



**KING III  
IN A NUTSHELL**



**EVERYTHING MATTERS**



## INTRODUCTION

The third report on Corporate Governance in Southern Africa (King III) was released by the Institute of Directors Southern Africa (IOD) on 1 September 2009. The report became necessary because of the anticipated introduction of the Companies Act No 71 of 2008 (the new Companies Act) within the next year and changes in international governance trends since the publication of King II in 2002.

King III will become effective on 1 March 2010. King II will apply until then. This overview gives a broad analysis of some of the issues contained in King III and highlights the important changes when compared to King II.

## THE STRUCTURE OF KING III

King III consists of two documents:

- a Code of Governance (the Code), which is a set of principles consisting of about 40 pages; and
- the Report, in which recommendations of the best practices for each principle are provided. The Report can more appropriately be described as a handbook on corporate governance and consists of 139 pages.

In addition to the Code and the Report, further practice notes are being issued by the IOD, which contain detailed guidance and tools for the implementation of the provisions contained in the Code.

The IOD holds the copyright in both the Code and the Report. The Code can be obtained without cost from the IOD, but the Report must be purchased.

## WHO MUST COMPLY WITH KING III?

In contrast to King II, King III applies to all entities regardless of their form or manner of incorporation. The premise is that adherence to the principles contained in King III will result in an entity practising good governance.

Application of King III may also be mandated by law or regulation - the JSE Listings Requirements, for example, compel a listed company to apply the principles of King III.

In this regard, the use of instructive language in King III is important in understanding its content:

- the word 'must' indicates a legal requirement - a public company is, for example, obliged to have an audit committee in terms of the new Companies Act;
- where it is believed that the application of the Code will result in good governance, the word 'should' is used; and
- the word 'may' indicates areas where certain practices are proposed for consideration.

## 'APPLY OR EXPLAIN' APPROACH

King III sets an international benchmark with an 'apply or explain' approach, which means that entities need not comply with the Code when they can justify their non-compliance. Where an entity has applied the Code and the best practice recommendations contained in the Report, a positive statement to this effect should be made to stakeholders. Where a specific principle or recommendation is not applied, this should be explained fully to stakeholders.

The introduction to the Report encourages institutional investors to oversee the implementation of the Code and to vote and engage with companies to ensure that best practice principles are consistently applied.

It should be noted that King III states that each principle contained in the Code is of equal importance and together they create a holistic approach. It follows therefore that substantial application of the Code and the Report does not achieve compliance.

## SUSTAINABILITY AND INTEGRATED REPORTING

One of the main themes running through the Report is sustainability. This has gained in importance internationally since the publication of King II. The most important effect is that an integrated report must be prepared annually and this will have a major impact on companies. This means that all statutory financial information and sustainability information has to be in the integrated report.

The requirement is not entirely new - King II contains a chapter dedicated to sustainability reporting on economic, social and environmental performance (the so-called 'triple bottom line').

*Continued on next page*

King III's requirements are far more comprehensive and compiling an integrated report will require substantially more effort and cost.

The integrated report should contain sufficient information to record how the company has impacted positively and negatively on the economic life of the community and the related environmental, social and governance issues. The board should furthermore report how it believes that in the coming year it can improve the positive aspects and eradicate or ameliorate the negative aspects.

## EMERGING GOVERNANCE TRENDS

**The following emerging trends have been incorporated in the Report:**

- **Alternative dispute resolution (ADR)** - administered mediation and, if that fails, an expedited arbitration is encouraged to ensure that directors exercise their duty of care.
- **Risk-based internal audits** - internal audits should be risk-based and every year the internal auditors should furnish an assessment to the board generally on the system of internal controls and to the audit committee specifically on the effectiveness of internal financial controls.
- **Shareholders and remuneration** - a board should put a company's policy of remuneration to a non-binding advisory vote of shareholders in a general meeting. In the policy the board should state the principles for fixing individual remuneration for senior management.
- **Evaluation of board and director performance** - both the board and the individual directors should be subject to evaluation and performance assessments.

## NEW ISSUES IN THE REPORT

**Some of the following new issues arise for the first time:**

- **IT governance** - an entire chapter (Chapter 5) deals with this issue. It focuses on providing the most salient aspects of IT governance for directors and is aimed at creating a greater degree of awareness at director level.
- **Business rescue** - this new concept is addressed for the first time in the new Companies Act. The Report and a practice note contain recommendations to directors to enable them to fulfil their duties and to be aware of the practicalities of business rescue.
- **Fundamental transactions** - the new Companies Act contains a new regime for fundamental transactions such as mergers and acquisitions. Guidelines are contained in a practice note on fundamental and affected transactions to ensure that directors are aware of their responsibilities and duties in this regard.

# HIGHLIGHTS OF SELECTED TOPICS AND COMPARISON WITH KING II

King II	King III
<b>Composition of the board</b>	
<p>The unitary board system with executive and non-executive directors interacting in a working group remains appropriate for SA.</p> <p>The board should comprise a balance of executive and non-executive directors, preferably with a majority of non-executive directors of whom a sufficient number should be independent of management.</p>	<p>Similar to King II</p> <p>The board should comprise a balance of power, with a majority of non-executive directors.</p> <p>The majority of non-executive directors should be independent.</p>
<b>Executive directors</b>	
<p>An individual who is involved in the day-to-day management and/or is in the full time salaried employment of the company and/or any of its subsidiaries.</p>	<p>Similar to King II.</p> <p>New recommendation: <i>'Executive directors should carefully manage conflict between their management responsibilities and their fiduciary duties in the best interests of the company'</i>.</p>
<b>Non-executive directors</b>	
<p>An individual not involved in the day-to-day management and not a full-time salaried employee of the company or of its subsidiaries.</p> <p>An individual in the full-time employment of the holding company or its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and its subsidiaries.</p>	<p>Not being involved in the management of the company defines a director as non-executive.</p> <p>Similar to King II.</p> <p><b>New recommendations.</b> Non-executive directors:</p> <ul style="list-style-type: none"> <li>■ <i>Play an important role in providing objective judgement independent of management on issues facing the company.</i></li> </ul>

*Continued on next page*

- *Are independent of management on all issues including strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and evaluation of performance.*
- *Should meet from time to time without the executive directors to consider the performance and actions of executive management.*

### Independent non-executive directors

A non-executive director who:

- i. Is not a representative of a shareholder who has the ability to control or significantly influence management;
- ii. has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years;
- iii. is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;
- iv. is not a professional advisor to the company or the group other than in a director capacity;
- v. is free from any business or other relationship which could be seen to materially interfere with an individual's capacity to act in an independent manner;

A non-executive director who:

- i. Is not a representative of a shareholder who has the ability to control or significantly influence management;
- ii. 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 past three financial years;
- iii. similar to (iii) in King II;
- iv. similar to (iv) in King II;
- v. 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;

*Continued on next page*

- vi. is not a significant supplier to, or customer of the company or group; and
- vii. has no significant contractual relationship with the company or group.

- vi. 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;
- vii. does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth; and
- viii. does not receive remuneration contingent upon the performance of the company.

#### **Additional recommendations.**

Independent directors:

- *Should be independent in fact and in the perception of a reasonably informed outsider.*
- *Although independence of mind is essential, perceptions of independence are important.*
- *Should be independent in character and judgement and there should be no relationship or circumstances which are likely to affect, or could appear to affect, this independence.*
- *Independence is absence of influence and bias which could be affected by the intensity of the relationship between the director and the company rather than any particular fact such as length of service or age.*
- *Every year independent directors should undergo an evaluation of their independence by the chairman and the board. If the chairman is not independent, process should be led by the Lead Independent Director (LID). All relevant factors that may impair independence must be weighed. Directors should be classified in the integrated report accordingly.*

*Continued on next page*

- *Any term beyond nine years should be subject to particular rigorous review - it should also take into account the need for refreshing the board.*
- *May serve longer than nine years if, after an independent assessment by the board, there are no relationships or circumstances likely to affect, or appearing to affect, the director's judgement. Assessment should show that independence is not affected or impaired by length of service. A statement to this effect should be included in the integrated report.*

### Minimum number of directors on the board

Not addressed.

As a minimum, two executive directors should be appointed to the board, being the chief executive officer and the director responsible for the finance function. This will ensure that there is more than one point of contact between the board and management. The effect of this is that a board should have not less than two executive directors and three non-executive directors so that the non-executives constitute the majority of board members. For listed companies, a financial director must be appointed to the board from June 2009.

### Rotation of non-executive directors

Rotation of non-executive directors is not addressed specifically.

In general it is recommended that there should be an effective programme of continuing rotation of appointments in respect of each individual director. All companies should adopt a process of staggered continuity and re-election of their boards to ensure continuity of experience and knowledge.

A programme ensuring staggered rotation of non-executive directors should be put in place.

Rotation of board members should be structured so as to retain valuable skills, maintain continuity of knowledge and experience and to introduce persons with new ideas and expertise.

At least one third of non-executive directors should retire by rotation at the company's AGM or other general meetings. The retiring board members may be re-elected, provided they are eligible.

*Continued on next page*

The board, through the nomination committee, should recommend eligibility considering past performance

### Removal of CEO

The memorandum of incorporation of the company should allow the board to remove the CEO as an executive director on the board without shareholder approval being necessary.

### Chairman of the board

The chairperson should preferably be an independent non-executive director.

It is preferable that the chairperson and the CEO functions are kept separate.

Not addressed.

The chairman of the board should be an independent non-executive director and free of conflicts of interest at appointment, failing which the board should appoint a LID.

Should not be the CEO.

Should be appointed every year by the board after carefully monitoring his/her independence.

In situations where the independence of the chairman is questionable or impaired, a LID should be appointed for as long as the situation exists.

### Lead independent non-executive director (LID)

Consideration should be given to appointing a senior independent or "lead" director to fulfil a role where any difficulties or conflicts arise between the non-executive component of the board and the executives, as well as in assisting the chairperson in fulfilling his tasks where required.

Such an appointment should be considered where the roles of the chairperson and the CEO are combined, or even where both the chairperson and the deputy chairperson might be executive directors.

Should be appointed if the chairman of the board is not independent and free of conflicts of interest on appointment.

Main function of the LID is to provide leadership and advice to the board when the chairman has a conflict of interest. Such assistance may be provided:

- at any board, committee meeting or other company meeting;
- at any meeting the chairman might initiate with the LID;
- in any consultations that any other director or executive might initiate with the LID; and
- in any consultation that the LID might initiate.

*Continued on next page*

### Share options for non-executive directors

Share options may be granted to non-executive directors but must be the subject of prior approval of shareholders.

Although permitted by the new Companies Act, the chairman and other non-executive directors should not receive share options or other incentive awards geared to share price or corporate performance, as such incentives align their interests too closely with executives and may be seen to impair their objectivity.

### Board committees

All companies should have, as a minimum, audit and remuneration committees.

Unless legislated otherwise\*, the board should appoint 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 terms of reference for each committee should, as a minimum, cover:

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

Practice notes have been published with proposed terms of reference for audit, nomination and remuneration committees.

The role of the audit committee is extensively covered in Chapter 3 of the Report.

\* Section 94 of the new Companies Act requires that a public company and state owned company must have an audit committee. Section 72(4) of the new Companies Act provides that certain categories of companies may be required to establish a social and ethics company.

This overview was compiled by:



**Johan Coetzee**

Director  
Corporate and Commercial  
Cliffe Dekker Hofmeyr

King III in a Nutshell is published for general information and is not intended as legal advice. As every situation depends on its own facts and circumstances, professional advice should be sought.

At Cliffe Dekker Hofmeyr, we have specialist corporate governance compliance and risk teams based at our Johannesburg and Cape Town offices. The teams are made up of experts from various practice areas, Corporate and Commercial including Intellectual Property; Tax; Environmental; Technology, Media and Telecommunications; Employment; Dispute Resolution: Litigation and Arbitration and Competition.

Our teams are ready to assist board members in understanding their obligations and helping them comply. We offer extensive compliance-related services in the form of training, presentations, assistance with the identification and management of legal risks and advice with regard to:

- Directors' fiduciary and other duties relating, for example, to corporate governance in general, corporate citizenship, risk management, managing stakeholder relationships, business rescue proceedings and fundamental transactions;
- proper governance of tax affairs;
- environmental issues and integrated sustainability reporting and disclosure;
- information technology governance;
- employment law;
- alternative dispute resolution;
- anti-corruption requirements; and
- competition law.

# CONTACT US

**Chris Ewing**

Director  
Corporate and Commercial  
T +27 (0)11 290 7120  
E [chris.ewing@dclacdh.com](mailto:chris.ewing@dclacdh.com)

**Johan Coetzee**

Director  
Corporate and Commercial  
T +27 (0)11 286 1121  
E [johan.coetzee@dclacdh.com](mailto:johan.coetzee@dclacdh.com)

**Francis Newham**

Director  
Corporate and Commercial  
T +27 (0)21 481 6326  
E [francis.newham@dclacdh.com](mailto:francis.newham@dclacdh.com)

**Justin Liebenberg**

Director  
Regional Practice Head: Tax  
T +27 (0)11 290 6514  
E [justin.liebenberg@dclacdh.com](mailto:justin.liebenberg@dclacdh.com)

**Patrick McGurk**

Director  
National Practice Head: Tax  
T +27 (0)21 481 6322  
E [patrick.mcgurk@dclacdh.com](mailto:patrick.mcgurk@dclacdh.com)

**Terry Winstanley**

Director  
National Practice Head:  
Environmental Law  
T +27 (0)21 481 6332  
E [terry.winstanley@dclacdh.com](mailto:terry.winstanley@dclacdh.com)

**Preeta Bhagattjee**

Director  
Technology, Media and Telecommunications  
T +27 (0)11 290 7210  
E [preeta.bhagattjee@dclacdh.com](mailto:preeta.bhagattjee@dclacdh.com)

**Aadil Patel**

Director  
National Practice Head: Employment  
T +27 (0)11 290 7212  
E [aadil.patel@dclacdh.com](mailto:aadil.patel@dclacdh.com)

**Gillian Lumb**

Director  
Regional Practice Head: Employment  
T +27 (0)21 481 6315  
E [gillian.lumb@dclacdh.com](mailto:gillian.lumb@dclacdh.com)

**Grant Ford**

Director  
Regional Practice Head:  
Dispute Resolution:  
Litigation and Arbitration  
T +27 (0) 21 405 6028  
E [grant.ford@dclacdh.com](mailto:grant.ford@dclacdh.com)

**Tim Fletcher**

Director  
Dispute Resolution:  
Litigation and Arbitration  
T +27 (0)11 290 7164  
E [tim.fletcher@dclacdh.com](mailto:tim.fletcher@dclacdh.com)

**Petra Krusche**

Director  
Regional Practice Head: Competition  
T +27 (0)21 481 6350  
E [petra.krusche@dclacdh.com](mailto:petra.krusche@dclacdh.com)

**Nick Altini**

Director  
Competition  
T +27 (0)11 290 7115  
E [nick.altini@dclacdh.com](mailto:nick.altini@dclacdh.com)

---

## JOHANNESBURG

6 Sandown Valley Crescent  
Sandown  
Sandton 2196  
Private Bag X40  
Benmore 2010  
South Africa  
Dx 154 Randburg  
T +27 (0)11 286 1100  
F +27 (0)11 286 1264  
E [jhb@dclacdh.com](mailto:jhb@dclacdh.com)

1 Protea Place  
Sandown  
Sandton 2196  
Private Bag X7  
Benmore 2010  
South Africa  
Dx 42 Johannesburg  
T +27 (0)11 290 7000  
F +27 (0)11 290 7300  
E [jhb@dclacdh.com](mailto:jhb@dclacdh.com)

## CAPE TOWN

11 Buitengracht Street  
Cape Town 8001  
PO Box 695  
Cape Town 8000  
South Africa  
Dx 5 Cape Town  
T +27 (0)21 481 6300  
F +27 (0)21 481 6388  
E [ctn@dclacdh.com](mailto:ctn@dclacdh.com)

©2009. For permission to  
reproduce a publication, please  
contact our marketing team on  
[marketing@dclacdh.com](mailto:marketing@dclacdh.com)

[www.cliffedekkerhofmeyr.com](http://www.cliffedekkerhofmeyr.com)