

Steering point • April 2016

What organisations should know about draft King IV™

Draft King IV™

An outcomes – based approach for a changing world



Without solid inputs there are no outcomes

In draft King IV™¹, delivering on an effective strategy and applying good governance go hand in hand. A practical approach to effective and ethical leadership under the governing body's responsibility will move towards greater accountability and transparency in achieving the desired governance outcomes. In considering the dynamics of an ever-changing world, this principles-based approach will help organisations be better positioned for the challenges that lie ahead.

Draft King IV™ Report on Corporate Governance for South Africa 2016 released for public comment

The Institute of Directors in Southern Africa and the King Committee released the draft King IV™ Report on Corporate Governance for South Africa 2016 (draft King IV™) for public commentary on 15 March 2016. The comment period closes on 15 May 2016 and is phase one of the public consultation process on King IV™. Phase two of the public consultation process relates to sector supplements to the draft King IV™ Report. The official launch of King IV™ is planned for 1 November 2016. This Steering Point contains an executive summary of draft King IV™.

Overview and summary

Draft King IV™ reinforces the notion that good corporate governance is a holistic and inter-related set of arrangements to be understood in an integrated manner – good governance is not a 'tick box' exercise.

Although draft King IV™ reflects updates that were necessary due to various local and international developments in corporate governance since King III came into effect in 2009, it does not represent a significant departure from the philosophical underpinnings of King III. The concepts that were introduced by King III and earlier versions of the report – ethical and effective leadership, the organisation being an integral part of society, corporate citizenship, sustainable development, stakeholder inclusivity and integrated annual reports – have remained, but have been refined in draft King IV™.

Draft King IV™ is, similar to King III, drafted for application by all organisations. It strives to instill a qualitative approach to corporate governance where recommended practices should be considered in order to achieve the Code principles and to realise the intended governance outcomes. The practices recommended in the Code are, however, pitched at an optimal level and may not be appropriate for all organisations: Application of the practices should be adapted and varied as appropriate to the size, resources and complexity of the strategic objectives and operations of an organisation.

Draft King IV™ in a nutshell

- Drafted to apply to all organisations, regardless of their form of incorporation
- Proportionality is explained (i.e. how the Code is to be applied by organisations and entities of a variety of sizes and resources and with strategic objectives and operations of varying degrees of complexity)
- 'Apply and explain' regime (as opposed to 'apply or explain')
- New 'look and feel' to the Report and Code
- Philosophical underpinnings in King III refined in draft King IV™
- Key new or enhanced recommendations in the Code relate to:
 - Remuneration disclosure and voting;
 - Tax strategy and policy;
 - Independence of members of the governing body;
 - Audit committee reporting on auditor independence and assurance matters;
 - Assurance and internal audit – 'five lines of assurance';
 - Social and ethics committees;
 - Responsible institutional investors;
 - Technology and information;
 - New perspectives on risk; and
 - Compliance – strategic relationships with regulators and professional bodies.

'Firsts' in draft King IV™

- Definition of 'corporate governance', for purposes of draft King IV™
- The Code's principles and practices are linked to desired outcomes, thereby articulating the benefits of good corporate governance
- Sector supplements will explain how the Code should be applied by certain organisations and sectors
- Draft King IV™ contains an application register with suggested illustrative 'apply and explain' disclosure.

¹The King IV Report on Corporate Governance for South Africa 2016, The Institute of Directors in Southern Africa. The Institute of Directors in Southern Africa (IoDSA) <http://www.iodsa.co.za> owns the copyright in all four of the King Reports and/or Codes on Governance, including the latest version, namely the King IV™ Report, and all the sections of the King IV™ Report. The Copyright Act No. 98 of 1978 protects the IoDSA's full ownership, rights and title in relation to copyright in the King IV™ Report.

New 'look and feel' to the Report and the Code

At first glance, draft King IV™ has a very different look and feel compared to King III: While King III consists of the King III Code, which contains the Code principles and recommended practices, and a separate King III Report, which contains the principles and more detail on the practice recommendations, draft King IV™ consists of nine parts:

Part 1 Foundational concepts	Part 2 Content elements and development	Part 3 Application of King IV™
Part 4 King IV™ on a page	Part 5 King IV™ Code	Part 6 Sector supplements
Part 7 Application register	Part 8 Glossary of terms	Part 9 King Committee

The five chapters of the draft King IV™ Code contain *principles*, *practices* and *governance outcomes* that interact as follows: The application of the practices should give effect to the principle; while governance outcomes are the benefits that could be realised in the event that the underlying principles are fully achieved. The practices are furthermore organised to address the strategy, policy, oversight and disclosure responsibilities of the governing body.

The table links the chapters in the draft King IV™ Code (Part 5) to their related chapter(s) in King III:

Draft King IV™ Code	Related chapter(s) in King III
Chapter 1 Leadership, ethics and corporate citizenship	Chapter 1 Ethical leadership and corporate citizenship
Chapter 2 Performance and reporting	Chapter 2 Boards and directors Chapter 9 Integrated reporting and disclosure
Chapter 3 Governing structures and delegation	Chapter 2 Boards and directors Chapter 3 Audit committees Chapter 4 The governance of risk
Chapter 4 Governance functional areas	Chapter 4 The governance of risk Chapter 5 The governance of information technology (IT) Chapter 6 Compliance with laws, rules, Codes and standards Chapter 7 Internal audit
Chapter 5 Stakeholder relationships	Chapter 8 Governing stakeholder relationships

'Apply and explain' vs 'apply or explain'

The application regime of draft King IV™ is 'apply *and* explain': 'Applying' the principles and 'explaining' how they are being effected. A narrative explanation is required, which should consist of high-level disclosure of the practices that have been implemented and the progress made in the journey towards giving effect to each principle. Disclosure is not required either against each practice or against the governance outcomes. Part 7 of draft King IV™ contains a template that organisations should use as guidance for the disclosure required in the draft King IV™ Code, which includes illustrative disclosures. Draft King IV™ recommends that the application register be posted on the organisation's website. The detail of information to be provided in the application register should be guided by materiality and what has already been disclosed elsewhere – duplication of King IV™ disclosures should be avoided.

Draft King IV™ indicates that it falls under the discretion of the governing body to determine where the King IV™ disclosures will be made – either in the application register and/or in the integrated annual report and/or in a sustainability or corporate citizen report.

In contrast, King III's application regime is 'apply *or* explain': An explanation is only required where a principle was not applied.

Impact on listed entities: Despite King III's 'apply *or* explain' requirement, the JSE Limited currently requires listed entities to apply *and* explain their application of the 75 King III principles. Reducing the number of principles from 75 to 17 in draft King IV™ may therefore lighten the disclosure obligation as it pertains to listed entities.

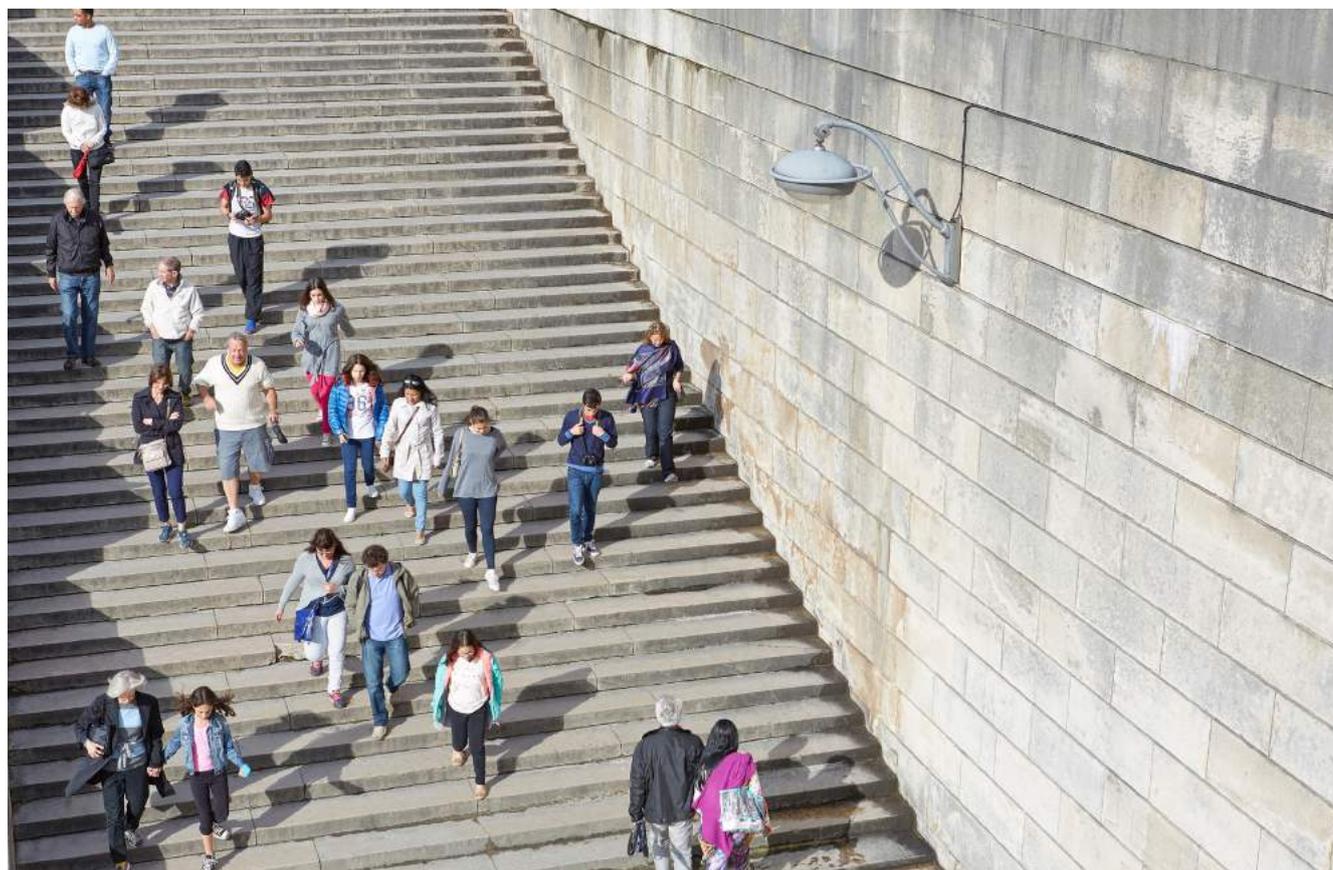
Extract from draft King IV™ Part 7 – King IV™ Application Register

PRINCIPLES, the application of which is assumed	EXPLANATION on the practices that have been implemented and the progress made in giving effect to the principle
OUTCOME: ETHICAL CULTURE	
Principle 1.1: The governing body should set the tone and lead ethically and effectively.	Specimen disclosure As governing body members we are holding one another accountable for decision-making and acting in a way that displays the ethical characteristics stated in King IV. The chair of the governing body has been tasked to monitor this as part of her duties. We furthermore undertook an assessment of the performance of individual members of the governing body which included peer evaluation of the ethical characteristics demonstrated by each member of the governing body. As a result of the evaluation the governing body agreed to make ongoing professional development of its members a priority for the coming year so that governing body members are able to fully demonstrate the characteristic of being informed.

Sector supplements

The proposed sector supplements are intended to provide applicable terminology and to address the governance challenges and considerations of that sector. The sector supplements are not intended to be used on their own and should be read in conjunction with the other parts of the King IV™ Report. Draft King IV™ indicates supplements for the following sectors:

- SMEs
- Non-profit organisations
- Public sector organisations and entities
- Municipalities and
- Pension funds.



Key new or enhanced recommendations in draft King IV™

Remuneration disclosure and voting

Draft King IV™ introduces recommendations to the effect that the remuneration committee and the social and ethics committee, with the oversight of the governing body, should consider and disclose the measures put in place to attain fair, responsible and transparent executive remuneration in the context of overall employee remuneration. [Draft King IV™ Code – Chapter 3 Recommended practice 64 and Chapter 4 Recommended practice 34]

Draft King IV™ recommends disclosure in three parts:

- i. A background statement that provides the context for remuneration policy and decisions;
- ii. An overview of the main provisions of the organisation-wide remuneration policy; and
- iii. An implementation report in the annual financial statements which should contain details of all remuneration and benefits awarded to individual members of the governing body and prescribed officers during the reporting period. [Draft King IV™ Code – Chapter 4 Recommended practices 36 to 39]

Draft King IV™ recommends that shareholders be given the opportunity to pass separate non-binding advisory votes on the adoption of the *remuneration policy* (every two years or whenever a change to the policy is approved by the governing body or whenever the policy was not adopted by a vote of at least 75% of the voting shares the year before) and its *implementation report* (every year), but with the consequence that compulsory shareholder engagement is triggered in the event that either the policy or its implementation report is not supported by a vote of at least 75% of the voting shares. [Draft King IV™ Code – Chapter 4 Recommended practices 41 to 43]

Draft King IV™ recommends that variable remuneration should be measured in accordance with targets relating to sustainable value created across the whole of the economic, social and environmental context. This is a departure from measuring financial targets only. [Draft King IV™ Code – Chapter 4 Recommended practice 39]

Tax strategy and policy

Part 1 of draft King IV™ states that it is no longer acceptable to have overly aggressive tax strategies and to exploit mismatches between the tax regimes of various jurisdictions, even if these actions are legal. Draft King IV™ recommends that the organisation's corporate citizenship considerations should include responsible tax policies. [Draft King IV™ Code – Chapter 1 Recommended practice 13]

Independence of members of the governing body

While previous versions of the King Report addressed the classification of non-executive directors as 'independent', draft King IV™ goes further by recommending that *all* members of the governing body, whether they are classified as executive, non-executive or independent non-executive, have a duty to act with independence of mind in the best interests of the organisation. [Draft King IV™ Code – Chapter 3 Recommended Practice 26]

Draft King IV™ has enhanced the provisions regarding the classification of non-executive members as 'independent'. It states that an 'independent' classification refers to the absence of any interest, position, association or relationship which is likely to unduly influence or cause bias in decision-making. The draft Code recommends a consideration of the combined effect of all relevant factors on a substance-over-form basis for this purpose. The draft Code lists *indicators* that may lead to a conclusion of a lack of independence, rather than reflecting an absolute list of independence criteria. [Draft King IV™ Code – Chapter 3 Recommended practice 27]

Audit committee disclosure requirements – auditor independence and significant matters considered by the audit committee

Draft King IV™ recommends that there should be disclosure on whether the audit committee is satisfied that the auditor is independent of the organisation, with the disclosure having reference to the nature and extent of non-audit services rendered, audit firm tenure and, in the event of the audit firm having been involved in a merger or acquisition, the tenure of its predecessor, and audit partner rotation and significant management changes during the course of audit firm tenure. Draft King IV™ furthermore recommends that the audit committee should disclose significant matters that the audit committee considered in relation to the external assurance over reports, and how these were addressed by the committee. [Draft King IV™ Code – Chapter 3 Recommended practice 58]

Assurance and internal audit – the five lines of assurance

King III introduced the combined assurance model. Draft King IV™ expands the traditional ‘three lines of defence’ to ‘five lines of assurance’ to incorporate all assurance role players:

- As first line of assurance: line functions that own and manage risk and opportunity
- As second line of assurance: specialist functions that facilitate and oversee risk and opportunity arrangements, such as enterprise-wide risk and opportunity management and compliance
- As third line of assurance: internal assurance providers that provide objective assurance such as internal audit, internal forensic examiners, fraud examiners and auditors, safety and process assessors, and statutory actuaries
- As fourth line of assurance: external assurance providers such as external audit, sustainability and environmental auditors or regulatory inspectors, external actuaries and external forensic examiners, and fraud examiners and auditors, and
- As fifth line of assurance: the governing body, and audit or other committees.

The model emphasizes that assurance is not primarily about defence; rather, it is about having an adequate and effective control environment and strengthening the integrity of reports for better decision-making. [Draft King IV™ Code – Chapter 4 Recommended practices 45 and 46]

Social and ethics committees

Draft King IV™ expands on the role of the social and ethics committee as provided for in the Companies Act, 2008 and its integration with broader governing structures. It ascribes the responsibility of reviewing fair and responsible executive remuneration practices in the context of overall employee remuneration to the social and ethics committee and the remuneration committee, with oversight by the governing body. [Draft King IV™ Code – Chapter 3 Recommended practice 64 and Chapter 4 Recommended practice 34]

Responsible institutional investors

Draft King IV™ requires the governing body of an institutional investor to ensure that the organisation responsibly exercises its rights, obligations, legitimate and reasonable needs, interests, and expectations, as holder of beneficial interest in the securities of a company. [Draft King IV™ Code – Principle 5.2]

It recommends that governing bodies of institutional investors should approve policy that articulates their strategic direction on responsible investment and that the policy should provide for the adoption of recognised responsible investment principles and practices to give effect to the governing body’s strategic direction. [Draft King IV™ Code – Chapter 5 Recommended practices 17 and 18] Part 1 of draft King IV™ indicates that responsible investing practices are set out in the Code for Responsible Investing in South Africa (CRISA), in line with the United Nations Principles on Responsible Investing.

Technology and information

Draft King IV™ addresses advances in technologies and digitalisation by recommending that the governing body should oversee the adequacy and effectiveness of technology and information management, including the exploitation of opportunities offered by technology and digital developments, and the ethical and responsible use of technology and information. [Draft King IV™ Code – Chapter 4 Recommended practice 16]

It furthermore recommends that the governing body should oversee the management of cyber-security risk. [Draft King IV™ Code – Chapter 4 Recommended practice 17]

New perspectives on risk

Draft King IV™ links risk and opportunities – the term ‘risk and opportunity governance’ has been introduced. [Draft King IV™ Code – Chapter 4 Recommended practice 1]

Compliance – strategic relationships with regulators and professional bodies

Draft King IV™ recommends that organisations should have strategic relationships with regulators and professional bodies in order to understand the environment and trends while creating the ability to influence that environment. [Draft King IV™ Code – Chapter 4 Recommended practice 24]



Governance Outcomes

Governing Body Leadership Responsibilities	Strategy	Policy	Oversight	Disclosure	Governance Outcomes
					
Principle 1.1	The governing body should set the tone and lead ethically and effectively.				Ethical Culture
Principle 1.2	The governing body should ensure that the organisation's ethics is managed effectively.				
Principle 1.3	The governing body should ensure that the organisation is a responsible corporate citizen.				
Principle 2.1	The governing body should lead the value creation process by appreciating that strategy, risk and opportunity, performance and sustainable development are inseparable elements.				Performance And Value Creation
Principle 2.2	The governing body should ensure that reports and other disclosures enable stakeholders to make an informed assessment of the performance of the organisation and its ability to create value in a sustainable manner.				
Principle 3.1	The governing body should serve as the focal point and custodian of corporate governance in the organisation.				
Principle 3.2	The governing body should ensure that in its composition it comprises a balance of the skills, experience, diversity, independence and knowledge needed to discharge its role and responsibilities.				
Principle 3.3	The governing body should consider creating additional governing structures to assist with the balancing of power and the effective discharge of responsibilities, but without abdicating accountability.				
Principle 3.4	The governing body should ensure that the appointment of, and delegation to, competent executive management contributes to an effective arrangement by which authority and responsibilities are exercised.				
Principle 3.5	The governing body should ensure that the performance evaluations of the governing body, its chair and members, the CEO and the company secretary or corporate governance professional result in continued improved performance and effectiveness.				
Principle 4.1	The governing body should govern risk and opportunity in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.				Adequate And Effective Control
Principle 4.2	The governing body should govern technology and information in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.				
Principle 4.3	The governing body should govern compliance with laws and ensure consideration of adherence to non-binding rules, codes and standards.				
Principle 4.4	The governing body should ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the creation of value in a sustainable manner.				
Principle 4.5	The governing body should ensure that assurance results in an adequate and effective control environment and integrity of reports for better decision-making.				
Principle 5.1	As part of its decision-making in the best interests of the organisation, the governing body should ensure that a stakeholder-inclusive approach is adopted which takes into account and balances their legitimate and reasonable needs, interests and expectations.				Trust, Good Reputation And Legitimacy
Principle 5.2	The governing body of an institutional investor should ensure that the organisation responsibly exercises its rights, obligations, legitimate and reasonable needs, interests and expectations as holder of beneficial interest in the securities of a company.				

Let's talk

PwC supports good corporate governance and will be providing commentary on draft King IV™. We would also like to engage with you to gain your insights on draft King IV™. Please feel free to contact your engagement partner or any of the following persons for a discussion on how King IV™ may impact you.

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