

Promoting the Application of Corporate Governance in the South African Public Sector

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ABSTRACT This paper examines the principles of corporate governance as underpinned in the Public Finance Management Act of 1999, King Reports I, II, III, King Codes of Corporate Practices and Conducts. The paper contributes to the on-going debate about the principles of corporate governance in the public sector. In examining the principles of corporate governance in the public sector, it looks at various institutions in the public sectors that promote corporate governance with the purpose of evaluating the principles of corporate governance in these institutions. It argues that the effectiveness and accountability of the public sector can be improved significantly if these principles of corporate governance are applied correctly.

INTRODUCTION

According to Clarke and Rama (2006), based on the rapidly increasing scale and activity of corporations, the importance of governance of these entities has become very significant. Scholars and practitioners argue that these business corporations have enduring impacts upon societies and economies, and how corporations are governed, their ownership and control, the objectives they pursue, the rights they respect, the responsibilities they recognise, and how they distribute the value they create (Jamali et al. 2008). Against the backdrop of these impacts, governance of business corporation has become a matter of the greatest significance, not simply to the directors and shareholders, but to the wider communities (Dekker and Esser 2008).

Koma (2009) asserts that the concept of corporate governance is not solely confined to private sector setting and as such, it is incumbent upon public sector organisations, to embrace corporate governance with a view to improve their efficiency, effectiveness, accountability and reputation. Senator (2003) correctly pointed out that “*while corporate governance concepts and terminology may have originated in the private sector, its impact has deepened and broad-*

ened ...[and] is no longer reserved for the private sector, but also applies to other areas of society – the education sector, the not-for-profit sector, and of course, the public sector.”

This signifies the crucial role that corporate governance plays in any sector, including the public sector (Blowfield and Murray 2011). Against this background, this paper examines the principles of corporate governance as underpinned in the Public Finance Management Act (PFMA 1999), King Report I, II, III, King Code of Corporate Practices and Conduct. It has often appeared as though the public sector is exempted from the application of corporate governance (Herman and Renz 2009). It is however, argued in this paper that the principles of corporate governance are not only applicable to the private sector, but also to the public sector (Howard and Seth-Purdie 2005). It is further argued that the effectiveness and accountability of the public sector can be improved significantly if principles of corporate governance are applied correctly (Rainey 2009). In examining the principles of corporate governance in the public sector, this paper looks at various institutions in the public sector that promotes corporate governance (Aldrich 2003).

Corporate governance is generally understood to mean the way in which companies are directed and controlled such that they can fulfil their goals and objectives in a manner that adds to the value of the companies and is also beneficial to all stakeholders in the long term (Hillb 2012, 2008). Thus, the emphases are on those

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organs which play a vital role in corporative decision-making (John and Senbet 1998). Corporate governance is based on principles such as conducting business with integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws of the land, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner (Rossouw 2005).

From the above explanation, it can be said that corporate governance had been originally associated with companies, thus having a domain in the company law (Nevondwe 2012).

In 1994, upon the election of a democratic majority government, the South African government found that some of the instruments used for delivering necessary services and carrying out policies were actually State Owned Entities (SOEs), and their control and governance were not based on any standardized principles or rules (Ponte et al. 2007). These SOEs were organized in many different ways and subordinate to a wide range of legislation and statutory regulations (DPE 2002). Some SOEs, in fact, acted as autonomous entities, having no direction or control from the previous government for a long period of time (DPE 2002).

South African SOEs form a significant portion of vital industries that drive the economy by providing factor inputs (Barnes and Morris 2004). According to DPE (2002), *“three key inputs, electricity, transportation and telecommunications are dominated by the SOEs. Without these key inputs, the resources, tourism, information technology and manufacturing sectors cannot function effectively. These sectors are principal drivers of the formal sector economy, and provide the bulk of economic growth.”*

The status of South Africa's SOEs and the extent of potential privatization have been the subject of lively debate within government and civil society since the first democratic elections (Hart 2002). Based on the special role of the SOEs, the need to sustain formal sector employment levels and skills retention and the debate on the ownership of key economic assets, a path of restructuring was adopted (Nellis 2005). Essentially, this policy recognised the need to inculcate efficiency within the SOEs while concurrently ensuring that social and infrastructural goals were met (DPE 2002).

In 1999, the Government affirmed the overall strategic vision of the restructuring of SOEs. The Department of Public Enterprises (DPE) was given an expanded mandate to lead the programme of restructuring with the active participation of the Cabinet. This led to corporate governance, as embodied in the new and revised Protocol. It is the Government's intent that the principles of the Protocol should apply to all public entities and their subsidiaries (DPE 2002).

In this context, according to DPE (2002) *“proper governance and control of SOEs became an important component of the restructuring process. The magnitude of this task cannot be overestimated, given the aggregate size of SOEs. These SOEs are the principal entities that deliver many social goods and services to ensure quality of life for all South Africans. The publication of the first King Report on corporate governance in November 1994 and secondly in March 2002 has given further impetus to the issues of governance not only in SOEs, but also in the full range of business entities.”*

Unlike the King Code, which covers a wide spectrum of entities in both the private and public sectors, the Protocol seeks to provide guidance specifically to the public sector, taking into account the unique mandate of the SOEs, which includes the achievement of socio-politico-economic objectives of the government (Nagiah 2012). It is recognized further that since the King Code is of general application, there are various specific public sector related issues which may not be fully addressed therein and need to be addressed in the Protocol (Scott and Shuttleworth 2007). It is pertinent to point out that the principles of the Protocol only seek to amplify and not supersede (or conflict with) those contained in the King Code and that the Protocol should, in fact, be read in conjunction with the King Code (DPE 2002).

Objectives

The objectives of this paper are three-fold. Firstly, it examines the principles of corporate governance in the public sector, by looking at various institutions in the public sector that promote corporate governance. Secondly, it evaluates the principles of corporate governance in these institutions and thirdly, it explains how the effectiveness and accountability of the public sector can be improved using the principles of corporate governance.

METHODOLOGY

This paper shows the importance of corporate governance in the public sector. The research methodology used in this paper was qualitative in nature, and involved the synthesis of previous work and the collection of papers and legislation dealing with corporate governance in the public and private sectors. Because of the diversity and nature of the topic, the study relied heavily on library resources such as policy documents, books, scholarly publications, decided cases, and statutes. Towards this end, the paper used substantially useful information from Department of Public Enterprises "Protocol on Corporate Governance in the Public Sector" (DPE 2002) and The King Codes on Reports on Corporate and Commercial/King Report on Governance for South Africa.

OBSERVATIONS AND DISCUSSION

Does Corporate Governance Apply to the Public Sector?

Corporate governance is often associated with the private sector than the public sector (Van Wyk 2004). The cardinal question is whether corporate governance is only confined to the private sector. From the definitions of corporate governance stated above, it can be deduced that corporate governance describes the overall management of an institution (Aguilera et al. 2007).

According to Van Wyk (2004), "the term 'Corporate' refers to a body or institution, and the use of the term 'corporate' in 'corporate governance' can be extended beyond companies and business corporations in the private sector. Corporate governance has, therefore, a broader application and should also form the base of financial management as well as other key organs in the public sector." Therefore, the overall management of an institution under corporate governance is not restricted to private sector but is also applicable to the public sector entities (Derwis 2001). McGregor (2007) rightly pointed out that governance is more than rules, regulations, accountability, structures and frameworks. She notes that governance is also about institutional attitudes, leadership, values and behaviours. She concludes that all these issues cut across all areas of an organisation whether private or public sector organisation.

Governance in the public sector has a political dimension because the roles of the stakeholders in governing the public sector are important (Hartley 2005). The stakeholders will be represented by a governing body, for example Parliament, who has through elected representatives, the responsibility for appraising performance (McGregor 2007). Stakeholders include providers of resources (taxpayers, lenders, bondholders, and creditors), service provider/partners (employees, contractors, and joint venture partners and other government entities), users of services (individuals and businesses who benefit from the services that the entity provides), interest groups, analysts/statistic gatherers (policy analysts, economists, financial analysts, rating agencies), media and the wider community (McGregor 2007: 413-414).

According to McGregor (2007:414), "*the main objective of corporate governance in the public sector is to ensure that the government delivers services in a way that is equitable, efficient, effective and affordable, and consistent with the principles of service delivery such as universal coverage and environmental sustainability. All these aspects are in harmony with the principles of corporate governance and indicate that corporate governance is just as applicable to the public sector as it is to the private sector.*" Corporate governance principles should be vigorously enforced in both the national and provincial governments for effective financial management (Fox et al. 2002). These principles involve openness, integrity and accountability, which can also be subdivided into features like independence, honesty, fairness, objectivity, discipline and responsibility (McGregor 2007: 414).

McGregor (2007:414) pointed out that "*the implementation of sound corporate governance and financial management in the public sector is hindered due to various managerial shortcomings. This includes inter alia, the lack of understanding of King Reports and the provisions of the PFMA 1999.*"

The Position of the Law on Corporate Governance

Corporate governance embodies processes and systems by which corporate enterprises are directed, controlled and held to account (Du Plessis 2011). Corporate governance in South

Africa was institutionalised by the publication of the King Report on Corporate Governance in November 1994. This report has however been superseded by the King Code of 2002 (Koma 2009). The purpose of the King Report is to promote the highest standards of corporate governance in South Africa. The Code of Corporate Practices and Conduct contained in the King Report applies *inter alia*, to SOEs and agencies that fall under the PFMA (Koma 2009).

PFMA is the principal Act promulgated by the Government to stipulate in detail, the rules and regulations relating to financial management and reporting to be followed and observed by SOE governing bodies and management (Scott 2007). The PFMA applies not only to SOE's, but other public entities, constitutional institutions, Parliament and provincial legislatures specified in the PFMA (Khumalo 2007).

Every public entity governed by the PFMA must have an accounting authority, usually the board, which must be accountable for the purposes of the PFMA (Nair 2008). However, if there is no board, the statutory governing body will be considered the 'authority.' In special circumstances, the relevant treasury may approve or instruct that another body serve as the accounting authority for that public entity (Roman 2008).

The King Code of Corporate Practices and Conduct provides specific guidelines for corporate governance (Leipziger 2010). The report applies to all companies with securities listed on the Johannesburg Stock Exchange (JSE), banks, financial and insurance entities, as well as public sector enterprises and agencies that are subject to the PFMA and the Municipal Finance Management Act (MFMA 2003) including any department of state or administration in the national, provincial or local sphere of government (Seakamela 2011).

The King Code of Corporate Practices and Conduct and the Protocol on Corporate Governance in the public sector provides particular reference to the following areas:

- Who should be on the board?
- Functions of the board;
- Distinction between the chairperson and the chief executive officer
- Role of directors;
- Remuneration committee;
- Allocation of share options;
- Board committees;
- Evaluation of directors;

- Dealing in securities;
- Business ethics and organisational integrity;
- Annual reports and general meetings;
- The company secretary (West 2009).

The government, as a major shareholder in SOEs, faces a wide range of risks associated with the operations of SOEs, including financial, reputation, political and operational risks (DPE 2002). It is the responsibility of each Executive Authority, in whom the primary responsibility for appropriate SOE oversight and accountability to Parliament rests, to ensure that these risks are identified, reduced and managed (Mathebula 2012). In this regard, a key requirement of SOEs is to report and account for their performance to the relevant Executive Authority in respect of financial and non-financial matters at the same time, however, maintaining independence in the conduct of their duties and free from day to day involvement by the Executive Authority (the line Ministry) (DPE 2002). Protocols, Shareholder Compacts and Policy Framework for SOEs are released by the relevant Executive Authorities from time to time. Through this, the government ensures that there are no actual or perceived conflicts of interest and that the government's broad policy objectives are met by the SOEs, ensuring that the SOE's boards operate efficiently and effectively (DPE 2002).

SOEs operate within the framework of a variety of legislation including, *inter alia*, PFMA (which is part of Government's broader strategy to improve financial management in the public sector), Companies Act 71 of 2008 and the relevant legislation under which an SOE operates. It is, therefore, important that directors of SOEs develop adequate working knowledge of this framework and ensure that the SOEs comply with their legal obligations (DPE 2002).

Application of King Reports

King I Report promotes the highest standards of corporate governance. It advocated an integrated and inclusive approach to corporate governance (Andreasson 2011). This approach requires companies to widen their focus beyond financial matters and to consider the company's triple bottom line that is, its economic, environmental and social impacts (Timothy and Tanya 2011). King I Report require that each company

pay heed to how these triple bottom-line factors impact on and affect a wide range of stakeholders with whom the company transact, rather than simply its shareholders (Timothy and Tanya 2011).

The King III Report and the Code apply to all entities incorporated in and resident in South Africa, regardless of the manner and form of incorporation or establishment and whether that establishment is in the public, private or non-profit sectors (Wyngaard and Hendricks 2010). In contrast, the King II Report only applies to certain categories of business enterprises, namely listed companies, financial institutions and sector enterprises, while companies falling out of these categories were merely required to consider the application of the King II Report where applicable (Nevondwe 2012).

In the USA the government codified its corporate governance provisions in the Sarbanes-Oxley Act of 2002 and legal sanctions are applied for non-compliance with this Act (Sama and Shoaf 2005). In South Africa, compliance with the King III Report and the code is mandatory for the companies listed on the JSE, financial institutions and sector enterprises, but for all other entities there is no statutory obligation to comply with the King III Report and the Code (Ramlall 2012). While corporate governance practices in South Africa may be voluntary, note that they are highly recommended and have considerable persuasive force (Miles 2009). Commonwealth countries and the European Union Member States have also not legislated their corporate governance practices; they have however embraced a similar approach to that adopted in South Africa (Nevondwe 2012).

According to the Institute of Directors of Southern Africa (2009), “the King III principles have largely been drafted in general terms so that all entities, including non-profit organisations could apply these in order to measure and achieve good governance”. King III allows for flexibility when it is implemented due to its ‘apply or explain’ regime. This is different to ‘comply or explain’, which was the approach followed in King I and King II. Although there is a subtle difference, this change represents a fundamental shift in understanding the nature of corporate governance. ‘Comply or explain’ potentially denotes a rules-based compliance where an organisation either complies or does not. In contrast to this the ‘apply or explain’ approach is a

much more nuanced approach (Institute of Directors of Southern Africa 2009).

Institutions and Structures of Governance in the Public Sector

There are various institutions and structures that play a vital role in promoting good governance in the public sector (Agere 2000). These institutions must adapt to the principles of good governance for the purposes of controlling the activities of organizations that operate as parastatals or public entities and others that function as business units within the broad context of the government sector (Yanacopulos 2005).

National Departments and Provincial Departments

The National departments and provincial departments are structures in the public sector most expected to promote the elements of good governance that includes inter alia accountability, transparency and responsibility (Webb 2010). These structures have a duty to support governance in the public sector.

The Standing Committee on Public accounts in particular ensures that the executives are held accountable for all its activities (Mutula and Author Vitae Wamukoya 2009). The Executive has to be accountable for public monies and for all the resources used on a day to day basis. This is essential especially in the evolving fraud and corruption in South Africa (Wehner 2002).

Auditor General

The Auditor General (AG) derives its general mandate from the Section 188 of the South African Constitution (1996). The AG accordingly has a duty to audit and report on the accounts, financial statements and financial management of (Masutha 2014):

- ♦ all national and provincial state departments and administrations;
- ♦ all municipalities; and
- ♦ any other institution or accounting entity required by national or provincial legislation to be audited by the Auditor-General (Botes 2011).

The AG reports are required to be made available for public domain by virtue of Section 188(3) of the South African Constitution. The avail-

ability of these reports to the public promotes transparency and accountability which are essential in good governance (Mbatha 2005). This discussion is relevant as the public sector is also subject to auditing. It is submitted that auditing in general must be understood by both the public servants and most importantly, managerial leadership.

The managerial leadership must be well acquainted with the processes of auditing; the lack of understanding of these processes would deprive the managerial leadership the opportunity to use the PFMA as a guiding policy for good governance in the public service. In support of accountability and responsibility, the AG must submit the annual report, financial statement and audit reports of financial statements within six months after the financial year relating to oversight mechanism and to the National Assembly (Siswana 2007).

Public Service Commission

There is a single Public Service Commission in the Republic of South Africa. This Commission is independent and impartial in the exercise of its duties by virtue of Section 196(1) of the South African Constitution. The Public Service Commission (PSC) is another structure that promotes the governance of the public sector (Naidoo 2012).

PSC is tasked and empowered to investigate, monitor and evaluate the organisation and administration of the public service by virtue of Section 196(4) of the South African Constitution (Omotoye 2011). This duty also includes the obligation to promote measures that would ensure effective and efficient performance within the Public Service and to promote values and principles of public administration as set out in the Constitution, throughout the Public Service by virtue of Section 196(4) of the South African Constitution.

It can therefore be deduced that the PSC promotes governance in the public sector through the regulation and promotion of ethical leadership, monitoring and evaluation, management and measurement activities in the public service (Govender 2013).

National Treasury

National Treasury (NT) seeks to ensure that good governance is at the heart of public ser-

vice (Siswana 2007). It also ensures that financial management in the public service is improved. To support its mandate, NT is responsible for the promotion and enforcement of transparency and effective management in respect of revenue, expenditure, assets, and liabilities of departments, public entities and constitutional entities (Siswana 2007).

Most importantly, according to Siswana (2007) *“the NT is expected to assess and monitor the implementation of the PFMA, as well as the norms and standards and treasury regulations so that financial management in the public service is at the optimal level. NT also promotes good governance by encouraging accountability, transparency and risk management in the public sector. NT may draft risk and fraud plans for the departments in public sector which may be implemented by both the departments and officials to promote good governance.”*

Public Protector

The Public Protector (PP) derives its mandate from the Constitution in terms of Section 182. PP has the power:

- ♦ to investigate any conduct in state affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper or to result in any impropriety or prejudice; in terms of Section 182(1)(a).
- ♦ to report on that conduct; in terms of Section 182(1)(b) and
- ♦ to take appropriate remedial action in terms of Section 182(1)(c).

From the above constitutional mandate, it can be deduced that the PP is supportive of corporate governance and its processes. It can further be deduced that the government departments are under scrutiny and observation by the public in support of good governance so that the rights of the public are not undermined (Siswana 2007). It is within this context that the members of the public are encouraged to lodge complaints against any misuse of public monies by government departments (Siswana 2007).

Principles of Corporate Governance

The following are the principles of corporate governance as provided by the King III Report and code, namely:

- ♦ ethical leadership and corporate citizenship;
- ♦ establishment boards and directors;
- ♦ establishment of audit committees;
- ♦ the governance of risk;
- ♦ the use of information technology;
- ♦ compliance with the laws, codes, rules and standards;
- ♦ internal audit;
- ♦ governing stakeholder relationships; and
- ♦ Integrated reporting and disclosure.

Ethical Leadership and Corporate Citizenship

The underlying philosophy of the King III Report revolves around leadership, sustainability and corporate citizenship. On the issue of leadership, the King III Report requires the board of directors to provide effective leadership based on an ethical foundation (Nevondwe 2012). Nevondwe (2012) writes that *“ethics or integrity is the foundation and reason for corporate governance. An ethical corporate culture constitutes more than social philanthropy or charitable donations. The reasoning behind the ethics of corporate governance, which requires the board of directors to ensure that the company is run ethically, is that, as this is achieved, the company earns the respect and approval of those affected by and affecting its operations.”*

Boards and Directors

The King III Report places great importance on the leadership, integrity and responsibility of the board (Hilb 2012). The board constitutes a fundamental base of corporate governance in the SOE's. Accordingly, each SOE should be controlled by an effective and efficient board, comprising of executive and non-executive directors with the majority of the directors being non-executive in order to ensure independence and objectivity in decision making (DPE 2002).

The King III Report differentiates an executive and non-executive director. An executive director is involved with the day-to-day management of the SOE. He or she is a full-time salaried employee of the SOE (Nevondwe 2012) and is generally under a contract of service with the company. A non-executive director, on the other hand, is a part-time director. He or she is not involved in the management of the SOE, but plays an important role in providing objective

judgment independent of management on issues facing the SOE (Fisheries 1980). Generally, non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors (Zattoni and Cuomo 2010). A non-executive director must not be biased and must always stay away and distance himself/herself from where conflict of interests arises (Nevondwe 2012).

In the case of Fisheries Development Corporation of SA Ltd v Jorgenses, Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd 1980 (4) SA156 (W) 165, the court stated that non-executive directors are not bound to give continuous attention to the affairs of the company. Their duties are of an intermittent nature, to be performed at periodical board meetings and at any other meetings that may require their attention. Non-executive directors are expected to attend board and relevant board committee meetings and to acquire and maintain a broad knowledge of the economic environment, industry and business of the company (Nevondwe 2012). The role of non-executive directors and the independence they are believed to bring to the board of directors has been a consistent theme of corporate governance theories, policies and programmes (Nevondwe 2012).

Nevondwe 2012) indicates that *“an independent non-executive director is a director who is required to be independent in character and judgment. There should be no relationships or circumstances that should affect, or could appear to affect their independence. In this context, ‘independence’ means the absence of undue influence and bias that 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. Not only should the director be independent, but he or she should also appear to be independent in the perception of a reasonably informed outsider.”*

The following are the roles of the Board in the SOE:

“The board of the SOE has absolute responsibility for the performance of the SOE and is fully accountable to the shareholder for such performance. As a result, the board should give strategic direction to the SOE, and in concurrence with the Executive Authority appoint the chief executive officer and ensure that an effec-

tive succession plan for all directors and key executives is in place and adhered to.

- ♦ In the SOE, the board of directors are responsible for submission of all reports, returns, notices and other information to parliament, the executive authority and National Treasury as may be required by the statutes.
- ♦ The board is also responsible for the management, including the safeguarding, of the assets and for the management of the revenue, expenditure and liabilities of SOE.
- ♦ The board must ensure that SOE has an Affirmative Action Plan in place to advance members of the groups historically discriminated against, including on the grounds of race, colour, origin, gender and disability.
- ♦ The directors shall, in the exercise of their powers, use their best endeavours to achieve the objectives of the SOE as set out in the Memorandum of Association of the SOE and as conveyed to them by the Executive Authority.
- ♦ If the board is unable to comply with any of the responsibilities stated in the PFMA, it must promptly report the inability, together with reasons to the Executive Authority and the National Treasury.
- ♦ The board of an SOE in terms of section 55 of the PFMA must:
 - 1) keep full and proper records of the financial affairs of the SOE;
 - 2) Prepare financial statements for each year;
 - 3) Must submit the draft financial statements within two months after year-end to the treasury and auditors for auditing; and
- ♦ Must submit the audited statements within 5 months after the financial year-end to the Executive Authority, National Treasury and the Auditor-General" (DPE 2002).

The board must annually, in consultation with its Executive Authority conclude a shareholder's compact. The Shareholder's compact must document the mandated key performance measures and indicators to be attained by the SOE as agreed between the parties. The board of an SOE must also establish procedures for quarterly reporting to the Executive Authority to facilitate effective performance, monitoring, calculation and corrective action (Nevondwe 2012).

Audit Committees

The King III Report requires the board of directors to ensure that the company has an effective and independent audit committee. An independent audit committee plays central role in corporate governance and is vital to ensure the integrity of integrated reporting, financial controls and to identify and manage financial risks (Van der Nest 2008).

Van der Nest (2008:546-548) provides useful insights and makes elaborate explanations in this regard as follows "*the PFMA and MFMA also require public sector institutions to establish independent audit committees and internal audit committees. The report requires listed companies and SOEs to establish an audit committee. The shareholders must elect the members at each annual general meeting. Private companies, non-profit companies and personal liabilities companies may voluntarily appoint an audit committee and define its composition, purpose and duties in the memorandum of incorporation. The audit committee should comprise of at least three members who should be suitably skilled and are experienced non-executive director. The Companies Act also prescribes further requirements. The chairperson of the board of directors should not be chairperson or member of the audit. The chairperson must only attend meeting upon invitation. The appointment of audit committee members in state-owned entities is governed by the PFMA and MFMA. Members of the audit committee must meet at least four times in a year. They should also meet and liaise with internal and external auditors at least once a year without the management being present. The mismanagement of public funds has led to public officials being required to give detailed report on how the public funds are being utilised. These accountability and sound financial management requirements have brought public sector managers in contact with accountability instruments such as internal audit and the audit committee of the institution. In essence, audit committees promote accountability which is one of the important elements of corporate governance. PFMA also touches on the element of accountability in the public sector through section 38. Section 38 requires the accounting officer therein to ensure that the department maintains a system of financial and risk man-*

agement and internal control. This system of internal control must be monitored by an internal audit function, under the control and direction of an audit committee. Audit committee has been built into the legislative framework as an accountability instrument.” These averred insights are to promote and strengthen implementation of corporate governance.

The Governance of Information Technology

The governance of Information Technology (IT) is stressed on for the first time in the King III Report. As acknowledged by the King III Report, IT has become an integral part of doing business and it is fundamental to support, sustain and grow the business. The King III Report states that IT governance is not an isolated discipline, but an integral part of overall corporate governance. Information technology governance can be considered as a framework that supports the effective and efficient management of IT resources to facilitate the achievement of a company's strategic objectives (Nevondwe 2012).

Nevondwe (2012) points out that *“the IT governance framework should include the relevant structures, processes and mechanisms to enable IT to deliver value to the business and to mitigate IT risks. It should focus on the governance of the information as well as the governance of technology. The King III Report requires the board of directors to be responsible for IT governance. The board may appoint an IT steering committee or a similar forum to assist with its governance of IT. It is recommended that the Chief Executive Officer (CEO) appoints a Chief Information Officer (CIO) to be responsible for the management of IT. There is an increased risk to organisations that embrace IT, therefore its directors should ensure that the prudent and reasonable steps have been taken to govern IT.”*

Addressing IT governance by legislation alone is not enough precaution to IT risks. International guidelines have been developed through organisations such as ITGI and ISACA, (COBIT and Val IT), the ISO authorities (for example, ISO 38500) and various other organisations such as OCEG. These may be used as a framework for audit for the adequacy of the company's information governance for instance, but it is not possible to have one size fits all. However, companies should keep abreast of the rap-

idly expanding regulatory requirements pertaining to information (Barrett 2004).

The Governance of Risk

According to Cassim et al. (2013), the King III Report requires that the board of directors be responsible for the governance of risk and determine the levels of risk tolerance that the company is able to bear in the pursuit of its objectives. Risk is defined as the taking of risk for reward (Khunen and Knutson 2005). The board of directors should determine the levels of risk tolerance at least once a year. It should review these limits during periods of increased uncertainty or any adverse changes in the business environment.

It is recommended that the board's responsibility for risk governance be expressed in the board charter. In addition, the board's responsibility for risk governance should manifest in a documented risk management policy and plan which should be widely distributed throughout the company and reviewed by the board at least once a year (Barrett 2004). The board should also comment in the integrated report on the effectiveness of the system and process of risk management.

A risk committee or audit committee should assist the board in carrying out its risk responsibilities. The risk committee should have at least three members including executive and non-executive directors in terms of Principle 4.3 of the King III Report (Hilb 2012). The committee should comprise people with adequate risk management skills and experience to equip the committee to perform its functions. The committee may invite independent risk management experts to attend its meetings which should convene at least twice a year in terms of Principle 4.3.2.4 of the King III Report, if necessary (Singh 2010).

Regarding risk disclosure, the King III Report recommends that the board of directors should ensure that there are processes in place that enable complete, timely, relevant, accurate and accessible risk disclosure to stakeholders in terms of Principle 4.10 of the King III Report. Undue, unexpected or unusual risks should be disclosed in the integrated report in terms of Principle 4.10.2 of the King III Report (Singh 2010).

In the public sector, risk management involves identifying risks that may prevent a department from achieving its objectives, analysing those risks, avoiding certain risks and man-

aging those that remain (Drennan and McConnell 2007). It has been suggested that audit committees should fulfil the role of assisting to assess risks facing the government department (Van der Nest 2008). In the premise, directors should keep the executive authority informed of risk management strategies by outlining them in corporate plans, progress reports and other reports when necessary (DPE 2012). In addition, unless otherwise qualified because of circumstances applying to a particular SOE, corporate plans and progress reports should contain a statement from 'the board indicating that the board has appropriate risk management policies and practices in place and that adequate systems and expertise are being applied to achieve compliance with those policies and procedures (DPE 2012).

Compliance with Laws, Rules, Codes and Standards

The King III Report requires the board of directors to ensure that the company complies with all applicable and relevant laws and that it considers adherence to non-binding rules, codes and standards in terms of Principle 6.1 of the King III Report (Gevers 2012). A compliance culture should be encourage through leadership, establishing the appropriate structures, education and training, communication and the measurement of key performance indicators relevant to compliance in terms of principle King III Report paragraph 21, 91. The board has a duty to take necessary steps to ensure the identification of laws, rules, codes and standards that apply to the company 11, 90. Details must be disclosed by the board in its integral report on how it has discharged its responsibility to establish an effective compliance framework and process in terms of Principle 6.1.2 of the King III Report

The King III Report goes as far as to require the board and each individual director to have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business in terms of Principle 6.2 of the King III Report. This is important for directors to adequately discharge their fiduciary duties and their duty of care, skill and diligence in the best interest of the company in terms of Principle 6.2.2 of the King III Report.

Compliance risk, which is the risk of damage arising from non-adherence to the law and regu-

lations, to the company's business model, objectives, reputation, going concern, stakeholders relationships or sustainability, should form integral part of the company's risk management process in terms of Principle 6.3 and King III Report, paragraph 14, 90.

The King III Report suggests that the board delegates someone to manage the implementation of an effective compliance framework and process in terms of Principle 6.4 of the King III Report. An independent, suitably skilled compliance officer may be appointed (Le Roux 2010). He or she should have access to, and interact regularly on, strategies compliance matters with the board and/or appropriate board committee and executive management in terms of Principle 6.4.7 of the King III Report. Although the chief executive officer may appoint a compliance officer to assist in the execution of the compliance function, note that accountability to the board of directors' remains with the CEO in terms of Principle King III Report paragraph 23, 91.

Internal Audit

According to Cassim et al. (2013), the King III Report requires the board of directors to ensure that there is an effective risk based internal audit in terms of Principle 7.1 of the King III Report. An internal audit should evaluate business processes, perform an objective assessment of the effectiveness of risk management and the internal control framework, systematically analyse and evaluate business processes and associated controls, and provide a source of information as appropriate regarding instances of fraud, corruption, unethical behaviour and irregularities in terms of Principle 7.1.2 of the King III Report (Smith 2012). An internal audit plays an important role in providing assurance to the board regarding the effectiveness of the system of internal controls and risk management of the company in terms of Principle King III Report paragraph 12, 25.

It is suggested that an internal audit charter be formally defined and approved by the board of directors, in terms of Principle 7.1.3 of the King III Report and that at a minimum, the internal audit Professional Practice of Internal Auditing and Code of Ethics in terms of Principle 7.1.4 of the King III Report (Muwandi 2010).

The King III Report recommends further that the internal audit should provide a written assessment of the effectiveness of the company's

system of internal control and risk management in terms of Principle 7.3 of the King III Report. It is the audit committee that should be responsible for overseeing the internal audit in terms of Principle 7.4 of the King III Report.

Governing Stakeholder Relationships

The King III Report adheres to the ‘triple context’ or integrated approach, which acknowledges that companies should act with economic, social, and environmental responsibility in terms of principle King III Report paragraph 18, 22. Directors should consider economic sustainability of the corporation. The shareholders should not be mere speculators, but owners concerned with the well-being of the company in which they hold shares, constantly checking whether the directors are practising good corporate governance (Nevondwe 2012).

Integrated Reporting and Disclosure

The board of directors should ensure the integrity of the company’s integrated report. An integrated report means a holistic and unified representation of the company’s performance in terms of both its finances and its sustainability in terms of principles encapsulated in King III Report paragraph 1, 108 (Marx and Mohammadali-Haji 2014). The integrated report should be prepared every year. Sustainability reporting and disclosure should be integrated with the company’s financial reporting. The annual financial statements should be included in the integrated report, and the board should include a commentary on the company’s financial results (Brockett and Rezaee 2012). Nevondwe (2012) points out that “this commentary should include information to enable stakeholder to make an informed assessment of the company’s economic value. The board should ensure that positive and negative impacts of the company’s operations, together with plans to improve the positives and eradicate or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.”

Lessons Learned from the Case of South African Broadcasting Corporation (SABC) LTD V MPOFU (SABC 2009)

This case deals with an appeal lodged by the SABC against the judgment of Tsoka J which

was dismissed with costs. The Court found that the suspension of Mr Dali Mpofu as Group Chief Executive Officer of the SABC at a meeting of 6 May, 2008 was not in accordance with the Papers of Association or good corporate governance. The court found that the board was not properly constituted as three of the directors of the board were excluded from a board meeting at the time the decision to suspend Mr Mpofu was taken.

The court also found that there was insufficient notice for the three directors to attend the board meeting. The court also found that Mpofu did have the necessary locus standi to seek reinstatement since he was acting in his own personal capacity and not on behalf of the company. The court observed that Ubuntu-botho (meaning-Humanity) is deeply rooted in our society. These values should assist in informing corporate decisions made by directors in state owned enterprises. Proper and constructive dialogue would enable better outcomes in the decision making process. This form of governance is underpinned by the philosophy of ubuntu-botho. The time is right to incorporate the views of ubuntu in the King code of good governance.

In paragraph 4 of Mpofu’s case, the court ruled that a crucial point is whether the board in making the decision to suspend the respondent (Group Chief Executive Officer) was mindful of, and applied proper corporate governance principles in coming to their decision. The central issue of corporate governance is the accountability of senior management and the board of a company because of the extensive powers vested in them.

The court pointed out in paragraph 29 that The King Report II on Corporate Governance for South Africa 2002 deals with public sector enterprises. The SABC is a public company and a public sector enterprise as defined in terms of PFMA. Companies and their boards are required to measure up to the principles set out in the Code. King Report recommends that public enterprise should try and apply the appropriate principles set out in the Code. The Code sets out principles and does not determine detailed conduct. The conduct of public enterprises must be measured against the relevant principles of the Code and must adhere to best practices. The Code regulates directors and their conduct not only with a view to complying with the minimum statutory standard but also to seek to adhere to

the best available practice that may be relevant to the company in its particular circumstances.

The court observed in paragraph 30 that the board and its directors are ultimately accountable and responsible for the performance and affairs of the company. King noted that given the synergy which takes place between individuals of different skills, experience and background, the unitary board structure with executive and non-executive directors interacting remains appropriate for a South African company.

In terms of the King Code, board meetings should include mechanisms that are efficient and timely. Board members should be briefed prior to meetings and board members should take the responsibility of being objectively satisfied that they have been furnished with all the relevant information and facts before making a decision. Although non-executive directors may meet separately, the attendance of both executive and non-executive directors at board meetings is of value as the diversity of views is important (IDSA 2010). The board has a collective responsibility to provide effective corporate governance and should exercise leadership, enterprise, integrity and judgment in directing the company in terms of the King's Report.

The court further ruled in paragraph 64 that integrity is a key principle underpinning good corporate governance. Good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly. There are no opportunities in corporate governance for cloaks and daggers. Such important decisions are not made in haste or in anger. There must be ethical behaviour in the exercise of dealings with fellow board members. These dealings must be dealt with in such a manner so as to ensure due process and sensitivity.

In paragraph 55, the court indicated that the Constitution of the Republic of South Africa recognises the importance of good governance. Section 195 deals with basic values and principles governing public administration. In terms of this section there must be a high standard of professional ethics. In fact, this standard must be promoted and maintained. These principles apply to organs of state and public enterprises.

This is not surprising, given South Africa history and the advent of the new democratic era. The Constitution compels government in all of its forms, both through government de-

partments and organs of state (including state-owned enterprises) to adhere to principles of good governance. State-owned enterprises such as the SABC are included in the definition of "organ of state." It is for this reason that the provisions of the Constitution as well as the legislation enacted in terms thereof are applicable to state-owned enterprises (Goodman 1998). The Constitution has enshrined certain rights that also have a direct bearing on the corporate governance of state-owned enterprises.

In paragraph 56, the court emphasised that the PFMA was promulgated to give effect to Chapter 13 of the Constitution. Accordingly this Act aims to modernise the system of financial management in the public sector. It represents a fundamental break from the past regime of opaqueness, hierarchical systems of management, poor information and weak accountability. The Act will lay the basis for a more effective corporate governance framework for the public sector.

Khoza and Adam (2005) have once asserted that the Constitution imposes a number of general obligations on all organs of state to promote cooperative government. In particular, organs of state involved in intergovernmental disputes are required to make every effort to settle the dispute and exhaust all other remedies before approaching the courts. This does not prevent organs of state seeking relief from the courts and is therefore a workable model. Reinforcing this assertion, Nevondwe (2012) pointed out that in state-owned enterprises, like other organisations, good corporate governance is ultimately about effective leadership. An organisation depends on its board to provide direction, and the directors need to understand what that leadership role entails

CONCLUSION

Public sector is not exempted from the principles of corporate governance. The governance in the public sector will improve when public servants are held accountable and responsible for the activities of their department. Within this context, it is suggested that departments should have a reporting system to support good governance. This would prevent public servants from using their positions for personal gain, which normally is monetary gain.

The principles of corporate governance should be welcomed in the public sector as they ensure that public servants are skilful and able to implement the vision and mission of the department, and national imperatives. The legal framework also plays a significant contributory role to the lives of ordinary people as it lays basis for the corporate governance principles framework for the public sector.

Whilst the principles and legal framework of corporate governance may be viewed to be intact, what appears to be the determining factor of a successful corporate governance in the public sector is the functioning of institutions and structures of governance because governance in general and public finance in particular must be driven and supported by institutions. These institutions must aim to operate within the ambit of the PFMA to avoid poor governance in the departments.

RECOMMENDATIONS

Trainings and seminars should be conducted for public servants to ensure that there is always adequate compliance with the PFMA. It is the interpretation, understanding and implementation of the PFMA by public servants that determines the potential failure of governance in the department.

There is no doubt that corporate governance is a key element in improving economic efficiency and growth as well as enhancing investor confidence. The King III report and the Code provide useful guidance to public sector institutions and directors on how to direct and control the business of the company or institutions and make decisions on behalf of the company/institutions.

The companies which are not listed in the JSE and which are not state-owned entities must voluntarily consider the principles of corporate governance. These principles will improve their control systems, governance, risk, audit, IT, financial reporting, stakeholder engagement and ethical issues which will contribute to the growth of the company and makes it profitable and sustainable.

The legislation, codes and regulations must make it compulsory for all institutions and companies operating business in South Africa to apply these principles. These principles if applied correctly will assist the government to

achieve its objectives of job creation and alleviating poverty. These principles must always be adhered to by people who are responsible for running of the SOEs, government departments, government agencies and municipalities.

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