the directors to elect a chairperson to chair the meetings of the board. Unless specified in the Memorandum of Incorporation, the chairperson remains in that position for as long as he or she is a director, or until the board elects otherwise.

The chairperson of the board is the individual charged with providing the board with leadership, and to harness the talents and energy contributed by each of the individual directors.

King III recommends that the chairperson should be an independent non-executive director. The chairperson should not also be the CEO. While the chairperson is required to retain an objective viewpoint of the affairs of the company, the CEO is often required to become intimately involved in developing and executing management plans for the company.

King III emphasises the importance of an independent chairperson. The chairperson of the board should be independent and free of conflicts of interest at appointment, failing which, the board should appoint a lead independent non-executive director (LID) (another independent director, usually the deputy chairperson). In situations where the independence of the chairperson is questionable or impaired, a LID should be appointed for as long as the situation exists. The role of the LID would be to act as the 'independent conscience' of the chairperson, i.e. to ensure that all decisions of the chairperson are justifiable from an independent point of view.

The most obvious role played by the chairperson is to govern the workings of the board, including directing the meetings of the board and acting as a conciliatory element when elements of the board differ. In case of a tied vote, the chairperson may cast the deciding vote (but only if he did not cast a vote in the initial round of voting).

The chairperson is obliged to use this power appropriately and not to influence the outcome of the meetings towards a specific agenda.

"The Chairperson of a general meeting is empowered "to preserve order, and to take care that the proceedings are conducted in a proper manner, and that the sense of the meeting is properly ascertained with regard to any question which is properly before the meeting."

National Dwellings Society v Sykes [1894] 3

According to King III the core functions of thechairperson include:

- setting the ethical tone for the board and the company
- providing overall leadership to the board
- formulating (with the CEO and company secretary) the yearly work plan for the board against agreed objectives, and playing an active part in setting the agenda for board meetings
- presiding over board meetings and ensuring that time in meetings is used productively
- managing conflicts of interest
- acting as the link between the board and management and particularly between the board and the CEO
- ensuring that complete, timely, relevant, accurate, honest and accessible information is placed before the board to enable directors to reach an informed decision
- monitoring how the board works together and how individual directors perform and interact at meetings
- ensuring that good relations are maintained with the company's major shareholders and its strategic stakeholders, and presiding over shareholders' meetings
- upholding rigorous standards of preparation for meetings, and
- ensuring that decisions by the board are executed.

Further responsibilities of the chairperson would be to identify and participate in selecting board members (via a nomination committee), and overseeing a formal succession plan for the board, CEO and certain senior management appointments such as the chief financial officer (CFO).

The chairperson should ensure that all directors are appropriately made aware of their responsibilities through a tailored induction programme, and ensuring that a formal programme of continuing professional education is adopted at board level. Also, he or she should ensure that directors play a full and constructive role in the affairs of the company and taking a lead role in the process for removing non-performing or unsuitable directors from the board.

The Chief Executive Officer

The chief executive officer (sometimes referred to as the managing director) has the responsibility for determining and maintaining the strategic direction of the company. The collective responsibility of management rests with the CEO, and as such the CEO bears responsibility for all management functions and decisions. The CEO is usually seen as the figurehead for the company in the public eye, and as such should be an individual with the ability to present a positive image of the company.

Certainly one of the most important functions of the board is to appoint a CEO. The CEO does not necessarily have to be an employee of the company in addition to holding a post as director. Where the CEO is an employee of the company, however, best practice internationally and in South Africa is that he or she should enter into at most a three year employment contract with the company.

Where the Memorandum of Incorporation so provides, the directors may delegate all of their powers to this one individual, thus conferring onto him or her an enormous amount of responsibility. However, it should be made clear that the board remains accountable to shareholders and stakeholders. The board should have regard to the directors' fiduciary and statutory responsibilities when delegating authority to management. Also, the board should have clear performance indicators to hold management accountable.

> *The board should define its own levels of materiality, reserving specific powers to it and delegating other matters to management. Such delegation by the board should have regard to directors' statutory and fiduciary responsibilities to the company, while considering strategic and operational effectiveness and efficiencies.*
>
> ***King III principle 2.17 par 50***

Some of the more important functions that King III suggests that the CEO perform include:

- recommending or appointing the executive team and ensuring proper succession planning and performance appraisals
- developing the company's strategy for consideration and approval by the board
- developing and recommending to the board annual business plans and budgets that support the company's long-term strategy
- monitoring and reporting to the board the performance of the company and its conformance with compliance imperatives
- establishing an organisational structure for the company which is necessary to enable execution of its strategic planning
- setting the tone in providing ethical leadership and creating an ethical environment
- ensuring that the company complies with all relevant laws and corporate governance principles, and
- ensuring that the company applies all recommended best practices and, if not, that the failure to do so is justifiably explained.

4.5 Board committees

The Act provides the board with the power to appoint board committees, and to delegate to such committees any of the authority of the board. The authority of the board to appoint board committees is subject to the company's Memorandum of Incorporation.

If the company's Memorandum of Incorporation, or a board resolution establishing a committee, does not provide otherwise, the committee may include persons who are not directors of the company. However, it should be noted that where non-directors are appointed to a board committee, such persons are not allowed to vote on a matter to be decided by the committee).

Board committees constitute an important element of the governance process and should be established with clearly agreed reporting procedures and a written scope of authority. The Act recognises the right of a board to establish board committees but by doing so, the board is not exonerated of complying with its legal responsibilities.

King III principle 2.23 par 125

King III recommends that the delegation of powers to a committee be made official, in order for the members to have formal terms of reference to determine the scope of their powers, and the responsibilities they bear.

The terms of reference should include detail pertaining to:

- the composition of the committee
- the objectives, purpose and activities
- the powers that have been delegated
- any mandate to make recommendations to the board
- the lifespan of the committee, and
- how the committee reports to the board.

The Act requires public companies and state owned companies to appoint an audit committee comprising three independent non-executive directors. King III proposes that all other companies provide for the appointment of an audit committee (the composition, purpose and duties to be set out in the company's Memorandum of Incorporation). In addition, King III proposes that the board should appoint the audit, risk, remuneration and nomination committees as standing committees. The board may also consider establishing governance, IT steering and sustainability committees.

Smaller companies need not establish formal committees to perform these functions, but should ensure that these functions are appropriately addressed by the board.

The Act requires listed public companies and state owned companies, as well as any other company that scored more than 500 Public Interest Score points in any two of the last five years, to establish a social and ethics committee. This committee should comprise at least three members. The members may be directors or prescribed officers, but at least one must be a director that is not involved in the day-to-day management of the company, i.e a non-executive director.

Board committees are allowed to consult with or receive advice from any person, including employees, advisors, or other board committees.

King III suggests that all board committees, other than the risk committee, should only comprise members of the board and should have a majority of non-executive directors. The majority of the non-executive directors serving on these committees should be independent. Committees should be chaired by independent non-executive directors, other than the executive committee which is ordinarily chaired by the CEO.

Advisors, experts and other external parties may attend committee meetings by invitation. Non-directors serving as members on committees of the board are not entitled to vote, and will be subject to the same standards of conduct and liability as if they were directors. Executive directors and senior management may be invited to attend committee meetings if the chair of the committee considers their input and contribution to be of value to the decision-making process.

The composition and functions of each of these sub committees are discussed below.

The Nomination Committee

The role of the nomination committee is to review, on a regular basis, the composition of the full board, and where it appears that the board is lacking in skills or experience in a certain area, to identify how best to rectify the situation. This may involve identifying skills that are required, and those individuals best suited to bring these to the board.

King III suggests that the committee should only comprise members of the board. The majority of the members should be non-executive, of which the majority should be independent. The ideal situation is for the chairperson of the board to also chair the nomination committee, failing which an independent non-executive director should be the chairperson.

The committee is empowered to consider the size and balance of the full board, and to make recommendations where, in the opinion of its members, improvements could be made. It remains the responsibility of the full board of directors to consider the recommendations made and to vote on any nominated appointments or, as the case may be, suggested removals.

One of the important considerations for the committee is whether there are adequate succession plans in place to mitigate the effects of losing key members of the board, specifically non-executives as these individuals may be more difficult to replace than executive directors who have followed a defined career path through the management of the company.

The role of the nominations committee may be extended to also consider the skill, experience and succession planning with respect to the executive management team.

The Remuneration Committee

The remuneration of a company's directors is one of the most sensitive and topical issues facing the board of directors today. It is therefore considered a crucial element of good corporate governance to establish a committee whose sole focus it is to consider and recommend the level and form of the directors' (and senior management's) remuneration.

King III suggests that the committee should only comprise members of the board. The majority of the members should be non-executive, of which the majority should be independent.

The chairman of the committee should be an independent, non-executive director. The chair of the board should not chair the remuneration committee, but may be a member.

One of the most important responsibilities of the members of the committee is to remain up to date on appropriate levels, structuring methods and types of remuneration in the environment in which the company operates.

The members of the committee are required to maintain a fine balance between recommending over-generous remuneration which is not in the interests of the shareholders, and a level of remuneration which fails to attract the desired quality of individual to the board.

While it is usually within the committee's mandate to deliberate on the remuneration of the non-executive directors, it is up to the shareholders to make the final decision on the appropriate level.

The Risk Committee

Risk management is an often misunderstood discipline within a company. Too often the responsibility for ensuring that the significant risks are adequately managed is not acknowledged, or is inappropriately delegated to the audit committee. There are two reasons why the risk management function should not report to the audit committee, but should be monitored by a separate risk committee.

The first is that, as a consequence of the composition of the committee, the function will often have financial focus when risk management should correctly extend far beyond the finances of a company.

Secondly, the audit committee should act as an independent oversight body.

Having to directly oversee the risk management function would generally involve a large amount of detailed review of the processes and workings of the company.

This would necessarily have a detrimental effect on the objectivity of the audit committee's members when considering reports of the risk management function. The formation of a separate committee recognises the fact that the identification and management of risks impacting the business, and the disclosure of these to the shareholders is vital to good governance.

King III recommends that the committee should have at least three members, and may comprise executive and non-executive directors, and even non-directors.

The chairperson of the committee should be a non-executive director. The chairperson of the board should not chair this committee, but may be a member.

The role of the committee is to perform an oversight function. In doing so, it should consider the risk policy and plan, determine the company's risk appetite and risk tolerance, ensure that risk assessments are performed regularly, monitor the whole risk management process, and receive assurance from internal and external assurance providers regarding the effectiveness of the risk management process. In turn, management is responsible for the design, implementation and effectiveness of risk management, as well as continual risk monitoring.

It is of vital importance that members of the risk committee have experience within the industry. This would allow them to identify areas of risk and be aware of the appropriate methods of managing the company's exposure via internal (the control environment) or external (such as thorough insurance cover) means.

To operate effectively, it is recommended that the committee produces reports that are reviewed and signed by the full board as acknowledgment that their responsibilities in this regard have been adequately discharged.

The Audit Committee

King III emphasizes the vital role of an audit committee in ensuring the integrity of financial controls and integrated reporting (both financial and sustainability reporting), and identifying and managing financial risk. This sentiment is confirmed in the Act. The appointment of an audit committee is regulated as part of the enhanced accountability and transparency requirements set out in Chapter 3 of the Act. The Act requires all public companies and all state owned companies to appoint an audit committee. Any other type of company may elect to appoint an audit committee (although the provisions of the Act pertaining to the audit committee will only apply to these companies to the extent provided for in their respective Memorandums of Incorporation.

Notwithstanding the requirements of the Act, King III proposes that all companies should have an audit committee.

The Act determines that where the appointment of an audit committee is required, the audit committee must be appointed by the shareholders at every annual general meeting.

This requirement highlights the importance of the board's nomination committee. As all audit committee members must be directors (members of the board), it is important that the nominations committee identifies suitably skilled and qualified individuals to nominate for appointment to the audit committee.

The shareholders may appoint anyone they deem fit and proper.

Section 94 of the Act determines that the audit committee must consist of at least three members. Each member of the committee must be a director of the company and not:

- be involved in the day to day management of the company for the past financial year;
- be a prescribed officer or full-time employee of the company for the past 3 financial years;
- be a material supplier or customer of the company such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and
- be related to anybody who falls within the above criteria.

The requirements of section 94 are prescriptive. It appears that if the company appoints an audit committee with persons other than those prescribed, it would not be an audit committee as required by the Act. As a result, any functions undertaken by a non-compliant (that is an "incorrectly constituted") audit committee will not have been performed by the audit committee as required by the Act.

The audit committee can consist of as many members as the company wishes to appoint, but each of them must meet the criteria and each of them must be a director of the company. The audit committee would, of course, be entitled to utilise advisors and obtain assistance from other persons inside and outside of the company. The audit committee may also invite knowledgeable persons to attend its meetings. However, the formally appointed members of the audit committee entitled to vote and fulfil the functions of the audit committee will have to meet the criteria (non-executive independent directors) in accordance with the prescribed requirements.

In this regard, cognisance should be taken of the position of shareholders as potential members of the audit committee. The Act makes no reference to shareholders, and the value judgement pertaining to independence relates only to suppliers and customers. The mere fact that a person holds shares in the company (or meets any of the other factual tests such as being related to a supplier) would not, on its own, preclude such a person from serving on the audit committee. It is proposed that, in line with the best practice principles set out in King III, the appointment of shareholders to the audit committee be carefully considered. A judgment on the effect of the shareholding or other relationship is required in order to establish the likely factual impact on the independence of a particular person.

The statutory duties of the audit committee include:

- making submissions to the board regarding the company's accounting policies, financial controls, records and reporting
- nominating an auditor that the audit committee regards as independent
- determining the audit fee
- ensuring that the appointment of the auditor complies with the Companies Act and other relevant legislation
- determining the nature and extent of non-audit services
- pre-approving any proposed agreement with the auditor for the provision of non-audit services
- preparing a report to be included in the annual financial statements describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company
- receiving and dealing with relevant complaints, and
- any other function designated by the board.

Since the Act prescribes the appointment process, composition and functions of the audit committee, it can now be described as a statutory committee. The audit committee will bear sole responsibility for its decisions pertaining to the appointment, fees and terms of engagement of the auditor. On all other matters it remains accountable to the board and, as such, it will function as a board committee.

An interesting development is the fact that the audit committee is now obliged to also report to shareholders. The audit committee will report to shareholders by including in the annual financial statements the audit committee's report describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company.

In addition to the legislative duties set out in the Act, King III proposes a number of additional functions, including:

- overseeing
  - financial risks and reporting
  - internal financial controls
  - fraud and IT risks as they relate to financial reporting
- ensuring that a combined assurance model is applied to provide a coordinated approach to all assurance activities (in terms of this model, assurance should be done on three levels, i.e. management, internal assurance providers and external assurance providers)
- overseeing integrated reporting (both financial and sustainability reporting)
- satisfying itself with regard to the expertise, resources and experience of the finance function
- overseeing the internal audit function
- playing a key role in the risk management process, and
- overseeing the external audit process.

In terms of King III, the audit committee is responsible to ensure integrated reporting (integrating financial and sustainability reporting). As a minimum, the audit committee should provide the following information 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 has 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 or other responsibilities, and
- a statement on whether or not the audit committee recommended the integrated report to the board for approval.

Ethical leadership and social responsibility is highlighted in King III. These same sentiments are echoed in the Act. Although it may be argued that the provisions of the Act are onerous and prescriptive, it should be acknowledged that the intention is for the audit committee to play a key role in ensuring accountability and transparency. As an independent, objective body, it should function as the company's independent watchdog to ensure the integrity of financial controls, combined assurance, effective financial risk management, and meaningful integrated reporting to shareholders and stakeholders alike.

Social and Ethics Committee

During the public hearings on the Companies Bill conducted by the Portfolio Committee on Trade and Industry in 2007, a proposal was made to include a requirement in the new Act to oblige certain companies to appoint a member of a trade union as a board member (director). The Portfolio Committee rejected this proposal, but presented a compromise. It was argued that there is a definite need in the South African context to encourage large companies (especially those companies that have a significant impact on the public interest) to not only act responsibly, but also to be seen doing so and to account from the public interest perspective for their decision making processes and the results thereof. In essence, it was argued that these companies should be obliged to develop a social conscience, and behave like responsible corporate citizens.

As such, the Companies Act now provides the Minister of Trade and Industry with the authority to require certain companies to have a social and ethics committee, having regard to the impact such companies have on the public interest. However, regardless of the requirement to appoint a social and ethics committee, the directors and prescribed officers of all companies are bound to act in accordance with an acceptable standard of conduct.

In terms of this standard, directors and prescribed officers are obliged to act in the best interest of the company. In this regard, the Act subscribes to the "enlightened shareholder value approach" – which requires that directors are obliged to promote the success of the company in the collective best interest of shareholders, which includes, as appropriate, the company's need to take account of the legitimate interests of other stakeholders including among others, the community, employees, customers and suppliers. In terms of section 72 of the Companies Act (read with Companies Regulation 43), the following companies should have appointed a social and ethics committee within one year after the Act became effective (i.e. by 30 April 2012):

- every state owned company
- every listed public company and
- any other company that has, in any two of the previous five years, had a public interest score of at least 500 points.

The social and ethics committee must comprise not less than three members. These members may be directors or prescribed officers of the company, however, at least one must be a director who is not involved in the day-to-day management of the company's business, i.e. a non-executive director, and must not have been so involved during the previous three financial years.

In terms of Companies Regulation 43 a social and ethics committee has to monitor the company's activities with regard to matters relating to:

- social and economic development, including the company's standing in terms of the goals and purposes of:
  - the 10 principles set out in the United Nations Global Company Principles;
  - the Organisation for Economic Co-operation and Development (OECD) recommendations regarding corruption (refer to the OECD website for further details (www.oecd.org));
  - the Employment Equity Act, No 55 of 1998;
  - the Broad-Based Black Economic Empowerment Act, No 53 of 2003;
- good corporate citizenship, including the company's:
  - promotion of equality, prevention of unfair discrimination, and measures to address corruption;
  - contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and
  - record of sponsorship, donations and charitable giving;

- the environment, health and public safety, including the impact of the company's activities and of its products or services;
- consumer relationships, including the company's policies and record relating to advertising, public relations and compliance with consumer protection laws; and
- labour and employment matters.

If one considers the requirements of King III with respect to ethical leadership and ethical behaviour, it appears advisable to assign to the social and ethics committee some of the responsibilities in this regard.

The additional functions may include:
- reviewing the adequacy and effectiveness of the company's engagement and interaction with its stakeholders,
- considering substantive national and international regulatory developments, overseeing their operationalisation as well as practice in the fields of social and ethics management,
- reviewing and approving the policy and strategy pertaining to the company's programme of corporate social investment,
- determining clearly articulated ethical standards (code of ethics), and ensuring that the company takes measures to achieve adherence to these in all aspects of the business, thus facilitating a sustainable ethical corporate culture within the company,
- monitoring that management develop and implement programmes, guidelines and practices congruent with the company's social and ethics policies,
- reviewing the material risks and liabilities relating to the provisions of the code of ethics, and ensuring that such risks are managed as part of the company's risk management programme,
- reviewing the company's performance in implementing the provisions of the code of ethics and the assertions made in this regard,
- obtaining independent external assurance of the company's ethics performance on an annual basis, and include in the Integrated Report an assurance statement related to the ethics performance of the company, and
- ensuring that management has allocated adequate resources to comply with social and ethics policies, codes of best practice and regulatory requirements.

The social and ethics committee must report to shareholders at the Annual General Meeting. At least one member of the committee must attend the Annual General Meeting of the company to report back to shareholders on the activities of the company. Although there is no legislative requirement for the committee to issue a written report, it is recommended that a written report be included in the company's Integrated Report, Director's Report or its Governance report, whichever is the most appropriate in the circumstances.

4.6 Relationships within the company

The board's relationship with the shareholders

The board of directors is ultimately accountable to the owners of the company. The shareholders therefore need to evaluate the performance of the board to the extent that they are able to. By exercising their rights to appoint and remove the directors of the company, the shareholders effectively control the board.

In most instances, however, the shareholders would not have access to the detailed decisions taken by the board, and consequently are not in a position to evaluate the success or failure of each decision made by the directors.

> *The board should encourage shareholders to attend AGMs and other company meetings, at which all the directors should be present. The chairmen of each of the board committees should be present at the AGM.*
>
> ***King III Report principle 8.2 par 18***

Directors are not required by law to attend general meetings of the shareholders. It is, however, general practice for the directors to attend the meetings to maintain a channel of communication between the shareholders and the board. Where a company is required to have a social and ethics committee, one member must attend the AGM to report to shareholders on the activities of the committee.

Usually the chairperson of the board also acts as the chairperson at a general meeting. However, depending on the company's Memorandum of Incorporation, the members may be able to appoint their own chairperson.

The board's relationship with the company secretary

> *The individual directors, and the board collectively, should look to the company secretary for guidance on their responsibilities and duties and how such responsibilities and duties should be properly discharged in the best interests of the company.*
>
> ***King III Report principle 2.21 par 101***

The Act requires every public company and state owned company to appoint a company secretary. The company secretary may be appointed either by the board or by an ordinary resolution of the holders of the company's securities. This individual is required to have (in the opinion of the directors) sufficient relevant experience and knowledge to perform this function adequately. In addition, the secretary should be permanently resident in South Africa.

The company secretary is accountable to the board.

> *The company secretary should provide a central source of guidance and advice to the board, and within the company, on matters of good governance and of changes in legislation.*
>
> ***King III Report principle 2.21 par 102***

The Act allows that the role of the company secretary be performed by a juristic person or partnership.

The directors have the power to remove the company secretary. The removed individual has the right to place a statement setting out his or her objections to the removal in the annual financial statements of the company.

Where there is a casual vacancy of the company secretarial position, the directors have 60 business days to find a replacement. The same restrictions on persons being appointed as directors apply to the appointment of the company secretary, apart from the fact that the company secretary does not have to be a natural person.

The Act, in section 88 sets out the duties of the company secretary. The company secretary is responsible for:

- providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers
- making the directors aware of any law relevant to or affecting the company
- reporting to the company's board any failure on the part of the company or a director to comply with the Memorandum of Incorporation or rules of the company or the provisions of the Act;
- ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company's audit committee, are properly recorded
- certifying in the company's annual financial statements whether the company has filed required returns and notices in terms of the Act, and whether all such returns and notices appear to be true, correct and up to date
- ensuring that a copy of the company's annual financial statements is sent to every person who is entitled to it, and
- ensuring that the company's annual return is filed in terms of section 33 of the Act.

As can be seen from the above duties, the company secretary plays a pivotal role in assisting and supporting the directors of the company.

In the past, the role of company secretary was often delegated to individuals who were meticulous in record keeping, but not much more was usually required from the individual.

The secretary, however, plays an important part in educating and inducting new directors to the board. In recent years the company secretary has become an important and powerful individual within the company. This role is enforced by the Act and King III.

King III suggests that a further important function of the secretary is to ensure that the directors receive all relevant information in their board papers. Such information should be complete to allow for an informed decision to be made, concise to ensure that the directors do not suffer from information overload and timely to be of any use to the directors.

The company secretary should have a direct channel of communication to the chairman and should be available to provide comprehensive practical support and guidance to directors, with particular emphasis on supporting the non-executive directors, the chairman of the board and the chairman of committees and the audit committee.

King III Report principle 2.21 par 103

The board's relationship with management
The directors have the power to appoint and remove the management of the company, unless the manager is also a director of the company, in which case the shareholders are responsible for his or her appointment or removal.

In practice however, it is often the board that takes decisions on executive director appointments, with shareholder approval being a "rubber-stamping" exercise.

It is management's responsibility to provide the directors with all relevant information that they require to make an informed decision as to the financial and operational affairs of the company.

In exceptional circumstances, managers who are not directors may attend directors' meetings. This may be the case where, for some reason, the directors require that a key member of management is required to explain or clarify an issue for the benefit of the board.

It should be noted that the Act determines that prescribed officers are required to perform their functions and exercise their duties to the standard of conduct as it applies to directors. Prescribed officers will be subject to the same liability provisions as it applies to directors.

Prescribed officers include every person, by whatever title the office is designated, that:

- exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
- regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

A person will be a prescribed officer regardless of any title or office they are designated.

Where executive directors play a dual role, the individual should ensure that he or she is able to detach him or herself from their role as a manager of the company when representing the interests of the shareholders on the board of directors.

The board's relationship with the external auditors

The shareholders are responsible for the appointment of the auditor at the annual general meeting. The audit committee has to nominate an independent auditor for appointment. However, nothing precludes the appointment by the company at its annual general meeting of an auditor other than one nominated by the audit committee. However, if such an auditor is appointed, the appointment is valid only if the audit committee is satisfied that the proposed auditor is independent of the company.

The board may remove the auditor. A vacancy created in the appointment of the auditor, either through the removal of the auditor by the board or by the resignation of the auditor, must be filled by the board within 40 business days. In such an instance, the company's audit committee must be satisfied that the auditor is independent of the company.

The audit committee is responsible, to the exclusion of the rest of the board, for the terms of engagement, the fees and the appointment of the external auditor.

The audit committee should be informed when there is a disagreement on auditing or accounting matters between the management and the external auditors. Where an accounting opinion has been requested from a person other than the external auditor of the company, the reasoning for the accounting treatment adopted should be obtained and should be approved by the audit committee before the committee's recommendation is made to the board. The audit committee should also be satisfied with the credentials of the person providing such an opinion.

King III Report principle 3.4 par 32

The board's relationship with internal audit

The internal audit function offers the board an objective review of the internal control systems within the company. The function should be staffed with appropriate individuals who are well respected within the organisation.

The internal audit function is accountable to the board, and operates under the direct oversight of the audit committee.

Internal audit should provide a written assessment of the effectiveness of the system of internal controls and risk management to the board. The assessment regarding internal financial controls should be reported specifically to the audit committee.

King III Report principle 7.3 par 16

The charter of the internal audit function should comply with the guidance published by the Institute of Internal Auditors. King III indicates that the key responsibility of internal audit is to the board, its committees, or both, in discharging its governance responsibilities and as a minimum to perform the following functions:

- evaluate the company's governance processes including ethics, especially the 'tone at the top'
- perform an objective assessment of the effectiveness of risk management and the internal control framework
- systematically analyse and evaluate business processes and associated controls, including IT, and
- provide a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities.

Internal audit should pursue a risk based approach to planning as opposed to a compliance approach that is limited to evaluation of adherence to procedures. A risk-based internal audit approach has the benefit of assessing whether the process intended to serve as a control is an appropriate risk measure. An internal audit function should be independent from management who instituted the controls and should be an objective provider of assurance with respect to the risks that may threaten the achievement of the company's strategic goals, as well as the opportunities that may contribute to the achievement of such goals.

King III proposes that the internal audit function should be positioned strategically within the company to ensure that its objectives are achieved. The Chief Audit Executive should have a standing invitation to attend as an invitee any of the executive committee or other committee meetings. The Chief Audit Executive should be apprised formally of the company's strategy and performance through meetings with the chairman, the CEO, or both.

The directors are required to take responsibility for the state of the internal controls at the company. In order to discharge this responsibility, the directors have to take a certain amount of reliance from the work performed by the internal audit department.

It is vital that each member of the board understands the significant risks impacting the company, and is therefore able to make an informed decision on the appropriateness of the focus of the internal audit function, as well as the work performed to draw an opinion on the functioning of the controls in place to mitigate the business, operational and financial risks.

Where the directors feel that there are significant risks that are not being sufficiently managed, they should be able to look to the internal audit function to work with management in creating and maintaining a comprehensive risk management plan to manage these risks.

4.7 Communication with stakeholders

The Directors' Report

> *All communication to stakeholders should use clear and simple language and should set out all relevant facts, both positive and negative. It should be structured to enable its target market to understand the implications of the communication. Companies should use communication channels that are accessible to its stakeholder.*
>
> ***King III Report principle 8.5 par 33***

The Act requires that the annual financial statements of a company must include a directors' report. As this report is considered part of the financial statements of the company, it is subject to review by the auditor.

The Act requires the directors to discuss in the directors' report any matter with respect to the state of affairs, the business and profit or loss of the company, or of the group of companies, if the company is part of a group, including any matter material for the shareholders to appreciate the company's state of affairs.

Ownership of Integrated Reporting and the Integrated Report

The actual effective ownership by the board of the Integrated Reporting process, and the Integrated Report itself, is of significant practical importance as it is one of the key determinants for a good Integrated Report.

There is indeed an important difference between the board actually setting and owning the agenda in this regard, or effectively acquiescing to an agenda actually set, and populated by, executive management or those that report to them and which is submitted to the board for approval, very often at a late stage of the process. Due to the relatively immature stage of development of Integrated Reporting and Integrated Reports, and a consequentially still developing framework, a greater degree of pro-activeness than is the case with the more traditional areas of responsibility where more mature and generally accepted frameworks are in place, is indicated. This requires boards to equip themselves properly in this area, and/or to seek the appropriate assistance to properly discharge their responsibilities.

According to King III, the board should ensure the integrity of the Integrated Report, and the audit committee should oversee the Integrated Report. Detailed requirements for audit committees in King III, that directly and indirectly impact on the effective ownership of the Integrated Report include:

- The responsibility to consider whether an unbiased picture of the company's position, performance or sustainability is being presented;
- The responsibility for evaluating the significant judgements and reporting decisions affecting the Integrated Report;
- The responsibility to understand how materiality for the Integrated Report has been determined; and
- The responsibility to ensure that forward-looking information provides a proper appreciation of the key drivers that will enable the achievement of such goals.

The purpose of an Integrated Report is tell the unique story of the company and the manner in which it sustains and adds value in the short, medium and long term.

To properly discharge these responsibilities, as well as those set out in the Companies Act and contained in Company Law, the board should pro-actively set and own the Integrated Reporting agenda. In this regard, the view from executive management is obviously important to take into account in setting the agenda and framework, but once these are finalised by the board, the primary role of executive management and those that report to them is to operationalise and report back to the board within the framework thus established. If, as is generally accepted, the Integrated Report indeed reflects the collective mind of the board and the integrated thinking that is essential for business in the modern world, a more reactive approach by the board would not effectively enable capturing the essential qualities and pre-requisites for Integrated Reports.

The purpose of an Integrated Report is tell the unique story of the company and the manner in which it sustains and adds value in the short, medium and long term. The board is clearly intended to be ultimately overall accountable for the company and its journey, and has been placed in a unique position to practically discharge this responsibility by a variety of formal and informal arrangements. In order to effectively discharge this accountability responsibility, the board should therefore also embrace the proactive and effective ownership of the Integrated Reporting process and the Integrated Report.

5. The powers of the board of directors

5.1 How can a director bind the company?

A company is a juristic person, and unless the company's Memorandum of Incorporation provides otherwise it has all of the legal powers and capacity of an individual, except if a juristic person is incapable of exercising any such power, or having any such capacity.

A company may limit, restrict or qualify the purposes, powers or activities of that company in its Memorandum of Incorporation. In addition, the Memorandum of Incorporation may limit the authority of the directors to perform an act on behalf of the company. It should be noted that the Act determines that where a company or its directors acts in contravention of such a limitation, qualification or restriction the action is not regarded as void for this reason only. Therefore, the Act provides that any person dealing with a company in good faith may presume that the company has complied with all of the formal and procedural requirements in terms of the Act, its Memorandum of Incorporation and any rules of the company, unless the person knew or reasonably ought to have known of any failure by the company to comply with such requirement.

Where an action by the company or the directors is inconsistent with any limit, restriction or qualification as set out in the company's Memorandum of Incorporation, the shareholders, by special resolution, may ratify such action.

The business and affairs of a company are managed by or under the direction of its board. The board of directors has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the Act or the company's Memorandum of Incorporation provides otherwise. It is important for directors to ensure that they are familiar with the provisions of the Memorandum of Incorporation, especially those provisions that limit or restrict the authority of the board and the directors.

It is the board of directors generally that has the power to contract on behalf of the company. Individual directors or members of management do not have such authority, unless the authority is expressly delegated to them by the board. Often such delegation occurs through the terms of reference of a position within the company, for example the position of managing director.

The board often reserves certain powers for itself, either because they are strategically important, or in monetary terms they are significant. This concept is discussed below.

5.2 Reservation of powers

As the board of directors bears the ultimate responsibility for the actions and performance of the company, it is usually considered appropriate that certain decisions may only be taken by the board itself.

In many instances, monetary limits are set for each level of responsibility within the company. For example, when authorising capital expenditure, limits for authorisation may be set for the divisional manager, the group financial director and the managing director. Any projects exceeding the managing director's limit would then need to be authorised by the board itself.

Further examples of when different levels of responsibility may be designated for the various tiers of management (or may be reserved only for the board to decide upon, depending on the materiality or strategic nature of the decision) are:

- Decisions regarding the use of auditors, consultants and other outside agencies
- Strategic marketing decisions affecting the company's brands and stakeholder communications
- Major tenders to be awarded
- Employee benefits awarded to senior and middle management
- Significant litigation issues

It is therefore appropriate for the board to prescribe the types of decisions that may be delegated, and those that need to be brought before the board. In some cases, it is appropriate for the board to require that certain decisions should be "pre-approved" or alternatively subsequently ratified.

The board should set some level of quantitative materiality for itself to ensure that issues discussed are significant in terms of the company as a whole. These limits may be more complex than a single threshold, and may take into account additional factors such as whether the decision is for an unbudgeted expense.

5.3 Which powers are restricted?

The Act reserves certain decisions for the shareholders and consequently the directors require the approval of the shareholders prior to any such decisions being finalised. In some instances the shareholders provide the directors with a general approval for such decisions, which is usually valid until the next AGM, but some decisions need to be voted on individually.

The Act requires approval of the shareholders by special resolution in the following instances:

- amendment of the company's Memorandum of Incorporation
- approval for the voluntary winding-up of the company
- approval of any proposed fundamental transaction (including the disposal of all or greater part of assets or undertaking, amalgamation, merger or scheme of arrangement)
- ratification of any action by the company or the directors that is inconsistent with a limit, restriction or qualification in the Memorandum of Incorporation
- approval of an issue of shares or securities to a director, future director, prescribed officer, or any person related or inter-related to the company, or to a director or prescribed officer of the company
- approval of financial assistance for subscription of securities (special resolution of the shareholders should be adopted within the preceding two years)
- approval of loans or other financial assistance to directors as well as related and inter-related companies (special resolution of the shareholders should be adopted within the preceding two years), and
- approval of the policy or parameters for director remuneration(special resolution of the shareholders should be adopted within the preceding two years).

5.4 Effectiveness of company actions and the role of the CIPC

The Act specifically reduces the company's reliance on the regulator, the CIPC. Although companies still have to comply with an administrative process to inform the CIPC of its decisions (for example the appointment of directors, changing of auditors, change of year end, amendment of the Memorandum of Incorporation), none of these decisions are dependent on the approval of the CIPC. In most instances, the company's decision is effective immediately and it merely needs to inform the CIPC of decisions or actions. However, in a few instances the effect of the decision is delayed until the necessary notices have been 'filed' with the CIPC.

Companies are often required to "file" a notice with the CIPC. Section 1 provides that "file", when used as a verb, means to deliver a document to the Commission in the manner and form, if any, prescribed for that document. If one looks at the Regulations, (Regulation 7 and Annexure 3), it clearly indicates that when a document is "delivered" to the CIPC, the date and time of delivery is determined as follows:

Method of delivery	Time of deemed delivery
By entering the required information in an electronic representation of that form on the internet website, if any, maintained by the Commission, if the document is a prescribed form; or	On the date and at the time recorded by the Commission's computer system, as verified by fax reply to the sender of the information.
By transmitting the document as a separate file attached to an electronic mail message addressed to the Commission; or	On the date and at the time recorded by the Commission's computer system, unless, within 1 business day after that date, the Commission advises the sender that the file is unreadable.
By sending a computer disk containing the document in electronic form, by registered post addressed to the Commission; or	On the date and at the time of delivery of the registered post to the Commission, as recorded by the post office, unless, within 1 business day after that date, the Commission advises the sender that the disk is unreadable.
By handing the document, or a computer disk containing the document in electronic form, to the Commission, or a responsible employee who is apparently in charge of the Commission's office.	On the date and at the time noted in a receipt issued by the Commission unless, the document is on a computer disk, and, within 1 business day after that date, the Commission advises the sender that the disk is unreadable.

It should be clear from the table above that "file" and "deliver" is defined so as to simply mean that a document must be submitted to the CIPC. There is no subsequent requirement for the CIPC to check or approve the particular action. Of course, the company needs to ensure that the particular filing complies with the provisions of the Act (relevant form completed correctly, required supporting documents attached, and the prescribed fee paid). Where the company fails to comply with the provisions of the Act, the company and its directors may be liable.

In order to illustrate the above conclusion, the provisions of the Act with respect to a few company actions will be investigated. To date, the CIPC still adheres to the approach followed by its predecessor CIPRO, in that they regard it as a core function to check and approve all documents filed with them, and then inform the company as to whether or not the particular company action is approved or rejected. This approach is outdated, and not provided for in the new Act. On the contrary, section 6(8) and (9) clearly provides for a 'substance over form' approach, and indicates that even if there is a deviation from the design or content of a prescribed form, or in the manner of delivery, it does not invalidate the action taken.

Appointment of directors

In terms of section 66(7):

"A person becomes entitled to serve as a director of a company when that person

(a) has been appointed or elected in accordance with this Part, or holds an office, title, designation or similar status entitling that person to be an ex officio director of the company; and
(b) has delivered to the company a written consent to serve as its director."

In turn, section 70(6) requires every company to file a notice (CoR39) within 10 business days after a person becomes or ceases to be a director of the company.

Thus, in terms of the Act the appointment of a director is effective as soon as he/she is appointed or elected, and has confirmed in writing that they are prepared to accept the appointment to the board. The CIPC has no role to play in the appointment of directors. The filing of the relevant notice does not affect the validity or the time of the appointment.

The question arises as to what would be the consequence if the CIPC fails to update its register of directors, delays the updating of the register, or includes incorrect information in the register?

Despite the requirement to file a notice of the appointment or removal of a director to the CIPC, the company is obliged to keep a record of its directors (section 24(3)(b) and 24(5)). This record may be accessed by any person who holds or has a beneficial interest in any securities issued by a profit company, or who is a member of a non-profit company. Any other person has a right to inspect or copy the register of directors of a company, upon payment of a prescribed amount. As such one may conclude that the register held by the company should be regarded as the 'official' register of its directors, and it is this register that should be consulted where there is a discrepancy between the company's register and CIPC's register, or where there is confusion or uncertainty as to the identity of the company's directors.

Change of the financial year end

In order to determine the exact date and time on which the financial yearend is changed, one needs to look at the provisions of the Act. Section 27(4) of the Companies Act determines that:

"The board of a company may change its financial year end at any time, by filing a notice of that change, but—

(a) it may not do so more than once during any financial year;

(b) the newly established financial year end must be later than the date on which the notice is filed; and

(c) the date as changed may not result in a financial year ending more than 15 months after the end of the preceding financial year."

As pointed out above, 'filing' in terms of the new Act simply means that the notice had been received by the CIPC (recorded in the CIPC's computer system, or the date on which registered or other mail is received by the CIPC). The CIPC is not required to approve or vet any decisions or actions of the company. The changing of the company's financial year end will be complete once the relevant notice (CoR25)is received by the CIPC.

Change of auditor

The Act requires certain companies to appoint an auditor (public companies, state owned companies, and any other category of company that meets the requirements set out in the Regulations). The Act provides for the appointment of the auditor by shareholders at the annual general meeting, and where a vacancy exists, for the directors to fill the vacancy within 40 business days. Section 85(3) requires the company to file a notice (CoR44) within 10 business days after making the appointment. In addition, the company has to maintain a record of its auditors (section 85(1)). Again, the Act does not link the filing of the relevant notice to the effectiveness of the appointment. However, where an auditor resigns, the Act expressly states that the resignation of the auditor is effective when the notice is filed (section 91(1)). This implies that a resignation letter submitted to the company by the auditor is not sufficient to terminate the appointment of the auditor. In order to complete the action, the company has to file the CoR44. The resignation will only be effective on the date and time when the notice was received (and recorded) by the CIPC.

Amendment of the Memorandum of Incorporation

Where a company amends its Memorandum of Incorporation, it has to file a Notice of Amendment (CoR15.2) within 10 days after such amendment (section 16(7) read with Regulation 15(3)). Where a company amends its Memorandum of Incorporation by means of a special resolution of shareholders (as provided for in section 16(1)(c)), the amendment will not be effective immediately. This constitutes the one instance where the Act delays the effectiveness of a special resolution of shareholders. Under other circumstances, a special resolution will take effect as soon as the required number of votes is obtained. However, where a special resolution is obtained to amend the Memorandum of Incorporation, the amendment to a company's Memorandum of Incorporation takes effect on the later of the date on, and time at, which the Notice of Amendment is filed, or the date, if any, set out in the Notice of Amendment (section 16(9)).

The new approach to enforcement of the Act, as illustrated by the examples above is in line with the Government's objectives for reform of our corporate law. The high-level objectives of the new Companies Act (as per a DTI presentation to Cabinet, dated 31 January 2007) were to:

- Reduce regulatory burden for small and medium-sized firms (mostly owner-managed, privately owned)
- Enhance protection of investors through enhanced governance and accountability (especially public interest companies), minority protection and shareholder recourse
- Create a more flexible environment, without comprising regulatory standards and objectives, to enhance investment.

The effect of the corporate law reform is clearly that the regulator now regulates with a much lighter touch, and that companies and directors need to bear responsibility for their actions. As a consequence, this new regulatory regime allows companies to take and implement its own decisions much easier and quicker, without having to wait for approval or a go-ahead by the CIPC. In most instances, mere 'filing' and 'delivery' will suffice to ensure compliance with the Act. Where documents are rejected by the CIPC, it does not invalidate the particular company action – it merely implies that the company needs to improve its administrative processes. Of course the new approach also points to the need for directors to carefully consider their decisions and actions, and to take into account the wider context and impact of such decisions. The Act clearly made it easier for companies to conduct business and has upped the ante for directors.

6. Remunerating directors

Remuneration of directors is one of the most debated topics in the corporate governance arena, due to the tension between shareholders demanding to understand their directors' remuneration levels and methods and the directors' desire for the privacy of their financial affairs.

6.1 The director's right to remuneration

Both executive and non-executive directors provide services to the company for which they deserve to be remunerated. Executive directors generally enter into an employment contract in which their remuneration (which may take a variety of forms as discussed below) is agreed upon. In many cases, non-executive directors have no formal contract with the company but are paid a standard level of fees for attending board and committee meetings.

"The shareholders at a meeting duly convened for the purpose, can, if they think proper, remunerate directors for their trouble or make presents to them for the services out of assets properly divisible amongst the shareholders themselves."

Re George Newman & Co 1895 1 Ch 674 (CA) 686

The Memorandum of Incorporation of a company generally provides for the remuneration of the directors, both for the services they provide and any expenses that they incur on behalf of the company. Where the Memorandum of Incorporation do not provide for this remuneration, the Act determines that the directors are entitled to payments only if such remuneration is authorised by a special resolution approved by the shareholders within the preceding two years.

6.2 Remuneration policy

King III suggests that the remuneration committee be tasked with setting and administering remuneration policies in the company's long-term interests. The committee should consider and recommend remuneration policies for all levels in the company, but should be especially concerned with the remuneration of senior executives, including executive directors, and should also advise on the remuneration of non-executive directors.

In proposing the remuneration policy, the remuneration committee should ensure that the mix of fixed and variable pay, in cash, shares and other elements, meets the company's needs and strategic objectives. Incentives should be based on targets that are stretching, verifiable and relevant. The remuneration committee should satisfy itself as to the accuracy of recorded performance measures that govern vesting of incentives. Risk-based monitoring of bonus pools and long-term incentives should be exercised to ensure that remuneration policies do not encourage behaviour contrary to the company's risk management strategy.

King III Report principle 2.25 par 151

King III proposes that the remuneration policy of the company be approved by shareholders, and that the board should be responsible for determining the remuneration of executive directors in accordance with the approved remuneration policy.

It is recommended that the remuneration committee set well defined criteria against which individual directors should be assessed. Directors often have a number of directorships within the same group, some executive and some non-executive. It is therefore not unusual for an individual to receive emoluments in various forms and from various sources.

6.3 What type of remuneration is appropriate?

Remunerating directors can take a number of forms, and there is ongoing debate as to the most appropriate way of both compensating the director for his or her time, and aligning their interests with the long term interests of the company they serve.

The various types of remuneration are discussed below. It is unusual for a remuneration policy to employ only one type and often a variety of different remuneration methods are negotiated.

In setting remuneration policies, the remuneration committee should ensure that remuneration levels reflect the contribution of senior executives and executive directors and should be rigorous in selecting an appropriate comparative group when comparing remuneration levels. There should be a balance between the fixed components and the bonus component of total remuneration of executives so as to allow for a fully flexible bonus scheme.

King III Report principle 2.25 par 157

Cash

While being the most traditional and easy-to-measure form of remuneration, cash can sometimes be the most controversial. When remunerating a director with cash the only corporate governance issue is generally the size of the cash payment to the director.

King III recognises the fact that the quantum of a director's remuneration package should be appropriate in terms of the value that the director adds to the company, bearing in mind the levels of remuneration that the market pays individuals of similar calibre in similar industries.

Where the company employs bonuses as part of the remuneration package, the bonuses should be related to specific performance indicators. Such performance indicators should be consistent with the long-term objectives of the company and long term value for shareholders. Although long- and short-term goals may be utilised in this regard, the company should guard against manipulation of results.

The company's own equities

Where a company is listed, and its shares are easily tradable, it is often appropriate to remunerate the directors by issuing them with the company's shares. The purpose of issuing a director with the company's own shares is that the shareholders' and directors' interests become more closely aligned.

King III proposes that the participation in share incentive schemes should be restricted to employees and executive directors. Such schemes should have appropriate limits for individual participation, and such limits should be disclosed. The chairperson and other non-executive directors should not receive share options or other incentives aligned to the share price or the company's performance, as this may impair their objectivity and align their interest too closely with those of the executive directors.

Often a "share incentive trust" or other such vehicle is used to house the shares to be issued to directors and employees. The purpose of such a scheme is to hold these shares in trust on behalf of the beneficiary. The share incentive trust is not a trading entity.

One of the problems with this remuneration strategy is that the directors become overly interested in maintaining the short-term share price, sometimes at the expense of the long-term interests of the company itself.

In many cases the options issued have relatively short terms to their maturity dates, thereby exacerbating the directors' incentive to look for short term gains at the expense of the long-term financial health of the company. It is therefore in the interests of the shareholders to ensure that the options have appropriate vesting periods.

A possible solution to this issue is to lock the directors into holding the shares for a reasonable period of time before they can dispose of them. King III suggests that options or other conditional share awards should be granted for the year in question and in expectation of service over a performance measurement period of not less than three years. This means that vesting of rights should be dependent on performance. Accordingly, shares and options should not vest or be exercisable within three years from the date of grant. In addition, options should not be exercisable more than 10 years from the date of grant. For new schemes it is best practice to restrict the exercise period to less than seven years.

> *To align shareholders' and executives' interests, vesting of share incentive awards should be conditional on achieving performance conditions. Such performance measures and the reasons for selecting them should be fully disclosed. They should be linked to factors enhancing shareholder value, and require strong levels of overall corporate performance, measured against an appropriately defined peer group or other relevant benchmark where yearly awards are made. If performance conditions for share-based incentive schemes are not met, they should not be re-tested in subsequent periods. Where performance measures are based on a comparative group of companies, there should be disclosure of the names of the companies chosen.*
>
> ***King III Report principle 2.25 par 174***

This may, however, prejudice the individual director from a cash flow perspective, and therefore it is usually preferable to employ a composite remuneration policy in which performance-related elements of remuneration constitute a substantial portion of the total remuneration package of executives. Such an approach will ensure the alignment of the directors' interests with those of the shareholders.

The price at which shares are issued under a scheme should not be less than the mid-market price or volume-weighted average price (or similar formula) immediately preceding the grant of the shares under the scheme.

A perceived benefit of issuing both equities and options is that the shares issued are seen as "free" to the company, with no impact on the earnings of the company. Such a perception, however, is not entirely accurate as any shares issued at less than market value dilute the existing shareholders' interests in the assets and earnings of the company.

In addition, accounting standards require companies to reflect share-based compensation as an expense in the income statement.

The issue of shares or securities convertible into shares, or a grant of options for the subscription of securities, or a grant of any other rights exercisable for securities is regulated by section 41 of the Companies Act. In these instances, the Act requires authorisation by a special resolution of the company. However, no shareholder approval is required if the issue of shares, securities or rights is

- under an agreement underwriting the shares, securities or rights
- in the exercise of a pre-emptive right to be offered and to subscribe shares
- in proportion to existing holdings, and on the same terms and conditions as have been offered to all the shareholders of the company or to all the shareholders of the class or classes of shares being issued
- pursuant to an employee share scheme, or
- pursuant to an offer to the public.

Loans to directors

The Act regulates financial assistance to directors (and others) in terms of section 45. In terms of this section, unless the company's Memorandum of Incorporation provides otherwise, the board may authorise direct or indirect financial assistance to the following parties:

- a director or prescribed officer of:
  - the company
  - a related or inter-related company, or
- a related or inter-related company or corporation
- a member of a related or inter-related company or corporation, or
- a person related to any of the above parties.

The requirements for the provision of financial assistance in terms of this section are:

- the provision of financial assistance must be pursuant to an employee share scheme, or
- the shareholders must have approved such financial assistance by special resolution (within the past 2 years), and
- the company's board of directors must be satisfied that after the transaction, the company will remain solvent and liquid.

An important development is that fact that the Act requires the board to inform all shareholders and trade unions representing employees whenever it decides to provide financial assistance in terms of this section.

6.4 Employment contracts, severance and retirement benefits

King III recommends that employment contracts (also for executive directors) should not commit companies to pay on termination arising from the executive's failure. Also, with respect to bonuses, there should be no automatic entitlement to bonuses or share-based payments in the event of early termination. Companies should not provide for balloon payments on termination.

Contracts should not compensate executives for severance because of change of control.

Where a company pays compensation to a director for loss of office, the Act requires the particulars of such compensation to be disclosed in the annual financial statements.

6.5 Disclosure of directors' remuneration

Section 30 of the Act regulates the disclosure in the company's annual financial statements of the directors' emoluments.

> *Companies should provide full disclosure of each individual executive and non-executive director's remuneration, giving details as required in the Act of base pay, bonuses, share-based payments, granting of options or rights, restraint payments and all other benefits (including present values of existing future awards). Similar information should be provided for the three most highly-paid employees who are not directors in the company.*
>
> ***King III Report principle 2.26 par 180***

The Act requires the annual financial statements of a company to include particulars of the remuneration and benefits received by each director. This should include:

- the amount of any pensions paid by the company to directors
- any amount paid by the company to a pension scheme
- the amount of any compensation paid in respect of loss of office
- the number and class of any securities issued to a director and the consideration received by the company for those securities, and
- details of service contracts of current directors.

For the purpose of disclosure, the Act defines remuneration' so as to include:

- fees paid to directors for services rendered by them to or on behalf of the company
- salary, bonuses and performance-related payments
- expense allowances
- contributions paid under any pension scheme
- the value of any option or right given directly or indirectly to a director
- financial assistance to a director for the subscription of shares, and
- with respect to any loan or other financial assistance by the company to a director, or any loan made by a third party to a director (if the company is a guarantor of that loan), the value of any interest deferred, waived or forgiven.

It is encouraging that more and more listed companies are compiling comprehensive remuneration reports which go far beyond the legislative and regulatory disclosure requirements.

These reports are increasingly reflecting not only the actual remuneration, but the justification for the levels of remuneration for each individual director in relation to the performance of the company for the period. This is in line with principles as set out in King III.

Where consolidated financial statements are provided, the information disclosed in terms of the Act relates only to the holding company's directors. In terms of best practice however, it would be recommended that the company should also reflect the remuneration of directors of subsidiary companies. This would remove any instances where directors structure their employment contracts through subsidiaries to avoid making public disclosure of their remuneration.

Section 30(5) of the Act requires that the disclosure must show the amount of any remuneration or benefits paid to or receivable by persons in respect of:

a. services rendered as directors or prescribed officers of the company, or
b. services rendered while being directors or prescribed officers of the company
   i. as directors or prescribed officers of any other company within the same group of companies, or
   ii. otherwise in connection with the carrying on of the affairs of the company or any other company within the same group of companies.

The effect of these requirements is that all remuneration paid to or receivable by a director or prescribed officer must be disclosed - thus, not only the remuneration paid to or received by the director or prescribed officer for services to the company, but also all other remuneration received by the director or prescribed officer for services rendered as a director or prescribed officer to any other company with the group. One person's remuneration may have to be disclosed by more than one company in the same group of companies.

Disclosure is required of all remuneration paid to or receivable by the directors and prescribed officers of the company for services as a director or prescribed officer of any other company within the same group of companies. In this regard the definition of a group should be considered. This means disclosure will have to account for all other companies in the group, and not only the subsidiaries of the company in question, therefore the company will have to take into account all companies in the group – thus upward, downward and sideways. It should be noted that the requirement applies only with respect to all "companies" within the group. In terms of the Companies Act a "company" is a juristic person incorporated in terms of the previous or current Companies Act, i.e. only South African companies. Therefore, any amounts paid to directors and prescribed officers for services rendered to a trust or a foreign subsidiary within the group would not be included in the disclosure, since *a trust or a foreign subsidiary (company) is not a "company" for purposes of the Companies Act.*

The Act requires all remuneration paid to or receivable by directors and prescribed officers to be disclosed – it does not only account for remuneration paid by the company, or another company in the group. Rather, it focuses on the amounts a director or prescribed officer earns for services as a director or prescribed officer (to the company or any other company within the group), or for carrying on the affairs of the company (or any other company within the group).

7. Assessment, removal and resignation

> *Effective and meaningful evaluation is only possible once the board has determined its own role, functions, duties and performance criteria as well as those for directors on the board and on board committees.*
>
> ***King III Report principle 2.22 par 110***

7.1 Assessment of performance

The assessment of the board of directors (collectively and individually) is becoming a critical success factor in any effective system of corporate governance. In capital markets such as the United States, where the level of shareholder activism is far greater than in South Africa, it has become common practice for directors, and in particular the CEO to be evaluated against the company's results. Where the results have not been consistent with the shareholders' expectations, it is almost inevitable that the individuals concerned are removed from his or her post.

King III recommends that the company carefully considers whether performance appraisals should be done in-house or by an independent service provider. Although an in-house process may yield proper results, an independent process may provide a more honest assessment. The assessment is usually led by the chairperson (through the nominations committee) with the assistance of the company secretary, or by an independent service provider.

King III proposes that an assessment of the board, the various board committees, and each individual director be done on an annual basis. This would assist the nominations committee to evaluate the levels of skill and experience on the board and committees with a view to identify training and skills development needs, as well as to evaluate the composition of the board and the respective committees. These evaluations should be reviewed by the nomination committee to be used in assessing whether the board requires additional skills, or that certain members of the board are not performing according to expectations. Due to the costs and time of initiating a new director, where possible it would be preferable for the existing directors to acquire any skills that the board lacks, rather than to have to seek to expand the board. The outcome of the evaluation should be used as the basis for an action plan to ensure that the board as a whole has the required skill and experience.

The annual evaluation of director performance should be used to determine whether or not a particular director should be nominated for re-appointment. Re-appointment should not be an automatic process, but rather be based on the director's contribution to the board and relevant committees.

The chairperson should ensure that all directors are aware of the annual evaluation, and that they understand the criteria used for evaluation. A director's role and contribution should be measured against his or her specific duties.

The chairperson should also be evaluated, and he or she should not be present when his or her performance is discussed by the board. Where an independent service provider is not used, the Lead Independent Director should lead the evaluation of the chairperson.

7.2 Why a director may be removed

Directors may be removed for a number of reasons. In some cases, the results of the evaluations discussed above may reveal the fact that an individual does not have the appropriate personality traits or other skills to continue to serve the board.

In other cases the director may become legally disqualified from his or her post as director, in terms of the Companies Act or other legislation. In some cases a director is removed not due to his or her performance (or lack thereof). When the nomination committee assesses the skills and balance of the board, the conclusion may be that the board is overloaded with certain skill sets, and unfortunately individual directors with redundant skills or experience may have to make way for others who possess the attributes that the board requires.

The Memorandum of Incorporation of a company may provide that where a director becomes interested in a contract with the company, and he or she fails to declare that interest to the board, that the director's office must be vacated.

7.3 Rotation of directors

The Memorandum of Incorporation of a company generally provides that a certain number or percentage of directors resign every year and offer themselves for re-appointment. The intention of such a provision is so that the shareholders will actively consider whether the director is performing according to their expectations, and where he or she is not performing, they will not be re-appointed.

Generally, the Memorandum of Incorporation will require that all directors retire at the first annual general meeting of the company, and that one third of the directors retire annually thereafter. It is usually the directors that have served the longest that retire, but where the directors have served an equal period of time, their retirement is selected by lot. The JSE Listings Requirements requires such provisions to appear in the Memorandum of Incorporation. King III provides for similar rotation requirements for non-executive directors.

The Listings Requirements provide for the exception where a managing director or other executive director has a contract with the company, he or she does not have to retire so long as they are employed by the company. They would not be taken into account when determining the number of directors that need to retire annually.

Any appointment (even re-appointment) is only valid once the director has provided written consent to serve as a director.

7.4 Vacancies on the board

In terms of the Act, a person ceases to be a director, and a vacancy arises on the board of a company when the person's term of office as director expires (in the case of a company whose Memorandum of Incorporation provides for fixed terms). A vacancy may also arise where a director:

- resigns or dies
- in the case of an ex officio director, ceases to hold the office, title, designation or similar status that entitled the person to be an ex officio director
- becomes incapacitated to the extent that the person is unable to perform the functions of a director
- is declared delinquent by a court, or placed on probation
- becomes ineligible or disqualified in terms of the provisions of the Act, or
- is removed by resolution of the shareholders or the board, or by an order of court.

In the case of a vacancy, the directors may have the power to appoint a director to the board. Such appointment will be temporary, until the director is elected and appointed by the shareholders in terms of the provisions of the Act. Schedule 10 of the JSE Listings Requirements requires that any appointment of a director needs to be confirmed at the next AGM of the company. In general, the shareholders are not under any obligation to fill the vacancy left by a retiring director, unless the number of directors has fallen below the minimum required by the Companies Act, the company's Memorandum of Incorporation or the JSE Listings Requirements where the company is listed.

The Listings Requirements require that the company's Memorandum of Incorporation provide for, where the minimum number of directors in terms of the Memorandum of Incorporation has been reached, a retiring director to be deemed to have been re-appointed where the shareholders do not fill the vacancy at the meeting even if they decided not to re-appoint that particular director.

7.5 The legal mechanics of removal

Section 71 of the Act determines that a director may be removed by an ordinary resolution adopted at a shareholders meeting. In any such case, the director should be given a reasonable opportunity to state his or her case. Also, where a company has a board comprising two or more directors, the board may remove a director where it is resolved that he or she:

- has become ineligible or disqualified in terms of the Act
- has become incapacitated to the extent that the director is unable to perform the functions of a director, or
- has neglected, or been derelict in the performance of his or her functions.

The Act provides the director concerned with the facility to air his or her grievances regarding the impending removal. The director is allowed the opportunity to make representations to those attending the meeting. Any person who feels that the representations may prejudice them may apply to the Court to stop the representations being communicated to the members.

Where the director does have a valid contract with the company, compensation may have to be paid to the director, as removal would in most instances constitute a breach of the contract (unless of course the removal is due to the fact that the director breached the contract in the first place). Any such payments should be reflected in the schedule of directors' remuneration in the annual financial statements of the company.

7.6 Formalities when a director resigns

A director generally resigns his or her office by providing the company with a notice of this intention (usually in writing in terms of the Memorandum of Incorporation of the company). From a practical point of view it would be preferable to have written record of the resignation.

> *"(A) director, once having given in the proper quarter notice of his resignation of his office, is not entitled to withdraw that notice, but, if it is withdrawn, it must be by the consent of the company properly exercised by their managers, who are the directors of the company. But, of course, that is always dependent upon any contract between the parties, and that has to be ascertained from the articles of association."*
>
> ***Glossop v Glossop 1907 2 Ch 374 & 375***

In addition, the relevant form needs to be sent to the CIPC. In terms of the JSE Listings Requirements, listed companies must report to the JSE when a director resigns or is removed from the board.

The ease with which the director is able to resign will be a function of the existence of any contract between the director and the company, and whether in addition the director acts as an employee of the company.

8. Financial institutions

Financial institutions are often viewed as companies with a higher public profile than their counterparts in other industries. These companies therefore often find themselves the focus of more regulation than companies operating in other sectors.

This fact results in the directors of these financial institutions being entrusted with added disclosure and performance responsibilities.

All financial institutions that are companies are regulated by the Companies Act and the case law that interprets it.

Consequently the discussions elsewhere in this guide are equally of application to directors of these institutions. Most financial industries, however, have specific legislation that increases the regulatory environment in that sector. The impact of this legislation on certain financial sectors is discussed in this chapter.

8.1 Directors of banks

The Companies Act determines that if there is an inconsistency between any provision of the Companies Act and a provision of any other national legislation, the provisions of both Acts apply concurrently. If, in case of a bank, it is impossible to apply or comply with one of the inconsistent provisions without contravening the Banks Act, the provisions of the Banks Act will prevail.

Directors applying for registration of a bank

The Registrar of Banks is not obliged to approve the registration of a new bank unless certain criteria are met. The Banks Act requires that the Registrar must be satisfied that the proposed composition of the board of directors is "appropriate having regard to the nature and scale of the business it is intended to conduct." In addition, in terms of section 25(4) of the Banks Act, the Registrar has the power to apply to the court to cancel or suspend the registration of a bank where the directors or executive officers have committed any offence in terms of the Banks Act.

Fiduciary duties of a bank's directors

In addition to the codified standard of director conduct in the Companies Act, the Banks Act has codified the specific fiduciary responsibilities of directors of a bank in section 60. This section states that each director, chief executive officer and executive officer of a bank owes a duty towards the bank to:

- act bona fide for the benefit of the bank
- avoid any conflict between the bank's interests and the interests of such a director, chief executive officer or executive officer, as the case may be
- possess and maintain the knowledge and skill that may reasonably be expected of a person holding a similar appointment and carrying out similar functions as are carried out by the director, chief executive officer or executive officer of that bank, and
- exercise such care in the carrying out of his or her functions in relation to that bank as may reasonably be expected of a diligent person who holds the same appointment under similar circumstances, and who possesses both the knowledge and skill mentioned above and any such additional knowledge and skill as the director, chief executive officer or executive officer in question may have.

> *"Each director, chief executive officer and executive officer of a bank owes a fiduciary duty and a duty of care and skill to the bank of which such a person is a director, chief executive officer or executive officer."*
>
> ***Banks Act 94 of 1990 Section 60 (1)***

The Regulations to the Banks Act further expand on the responsibilities of the directors of a bank.

Regulation 39 requires that each director of a bank acquire at least a basic knowledge of the bank's business, and those laws and regulations that govern it. The Regulation further states that while not every director on a bank's board necessarily has to have an intimate knowledge of the workings of a bank, each director's knowledge thereof must be evaluated, based on the size and complexity of the bank.

In the case of a director of a controlling company of a bank, his or her required level of knowledge becomes a function of the diverse nature of the banks controlled by that company.

Appointment of directors

When appointing any new director, the Banks Act requires that the particulars of the potential new director be forwarded to the Registrar of Banks at least 30 days before the appointment is made.

The Banks Act in section 60 (3) mandates the appointment of non-executive directors by requiring that at most 49% (rounded down to the next lowest whole number) of the directors of the bank may be employees of the bank or its subsidiaries. Where the bank is controlled by a controlling company, only 49% of that company's directors can be employees of that company or the bank.

In addition, at each directors meeting, the votes of the executive directors may only count at most 49% of the total votes on each resolution voted on by the board.

Audit Committee

It should be noted that section 94 of the Companies Act (dealing with the audit committee) applies concurrently with section 64 of the Banks Act. However, the provisions of the Companies Act pertaining to the *appointment and requirements for membership* of the audit committee, do not apply to the audit committees of banks.

The Banks Act in section 64 requires that the board of directors establish an audit committee. Regulation 64 to the Banks Act further requires that at least three directors be appointed to the committee. The majority of directors appointed to the committee must, in terms of section 64 (3) be independent non-executive directors.

The chairperson of the board may not serve on the audit committee. Also, the chairperson of the committee may not be an executive director. The Banks Act in section 64 (4) allows an exemption from creating an audit committee in the circumstances where the bank is part of a group of companies and the holding company has appointed an audit committee that has assumed responsibility for all the banks within the group.

Section 64 (2) of the Act provides guidance for the functioning of the committee. The section states that the primary responsibilities assumed by the members of the committee are to: *"assist the board of directors in its evaluation of the adequacy and efficiency of the internal control systems, accounting practices, information systems and auditing processes applied within that bank in the day-to-day management of its business."*

The members of the committee are therefore required to have a reasonably detailed understanding of the workings of the bank, including the design and operation of the internal controls, the pertinent accounting issues, the information technology applied and the scope and function of the internal audit department.

"facilitate and promote communication, regarding the matters referred to in paragraph (a) or any other related matter, between the board of directors and the executive officers of, the auditor appointed under section 61 or 62 for, and the employee charged with the internal auditing of the transactions of, the bank."

As in other companies, the audit committee is intended to bridge the gaps between management and the external and internal audit functions at the bank. Any unresolved differences that occur within the three parties must be brought before the committee for resolution.

"introduce such measures as in the committee's opinion may serve to enhance the credibility and objectivity of financial statements and reports prepared with reference to the affairs of the bank."

It is clear that the audit committee is entrusted with the responsibility for optimising the disclosures made by the bank, whether in the annual report or in the statutory returns made to the Registrar of Banks.

In addition to the functions set out in the Banks Act, the audit committee appointed in terms of section 64 of the Banks Act will also be responsible for the functions of the audit committee as set out in section 94 of the Companies Act. The legislative duties of the audit committee as provided for in section 94 of the Companies Act include:

- nominating an auditor that the audit committee regards as independent
- determining the audit fee
- ensuring that the appointment of the auditor complies with the Companies Act and other relevant legislation
- determining the nature and extent of non-audit services
- pre-approving any proposed agreement with the auditor for the provision of non-audit services
- preparing a report to be included in the annual financial statements describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company
- receiving and dealing with relevant complaints
- making submissions to the board regarding the company's accounting policies, financial controls, records and reporting, and
- any other function designated by the board.

Responsibilities of a director

The Regulations to the Banks Act provide guidance for directors in carrying out their responsibilities.

Regulation 38 states that the board of directors is responsible for establishing an effective corporate governance process within the bank. The scope of this process is intended to be consistent with the risks, complexity and nature of the bank's operations. Sub-committees may be established to assist the board in carrying out these corporate governance processes.

The regulation stresses that a bank's business revolves around the effective management of the different risks impacting the bank. These risks are listed in the regulations as:

- Solvency
- Liquidity
- Credit
- Currency
- Market or position risk
- Interest-rate
- Counterparty
- Technology
- Operational
- Compliance

> *"In view of the fact that the primary source of funds administered and utilised by a bank in the conduct of its business is deposits loaned to it by the general public, it shall be the duty of every director and executive officer of a bank to ensure that risks that are of necessity taken by such a bank in the conduct of its business are managed in a prudent manner."*
>
> ***Regulation 39 (3) to the Banks Act 94 of 1990***

The board has the responsibility for evaluating the effectiveness of the corporate governance processes at the bank (or controlling company) on an ongoing basis. While this task may be operationally delegated to a sub-committee of the board, the responsibility for corporate governance at the bank remains with the board.

At least once a year the corporate governance assessment is required to be formally documented.

Directors' duty to establish a compliance function

As a result of the numerous pieces of legislation impacting a bank, there is a considerable risk that the bank does not comply with all laws and regulations impacting it. In order to manage this risk, Regulation 47 to the Banks Act requires that the directors establish an internal compliance function.

The function should be headed by a compliance officer who has the necessary senior status within the organisation to effectively address the bank's regulatory risk.

To be effective, the Regulation suggests that the compliance function should:

- be independent of internal audit;
- have direct access to, and be supported by the CEO of the bank;
- report to the board and the audit committee on compliance with laws and regulations and submit a copy of this to the Registrar; and
- avoid any conflict of interest with other internal functions.

The compliance function performs an important monitoring role within the bank. The Regulation reinforces this by requiring the following activities to be performed:

- a culture of risk management and compliance should be established
- create a channel of communication to line management to monitor compliance with laws and regulations
- instil a compliance focus into line management
- incorporate regulatory requirements into operational manuals, and
- recommend improvements to ensure greater compliance with laws and regulations.

In terms of reporting, recommendations and findings reported by the compliance officer should be documented together with the action plan for rectifying problems. In order that issues are resolved promptly, the channel for the compliance officer to report problems should always be available and open.

The compliance function should be staffed by capable individuals that receive regular training to enable them to remain technically up to date with regulatory issues at the bank. A comprehensive compliance manual should be developed and kept up to date.

Reporting by directors

The board of directors of a bank is required by Regulation 39 (4) to the Banks Act to report to the Registrar of Banks on certain matters within 120 days of the end of the financial year of the bank, including whether:

- the bank's internal controls provide reasonable assurance as to the integrity and reliability of the financial statements and safeguard, verify and maintain accountability of the bank's assets
- the internal controls are based on established policies and procedures and are implemented by trained, skilled personnel , whose duties have been segregated appropriately
- adherence to the implemented internal controls is continuously monitored by the bank
- all bank employees are required to maintain high ethical standards, thereby ensuring that the [bank's] business practices are conducted in a manner that is above reproach, and
- anything has come to the directors' attention to indicate that any material malfunction , as defined and documented by the board of directors, which definition has to be submitted to the Registrar of Banks, in the functioning of the aforementioned controls, procedures and systems has occurred during the period under review.

In addition, the directors are required annually to report to the Registrar of Banks on the going concern assumption at the bank. Where there is a potential going concern problem, the details thereof should be disclosed.

When making supervisory returns to the Registrar of Banks, both the CEO and Chief Accounting Officer are required to certify that the returns are correct.

8.2 Directors of insurance companies

Audit committee

Both the Long Term Insurance Act (in section 23) and the Short-Term Insurance Act (in section 22) require that the board of directors establish an audit committee unless exempted by the relevant Registrar on the grounds of impracticality or inappropriateness. The committee must have at least three members, and at least two of those must be directors of that insurance company.

The chairperson, as well as the majority of the members must be non-executive. The Acts state that the objectives of the committee are to:

- assist the board of directors in its evaluation of the adequacy and efficiency of the internal control systems, accounting practices, information systems and auditing and actuarial valuation processes applied by the insurer in the day-to-day management of its business
- facilitate and promote communication and liaison concerning the matters referred to above or a related matter, between the board of directors and the managing executive, auditor, statutory actuary and internal audit staff of the insurer
- recommend the introduction of measures which the committee believes may enhance the credibility and objectivity of financial statements and reports concerning the business of the insurer, and
- advise on a matter referred to the committee by the board of directors. The audit committee of an insurance company therefore has a similar brief to that of a financial institution.

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