

King III explained

The need for King III

The anticipated new Companies Act and changing trends in international governance led to the necessity for King III. As with previous versions, the King Committee endeavoured to be at the forefront of governance internationally and this has again been achieved by focusing on the importance of reporting annually on how a company has both positively and negatively affected the economic wellbeing of the community in which it operated during the year under review.

In addition, emphasis has been placed on the requirement to report on how the company intends to enhance those positive aspects and eradicate or ameliorate any possible negative impacts on the economic wellbeing of the community in which it will operate in the year ahead.

Application of the Code – a welcome change

In contrast to King I and King II, King III applies to all entities and companies, whereas King II only applied to listed companies, financial institutions and public companies.

It is recommended that all entities disclose which principles and/or practices they have decided not to apply or explain. This level of disclosure will allow stakeholders to comment on and challenge the board to improve the level of governance within an organisation.

Importantly, attention is now securely on risk, from operational risk right through to financial and market risk, and what measures companies need to put in place to better measure, monitor and mitigate risk factors.

King III also focuses on future planning and sustainability, a key thread that runs throughout the report, and as previously mentioned, should be seen as inseparable from basic performance. In keeping with the developments in the way we do business, technology and IT risks are given significant attention and will no doubt be considered a critical component of the standards and the general health of a company. As with risk generally, King III calls for IT to be seen and managed as a crucial function of any organisation or business and therefore strategic responsibility should lie with the board and the implementation thereof with the management.

The role of the Board

One of the key principles promoted by King III is the need for a board to appreciate that strategy, risk, performance and sustainability are inseparable. This focus will force the hand of companies to begin planning their business approach with a view to the future.

King III places greater emphasis on the role of the board in the integrity of financial reporting. In addition, boards are now urged to take more interest in the organisation by means of ensuring that the company implements an effective compliance framework and related processes. This means that the board needs to keep its own house in order. They will need to ensure that they have the required information on hand as they will ultimately be held accountable for everything within the organisation to the point where ignorance will no longer be a defence.

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Key principles of King III

King III has broadened the scope of corporate governance in South Africa with its core philosophy revolving around leadership, sustainability and corporate citizenship.

These key principles are given prominence:

- Good governance is essentially about effective leadership. Leaders need to define strategy, provide direction and establish the ethics and values that will influence and guide practices and behaviour with regard to sustainability performance.
- Sustainability is now the primary moral and economic imperative and it is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that need to be understood by decision makers. Incremental changes towards sustainability are not sufficient – we need a fundamental shift in the way companies and directors act and organise themselves.
- Innovation, fairness, and collaboration are key aspects of any transition to sustainability – innovation provides new ways of doing things, including profitable responses to sustainability. Fairness is vital because social injustice is unsustainable and collaboration is often a prerequisite for large-scale change.
- Social transformation and redress is important and needs to be integrated within the broader transition to sustainability. Integrating sustainability and social transformation in a strategic and coherent manner will give rise to greater opportunities, efficiencies, and benefits, for both the company and society.
- King II required companies to implement sustainability reporting as a core aspect of corporate governance. Since 2002, sustainability reporting has become a widely accepted practice and South Africa is an emerging market leader in the field. However, sustainability reporting is in need of renewal in order to respond to the lingering trust shortage among society of the intentions and practices of big business and concerns among business decision makers that sustainability reporting is not fulfilling their expectations in a cost-effective manner.

Governance framework

King III has moved from a "comply or explain" to an "apply or explain" approach. Where the board believes it to be in the best interests of the company, it can adopt a practice different from that recommended in King III, but must explain it. Explaining the different practice adopted and an acceptable reason for it, results in consistency with King III principles.

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The framework recommended by King III is principles-based and there is no 'one size fits all' solution. Entities are encouraged to tailor the principles of the Code as appropriate to the size, nature and complexity of their organisation. This is good news for companies in South Africa as it avoids some of the pitfalls seen in the United States where a 'one size fits all' approach was initially adopted.

New requirements

Some of the requirements introduced by King III include:

- The need for an annual integrated report that focuses on the impact of the organisation in the economic, environmental and social spheres.
- A statement by the audit committee to the board and shareholders on the effectiveness of internal financial controls to be included in the integrated report.
- The consideration of the strategic role of IT and its importance from a governance perspective.
- The positioning of internal audit as a strategic function that conducts a risk-based internal audit and provides a written assessment of the company's system of internal control, including internal financial controls.
- The governance of risk through formal risk management processes.

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