

COMPLIANCE AND CORPORATE GOVERNANCE CONSIDERATIONS: HIGH LEVEL OVERVIEW

1. INTRODUCTION

Every organisation is subject to a host of compliance requirements, emanating from a number of different sources, including:

- the law (legislation, regulations and the common law);
- contractual obligations (e.g. shareholders' agreements, funding agreements, supply agreements, etc);
- internal policies and procedures; and
- corporate governance and best practice guidelines and recommendations.

The sanction for non-compliance to any of the above varies from severe fines and/or imprisonment and civil claims from third parties for damages suffered to a mere "comply or explain" regime (corporate governance and best practice). Not only is the organisation at risk in this regard, but the directors also face the potential of personal liability in certain circumstances.

The benefits of ensuring a proper compliance culture and system within an organisation include, amongst other things, the protection of the organisation and its office bearers (specifically the board of directors) from financial liabilities, imprisonment and reputational harm. This holds true for both listed and unlisted, private companies. For listed companies and those organisations who wish to secure benefits such as funding, skilled and experienced employees, a constructive relationship with the authorities and other stakeholders, etc, an effective compliance regime is imperative. Also, focusing on contractual obligations, the benefit of properly managing these and adhering thereto from day one should not be underestimated, especially when disputes between contracting parties arise.

2. THE COMPLIANCE ARENA

The sources of compliance requirements, as listed above, warrant some additional comments:

2.1 The law

On any given day there are more than 100 pieces of legislation that impacts on the operations and affairs of an organisation. It goes without saying that a prudent organisation, through its board of directors, will ensure compliance thereto as part of its risk management policy and procedures.

Personal liability of directors is of specific relevance in this area as a number of laws, including the Companies Act, tax laws and several environmental laws, provide for such liability. It is vital for directors to have a sound understanding of their duties,

responsibilities and powers in these areas as part of their own individual “risk management strategy”.

As far as reputational risk is concerned, one only need to be reminded of the recent embarrassment suffered by directors of large, “reputable” companies for alleged contraventions of the competition laws.

The implications of the common law, specifically as far as directors’ exposure and potential liability is concerned, also warrant some consideration. Directors need to be very clear on their fiduciary duties to the company. Our courts have on several occasions enforced the legal principle that a director at all times have to act in the best interest of the organisation of which it is a director, even to the exclusion of the interests of its principal. This is of specific relevance to directors who have been appointed by any stakeholder in the organisation to “protect the interests of the stakeholder”. A number of directors have already found themselves on the wrong side of the law, specially where liquidators fight to return some monies to creditors of liquidated companies, for disregarding their common law duties as directors and thereby laying the foundation for a claim of reckless trading as envisaged in s424 of the Companies Act of 1973.

These common law duties have also now been codified in the recent Companies Bill and directors will be well advised to ensure that they are properly briefed on the provisions of the Bill as far as the standard of directors’ conduct and possible liability of directors, amongst other things, are concerned.

2.2 Contractual obligations

The proper management of contractual undertakings and obligations is essential to, inter alia, protect the organisation against possible legal action and damages.

Contracts such as a shareholders’ agreement could also be of relevance in the governance of a company as issues such as the composition and operation of the board of directors are often addressed in agreements of this nature. The statement that corporate governance is mainly a “comply or explain” regime therefore needs to be qualified by highlighting those governance related issues that have become part of contractual obligations as a result of these being incorporated into the shareholders’ agreement.

2.3 Internal policies and procedures

A number of policies and procedures have to be implemented as a result of legislative requirements and these need to be identified, prepared and implemented by an organisation to ensure compliance with the law.

In addition to the above, corporate governance and best practice guidelines recommend the adoption of additional policies and procedures to ensure an effective corporate governance regime.

It goes without saying that an organisation has little, if any, flexibility in deciding whether to implement policies and procedures which are required by law. The implementation of additional policies and procedures as recommended in terms of best practice will depend on a number of factors including the status of the organisation (i.e. listed or unlisted), the nature of the industry in which the organisation operates and the sincerity of the board of directors to commit the organisation to best practice and proper governance compliance and the extent of such compliance.

2.4 **Corporate governance and best practice guidelines**

For companies in the listed environment this is a “comply or explain” regime where the JSE, for example, requires of an issuer to include a statement in its annual report as to whether it complies with the Code of Corporate Practices and Conduct as contained in King II and, if not, to explain the reasons for such non-compliance. For unlisted companies, compliance in this area will depend to a large extent on the drivers as highlighted in 2.3 above, such as the appreciation of the board of directors for the benefit of being able to demonstrate a positive governance culture and regime when having to secure funding or in dealing with the authorities, stakeholders or potential investors.

Organisations in South Africa have the King Report on Corporate Governance for South Africa, 2002 including the abovementioned Code, as guidance in this regard. The draft King III Report was also recently published for public comment and directors need to once again ensure that they are fully briefed as to the possible impact of the King III recommendations on their organisations.

3. **RECOMMENDATIONS**

In light of the above, the following should be considered by every board of directors:

- 3.1 The board needs to ensure that a proper **compliance matrix** is prepared and that at least an annual report is submitted to the board on the company’s level of compliance in respect of all material laws and legislative requirements.
- 3.2 An efficient **contract management system** needs to be implemented and managed to ensure compliance with contractual undertakings and obligations and to ensure timely enforcement of contractual rights.
- 3.3 In the event of a shareholders’ agreement being in place, the shareholders, in consultation with the board of directors, may want to revisit the **provisions of the shareholders’ agreement** to limit the possible impact of these provisions on the board’s ability to implement value adding governance policies and procedures based on the relevant recommendations in King II/III. In addition, in keeping to the common law duties of directors it is imperative that directors are empowered to fulfil their duties and their role, by a clear divide between the powers of shareholders and that of the board of directors and that of management.

3.4 **Director induction** is essential for the board of directors to ensure that each individual director is fully briefed on the relevant provisions as far as issues such as the personal liability of directors is concerned, and that directors fully appreciate not only the rights, duties and responsibilities of directors but also the role of the board.

4. **CONCLUSION**

The above recommendations should not be seen as a comprehensive list, but rather as a starting point to assist the board of directors in putting a foundation in place on which it can build as the organisation grows and moves through different phases to assist the board in the proper fulfilment of its role and responsibilities.

At the end of the day, the implementation of best practices does not necessarily provide a guarantee against corporate governance and compliance failures. It is to a large extent dependent on the culture of the organisation and on the values that form the basis of all aspects of the business.

Also, directors are human and as such mistakes can and do occur. This is recognised even in our Companies Act which provides that a director could escape liability if it can be shown that he/she acted honestly and reasonably and in the circumstances “ought fairly to be excused”. It is for each individual director to ensure in fulfilling his/her duties, that such behaviour can be demonstrated. Applying your mind to the issues raised above and implementing procedures to address those issues that are relevant to the organisation is a definite step in the right direction.

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