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## **A Review of The King IV Report** on Corporate Governance

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COMMERCIAL LAW FIRM**  
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01

**What is King IV and when**  
will it become effective?



**The King IV Code sets out the philosophy, principles, practices and outcomes which serve as the benchmark for corporate governance in South Africa.**

A draft of the fourth edition of the King Reports on Corporate Governance, namely the King IV Code, was published by the Institute of Directors in Southern Africa NPC (IoDSA) for public comment on 15 March 2016. IoDSA, as Secretariat for the King Committee and custodian of the King Reports on corporate governance in South Africa, has led the development of King IV.

The King IV Code sets out the philosophy, principles, practices and outcomes which serve as the benchmark for corporate governance in South Africa. The King IV Code, which will be launched on 1 November, will replace the previous editions of the King Reports, namely the King III Code. The IoDSA estimates that the King IV Code will become effective mid-2017. King IV is available from the IoDSA.

**02**

**Why the update from King III?**

There have been significant corporate governance and regulatory developments, locally and internationally, since King III was issued in 2009, such as the enactment of the Companies Act 71 of 2008.

Non-profit organisations, private companies and entities in the public sector have experienced challenges in interpreting and adapting King III to their particular circumstances.

The aim is to make King IV more accessible to all types of entities across sectors.

King IV contains more succinct and fewer principles for easier interpretation and implementation. Sector supplements will also be published alongside King IV to aid in its interpretation by organisations in different sectors.

**Non-profit organisations, private companies and entities in the public sector have experienced challenges in interpreting and adapting King III to their particular circumstances.**

03

How is King IV different  
**from King III?**

**King IV sets out the following differences between it and King III:**

- > The 75 King III principles have been consolidated into 17 principles, each linked to very distinct outcomes. In King IV, there is a clear differentiation between principles, practices and governance outcomes.
- > King III's philosophy of "apply or explain" has become "apply and explain" in King IV. The intention here is to move beyond a compliance "tick-box" mind-set to describing how implemented practices advance progress towards giving effect to each principle.
- > The test for the classification of non-executive directors as 'independent' is broadened in King IV. King III provides an exhaustive set of criteria to be met in order to be classified as an 'independent' non-executive director, while King IV focuses on the combined effect of all relevant factors on a substance-over-form basis when making an assessment of independence.
- > The concept and requirement of integrated reporting has also been refined in King IV to align with the Integrated Reporting Framework by the International Integrated Reporting Council (IIRC) which was released in 2013.
- > In respect of the role of the social and ethics committee, King IV expands on the Companies Act Regulations 2011 in the context of the committee's direction and oversight of the management of ethics, as well as the socially responsible aspects of the remuneration policy.
- > Both King III and King IV recommend that the company's remuneration policy be submitted to shareholders for their approval by vote. Under King III, this entails a vote supported by an ordinary majority (a 50% + 1 vote). King IV, however, goes further in that compulsory engagement with the shareholders will be triggered if the remuneration policy or its implementation is not supported by a vote of at least 75% of voting shares. This aspect of King IV is very controversial and may be subject to amendment (or even deletion) by the time King IV is launched in November 2016.
- > In order to address the concern that not all organisations are deriving benefit from or are necessarily in a position to apply King III, King IV will include sector supplements that provide specific guidance to certain categories of organisations and sectors. These sector supplements are further discussed below.
- > The responsibilities of investors and key shareholders, and the concept of 'responsible investing' have also been expanded and developed in King IV in line with the responsible investing practices set out in the Code for Responsible Investing in South Africa (CRISA), and the United Nations Principles on Responsible Investing. Shareholders are to play a more active role in corporate governance and the board is required to hold the board accountable for its actions and disclosures. King IV cautions that, in order to create value in a sustainable manner, there must be a shift from short-termism to long-term thinking.



- > Auditor independence requirements are expanded in King IV. In King IV, the audit committee's duty to oversee auditor independence is aligned with the rule that was published by the Independent Regulatory Board for Auditors on 4 December 2015, which requires all auditors' reports on annual financial statements to disclose the number of years for which the audit firm has been the auditor of the organisation. King IV also prescribes certain factors to be taken into account by the audit committee when overseeing auditor independence. It also mentions that, although audit firm rotation may be used to reinforce auditor independence, governing bodies must be mindful of the learning curve that new audit firms will experience and how that will impact the entity or group.
- > King IV places numerous obligations on the board regarding the management, protection and oversight of technology and information, including the development of a 'cyber-security plan'. The board is further required to carry out a formal review on the adequacy and effectiveness of the organisation's technology and information function, and to comply with certain disclosure requirements with respect to technology and information. We note with interest that King IV does not advocate for a 'social media policy' to protect the entity's reputation, but merely mentions social media as a platform for stakeholder engagement.
- > The concept of 'combined assurance' has been expanded in King IV, which broadens the traditional 'three lines of defence' to 'five lines of assurance' to incorporate all assurance role players, and to emphasise that assurance is about having an adequate and effective control environment and strengthening the integrity of reports for better decision making. The five lines of assurance include (1) line functions that own and manage risk and opportunity, (2) specialist functions that facilitate and oversee risk and opportunity, (3) internal assurance providers, (4) external assurance providers, and (5) governing body and committees. King IV requires the audit committee to ensure that implementation of the combined assurance model results in combining, co-ordinating and aligning assurance activities across the various lines of assurance.
- > King IV introduces new recommendations regarding the contents of the framework documents of organisations. King IV also allocates responsibility for the implementation of a group governance framework to the holding company board.
- > King IV emphasises the role of the board in risk and opportunity oversight, and recommends that membership of the risk committee should overlap with that of the audit committee for better functioning, and that, if the risk and audit roles are combined in a single committee, the meeting agenda should address audit, risk and opportunity as separate agenda items.
- > King IV specifically requires the board to approve the formal strategy by which 'the core purpose of the organisation is identified and its short-, medium- and long- term direction is set'. The governing body must provide oversight over the policies and plans that are developed from the approved strategy and implemented by management.



04

**What are the 17 principles?**

### The 3 principles for the entity's ethical cultures

- > The governing body should set the tone and lead ethically and effectively.
- > The governing body should ensure that the organisation's ethics are managed effectively.
- > The governing body should ensure that the organisation is a responsible corporate citizen.

### The 2 principles for performance and value creation

- > The governing body should lead the value creation process by appreciating that strategy, risk and opportunity, performance and sustainable development are inseparable elements.
- > 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.

**The governing body should ensure that the organisation's ethics are managed effectively.**

**The governing body should ensure that the organisation is a responsible corporate citizen.**

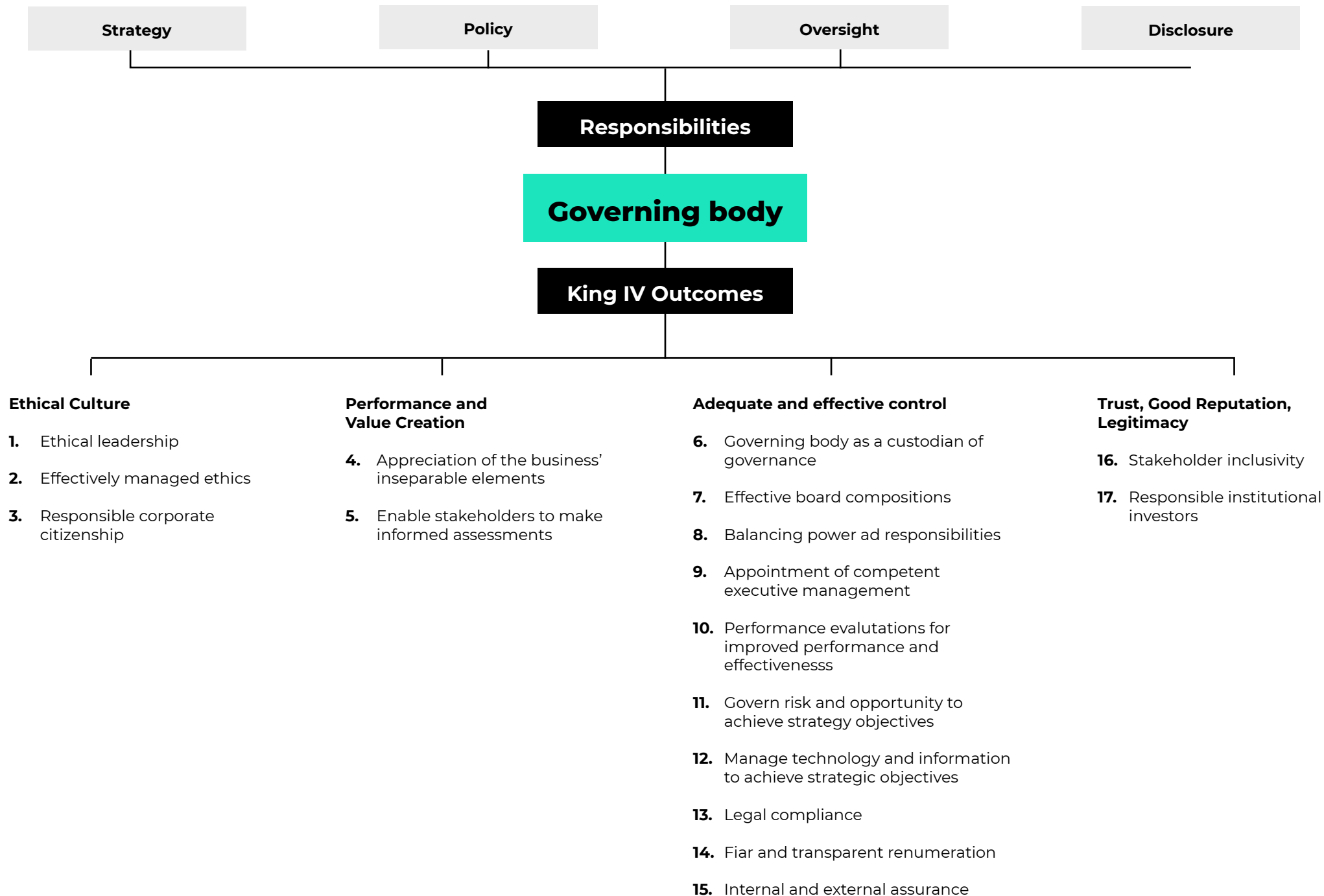
### The 10 principles for adequate and effective control

- > The governing body should serve as the focal point and custodian of corporate governance in the organisation.
- > 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.
- > 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.
- > 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.
- > The governing body should ensure that the performance evaluations of the board, its structures, its chairs and members, the CEO and the company secretary or corporate governance professional result in continuous improved performance and effectiveness.
- > The governing body should govern risk and opportunity in a way that supports the organisation in defining its core purpose and to set and achieve strategic objectives.
- > The governing body should govern technology and information in a way that supports the organisation in defining its purpose and to set and achieve strategic objectives.
- > The governing body should govern compliance with laws and ensure consideration of, and adherence to, non-binding rules, codes and standards.
- > 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.
- > The governing body should ensure that assurance results in an adequate and effective control environment and the integrity of reports for better decision making.

## **The 2 principles for trust, good reputation and legitimacy**

- > In the course of making decisions in the best interest 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.
- > 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.

**The governing body should govern risk and opportunity in a way that supports the organisation in defining its core purpose and to set and achieve strategic objectives.**



## 05

How should these principles  
**be implemented?**

The King IV Code provides extensive guidance in relation to the implementation of the principles by listing recommended practices under each principle.

These recommended practices describe how each principle should be implemented and serve as a guideline in this regard. That is, application of these practices should be adapted and varied where necessary, with the ultimate aim of realising the intended governance outcome.



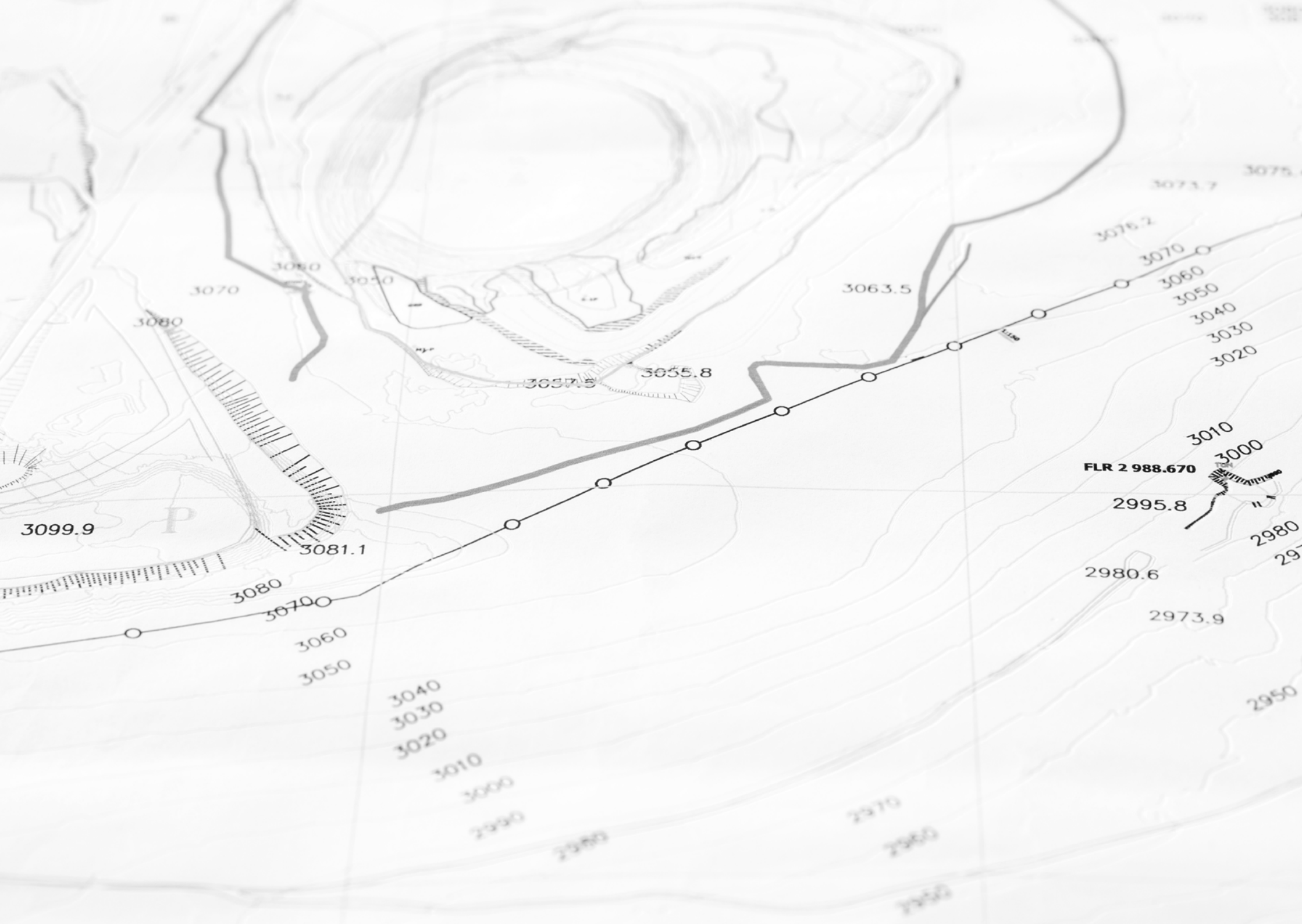
**The King IV Code provides extensive guidance in relation to the implementation of the principles by listing recommended practices under each principle.**



06

Sectoral  
**Determination**





## The main objective of the King IV Code is to broaden acceptance of corporate governance by making it accessible and fit for application.

Sector supplements for specific categories of organisations have been included in order to broaden acceptance of corporate governance and to make King IV accessible and fit for application across sectors, organisations and entities of varying sizes, resources and complexity (in addition to the traditional audience of listed, public and large private companies).

Every sector supplement sets out how the terminology, concepts and recommended practices in the King IV Code can be interpreted, adapted and customised to meet the needs and requirements of organisations in specific sectors.

### SMEs

- > The sector supplement for small and medium enterprises (SMEs) applies to SMEs which have a public interest score of at least 350, calculated in terms of regulation 26(2) of the Companies Regulations 2011 published in terms of the Companies Act 71 of 2008.
- > The purpose of this sector supplement is to encourage SMEs, through the application of good governance principles, to set up the leadership and other structures, processes and frameworks that drive optimal growth and ensure the maximisation of the important role that SMEs play in the South African economy.

### Non-profit organisations (NPOs)

- > The NPO supplement recognises that NPOs can be incorporated in various forms including as a not-for-profit company, charitable trust, voluntary association, club or fund. The supplement applies to non-profit legal forms, including public benefit organisations (PBOs) and is not limited to organisations that have been granted 'NPO status' in terms of the Non-profit Organisation Act.
- > Essentially, this supplement requires NPOs to adopt viable strategies and business models that will ensure survival and growth of this sector.

## Public sector organisations and entities

- > The focus of this supplement is on the corporate governance of state-owned entities (SOEs), and applies to all entities listed in schedules 2 and 3 of the Public Finance Management Act 1 of 1999, which lists by name certain state-owned entities.
- > The aim of this sector supplement is to support the maintenance of viable, efficient and competitive SOEs in order to address the serious challenges facing South Africa today in respect of service delivery and other economic and social issues.

## Municipalities

- > The sector supplement for municipalities applies to category A, B and C municipalities, as provided for in the Municipal Structures Act 117 of 1998 and the Constitution.
- > The supplement aims to guide municipalities in achieving their objectives and duties, which are entrenched in the Constitution, including, amongst others, to promote social and economic development, to provide a safe and healthy environment and to ensure the provision of services to communities in a sustainable manner.

## Pension funds

- > The supplement for retirement funds applies to all 'retirement funds', including the following (as defined in the Income Tax Act 58 of 1962)
  - pension funds;
  - provident funds;
  - preservation funds; and
  - retirement annuity funds.
- > In line with the Code for Responsible Investing in South Africa, the supplement aims to enhance corporate governance for investee companies by ensuring that retirement funds are well governed, following and mandating responsible investing principles, and holding investee companies accountable for good corporate governance.

## 07

What are the consequences  
of non-compliance with  
**the King IV code?**

King IV is a set of voluntary principles and good practices of corporate governance. If King IV conflicts with any legislation, the legislation will prevail. However, for entities with a primary listing on the JSE Limited Securities Exchange certain aspects of King IV are binding by virtue of the listings requirements imposing obligations on issuers to comply therewith.

The fact that King IV is not legally binding in itself does not mean that there are no legal consequences arising from non-compliance. A court will consider King IV when evaluating what is regarded as practice in a particular situation, especially where governance duties are involved. Failure to meet corporate governance practice, and by implication the principles set out in King IV, may invoke liability of the board in certain circumstances.

A court will consider King IV when evaluating what is regarded as practice in a particular situation, especially where governance duties are involved.

**08**

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Nastascha Harduth is a Director and has been with Werksmans since 2008. She was admitted in 2010, and has been a director within the firm's Insolvency, Business Rescue and Restructuring practice since 2014. Her legal practice focusses on business rescue and restructuring matters, but she has wide ranging experience in corporate insolvencies, dispute resolution and commercial litigation, as well as corporate debt recoveries. Nastascha often advises on the duties and responsibilities of directors, the risk of incurring personal liability, and how to mitigate it.

Her experience extends well beyond the South African jurisdiction, and includes cross-border experience in the United States of America, Mauritius, Seychelles, Zambia, Botswana and Lesotho.

Nastascha Harduth regularly writes for various publications and contributes to the media. She is a member of the South African Restructuring and Insolvency Practitioners Association (SARIPA) and is a fellow of INSOL International, where she is extensively involved, sitting on the INSOL Fellows Steering Committee, the INSOL Webinar Committee, and on the INSOL Touchpoint Newsletter's Editorial Committee.

Senior Associate Laura Alexander works in the Banking & Finance practice area, specialising in corporate mergers and acquisitions; restructuring of corporate entities; due diligence investigations; private equity; acquisition and leveraged finance; banking and finance; and property finance.

Laura graduated with an LLB (with distinction) from the University of the Pretoria. Laura was awarded Academic Honorary Colours in 2013, and, throughout her LLB degree, she was consistently on the Dean's Merit List and was the top student in her class for numerous modules.



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## Meet the team



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## About us

Established in the early 1900s, Werksmans Attorneys is a leading South African corporate and commercial law firm, serving multinationals, listed companies, financial institutions, entrepreneurs and government.

Operating in Gauteng and the Western Cape, the firm is connected to an extensive African legal alliance through LEX Africa.

LEX Africa was established in 1993 as the first and largest African legal alliance and offers huge potential for Werksmans' clients seeking to do business on the continent by providing a gateway to Africa.

With a formidable track record in mergers and acquisitions, banking and finance, and commercial litigation and dispute resolution, Werksmans is distinguished by the people, clients and work that it attracts and retains.

Werksmans' more than 200 lawyers are a powerful team of independent-minded individuals who share a common service ethos. The firm's success is built on a solid foundation of insightful and innovative deal structuring and legal advice, a keen ability to understand business and economic imperatives and a strong focus on achieving the best legal outcome for clients.



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