

South Africa's King III: A Commercial Governance Code Determining Standards of Conduct for CSOs

1. Introduction

The [King Code of Governance Principles](#) (the Code) and the [King Report on Governance for South Africa](#) were published on 1 September 2009 and became effective on 1 March 2010. Like the first and second reports, this third report is aimed at promoting good corporate governance in South Africa and was compiled by the King Committee under the chairmanship of Professor Mervyn E. King. The King Committee has received both local and international acclaim for its contribution towards corporate governance.

In its first two reports the King Committee did not make any effort to explain its relevance to civil society organisations (CSOs). The King Committee was noticeably more concerned with the governance of commercial companies. CSOs were left in the dark as to the relevance and applicability of the first two codes.

King III has now boldly declared that it applies to 'all entities regardless of the manner and form of incorporation or establishment and whether in the public, private sectors or nonprofit sectors'.³ The principles contained in the report have purportedly been drafted so that 'every entity can apply them and, in doing so, achieve good governance'.⁴ The accuracy of this statement is questionable.

Although King III is a very important document in the history of corporate governance in South Africa, it must be recognised for what it is: a code suited for commercial entities that may find limited application in CSOs.

This article briefly explores the potential implications of King III on CSOs.

2. The development of the King Codes

In 1992 the King Committee was established with the specific aim of researching and making recommendations into corporate governance in South Africa. The first King report was published in 1994. King I recognised that companies do not act independent from society. For this reason the highest standards of corporate governance were encouraged through enterprise with integrity. This entailed that a wide range of stakeholders' interests are to be considered as it relates to the fundamental principles of good financial, social, ethical, and environmental practice. The second King Report (King II) was released in 2002. Without deviating from the principles of its predecessor, King II was more focused on introducing the idea of corporate citizenship and the notion of a triple bottom line. The latter involved the exercise of the corporate governance function with due regard to the company's actions on people, planet, and profit.

Some of the recommended practices of the King II report were incorporated into the Companies Act 71 of 2008 and some have become regulatory prescriptions to companies listed on the Johannesburg Stock Exchange. King III now states that —Good governance is not something that exists separate from the law and it is inappropriate to unhinge governance from the law. ⁵ The argument is that with time governance practices eventually becomes the standard against which the board is measured. Should a court have to look at an incident in respect of governance, such standard (governance practices) will be used to measure the conduct of directors. The insinuation is clearly being made that components of King III stand a good chance to attain the standard of law. King III further argues that: — Corporate governance practices, codes and guidelines therefore lift the bar of what are regarded as appropriate standards of conduct. Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable at law.

There is no doubt that some of the principles contained in King III would eventually become law. This raises the question whether King III lays a proper foundation that could inspire legislation that will govern CSOs.

3. Is King III an appropriate standard for civil society governance?

King III is not legislation. The fact that King III suggests that organisations should ‘apply or explain’ why they are not applying it, creates the illusion that it has the same authority as legislation. Given this insistence that King III applies to all entities, some funders may view it as the standard of governance for all CSOs in South Africa. King III, whether appropriate or inappropriate for CSOs, can in effect play the role of a gatekeeper for donor support.

King III is heavily skewed, in language and meaning, towards the commercial sector. This is highlighted by the fact that the report speaks overwhelmingly to business and commercial enterprises and assumes that trading activities are the sole means of sustaining all entities. King III is seemingly unmindful of the fact that a large number of CSOs in South Africa do not generate their own income through trading activities. It can only be deduced that this assumption is a consequence of a neglected consideration of the nonprofit sector.

King III is heavily associated with the Companies Act. Throughout the Report consistent reference is only made to the Companies Act of 2008 as the Act regulating the establishment of entities in South Africa. Now, one can only deduce that the intention was to speak to the governance of companies that have been and will be registered in terms of the companies’ legislation.

Given these factors alone there is reason to be concerned with the impact that King III may have on the enabling environment of CSOs — in particular on community-based organisations, as the Cinderellas to our sector.

It is claimed that King III was necessary in light of the new Companies Act 71 of 2008 and changes in international governance trends. This poses two very important considerations. First, not all CSOs are established in terms of the Companies Act and King III is seemingly not cognisant of the tens of thousands of voluntary associations that operate in terms of common law in South Africa. Second, an increased expectation of a high level of sophistication has now been imposed by King III on smaller community-based organisations. This seemingly academic approach has placed less emphasis on the local context.

The more sophisticated NGOs would be better placed to keep in step with the latest tunes. That however is not the reality for the majority of community-based organisations, which comprise the overwhelming component of CSOs in South Africa.

The Nonprofit Organisations Act, No. 71 of 1997 (the NPO Act) is one of the key pieces of legislation for the nonprofit sector in South Africa. It provides for the establishment of a Nonprofit Directorate which has, amongst others, the function “To ensure that the standard of governance within nonprofit organisations is maintained and improved.”⁷ It is clear that the King III report was compiled without involvement from the NPO Directorate. This is an important factor, as the NPO Act is in particular aimed at — creating an environment in which nonprofit organisations can flourish.⁸

4. The implications of King III for civil society governance

It is not difficult to see how some CSOs would snugly embrace King III and would most probably gain competitive advantage in implementing it. The authors of King III claim that it has been prepared so that ‘every entity can apply them and, in doing so, achieve good governance’. This is hardly evident from the Report. A number of principles contained in King III cannot realistically be applied to all legal entities. The following are such examples:

a. Audit Committees: Principle 3.1 of King III recommends that the board should voluntarily appoint an effective and independent audit committee consisting of at least three members. It further suggests that ‘there should be a basic level of qualification and experience for audit committee membership’.⁹ This audit committee should collectively have an understanding of a wide range of issues, namely: integrated reporting, internal financial controls, external audit process, corporate law, risk management, sustainability issues, information technology governance, and governance processes within the company.¹⁰ This expectation is out of sync with the reality of most community-based organisations in South Africa. In addition, the preparation of audit reports is not a legislative requirement for all companies in terms of the Companies Act of 2008.¹¹

b. Internal Audit: Principle 7.1 of King III provides that the board should ensure that there is an effective risk-based internal audit. The Report further suggests that the internal audit function 'should adhere to the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing and Code of Ethics at a minimum'.¹² The implication is that all CSOs should introduce the standards of a professional practice as a minimum requirement into its internal audit function.

c. Remuneration: Principle 2.25 of the Code states that 'Companies should remunerate directors and executives fairly and responsibly'.¹³ The Report further states that —The Board should promote a culture that supports enterprise and innovation with appropriate short-term and long-term performance-related rewards that are fair and achievable.¹⁴ King III has not taken into account that nonprofit boards are, due to the nature of nonprofit organisations, predominantly volunteers and are not getting paid for serving. The payment of nonprofit board members may have detrimental consequences for the nonprofit sector.

Community-based organisations, in particular, may find the implementation difficult for the following reasons:

- A lack of financial resources
- The availability of proficient board members to ensure compliance with King III.
- The additional financial burden or potential mission drift that may result from having to now also consider matters pertaining to business that do not form part of their main objective
- Many of the recommended practices ignore the fact that CSOs derive income through soliciting funding from a donor. Whether cash-strapped CSOs would be able to mobilise additional resources to implement King III remains to be seen.

5. Some issues not covered by King III

King III has introduced a code on governance that largely considers governance practices from a market-based perspective. It has not taken into account that the nonprofit sector does not operate primarily on the premise of supply and demand. The Code accordingly lacks principles on key areas that are central to civil society governance.

King III has not mentioned the issue of resource mobilisation, being a key responsibility of nonprofit boards. It is premised on the assumption that business is a means of sustaining all entities. King III does not take into account that a large part of CSOs have come into existence due to market failure. Accordingly, a number of organisations caring for the poor and needy (who are unable to pay for services) have to rely on donations and fundraising.

King III provides no guidance on how CSO boards should go about recruiting new board members. Recruiting new board members to volunteer their time serving on a CSO board is very different from offering someone a salary to become a director of a commercial company. Nonprofit directors carry similar responsibilities as for-profit directors, but are ordinarily not remunerated. The motivation to serve on the board of a nonprofit is therefore different compared to a for-profit. The commercial director is motivated primarily by financial gain whilst the CSO director will not ordinarily receive financial payment. The recruitment of directors to serve on nonprofit boards is therefore a central component of nonprofit governance – an aspect that King III has simply ignored.

King III does not take into account that different models of CSO governance have evolved over time. King III has, however, impliedly given recognition to the existence of different commercial models. King III does not offer guidance on some of the governance challenges faced with different CSO governance models. In one CSO model, for example—the constituent model—board members are appointed with the mandate of representing a particular constituency on the board. This governance model is widespread in the South African CSO sector and is also being promoted by the South African government. One of the shortfalls of this governance model is that it is not aimed at ensuring individuals with diverse governance skills are represented on the board. King III is unmindful of these unique challenges and offers no guidance on them.

6. Conclusion

Developments in the marketplace continue to have impacts on the development of legislation affecting the nonprofit sectors across the world. Legislatures often do not take into account the implications of such legislation on nonprofit organisations. The confusion following the applicability of the Sarbanes-Oxley Act to nonprofit organisations in the United States, shortly after its introduction, is an example of this.

CSO accountability should be promoted through laws and codes. The intention of this article is not to argue for lesser standards of governance and accountability of CSOs, but for suitable standards. Governance standards should not be introduced on the assumption that marketplace standards are suitable for CSOs. This form of legislative development is detrimental to the unique character of CSOs and will corrode the values underlying the nonprofit sector.

At least two prominent institutions have blamed weak corporate governance arrangements for the current global financial crisis. The Organisation for Economic Cooperation and Development concluded that: —...the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements. When they were put to the test, corporate governance routines did not serve their purpose to safeguard against excessive risk taking in a number of financial service companies. 5 In a similar vein, the United Nations found that: —...it is equally urgent to recognize the root causes for the [global economic] crisis and to embark on a profound reform of the global economic governance system.||16 It is likely that the global financial crisis will result in further legislative and governance reforms. King III illustrates how commercial entities and CSOs can easily be thrown together and measured with one measuring tape. This is clearly inappropriate in the South African context and the consequences of it remain to be seen. A governance code aimed at promoting good governance will overburden and may potentially stifle the growth of CSOs.

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3 The King Committee, (2009) King Report on Governance for South Africa, Institute of Directors, p. 17

4 Ibid.

5 Ibid, p.7

6 Ibid, p. 8

7 Section 5b(ii) of *Nonprofit Organisations Act*, No. 71 of 1997

8 Section 2 (a) of the *Nonprofit Organisation Act*, No. 71 of 1997

9 *The King Committee, (2009) King Report on Governance for South Africa, Institute of Directors*, p. 57

10 Ibid.

11 *The draft regulations of the Companies Act of 2008 are more in line with a threshold approached adopted by the California's Nonprofit Integrity Act of 2004 which requires charities with gross revenue of \$2 million or more to appoint an audit committee, which amount excludes grants received from government.*

12 The King Committee, (2009) King Report on Governance for South Africa, Institute of Directors, p. 93

13 Ibid, p. 48

14 Ibid

15 The Corporate Governance Lessons from the Financial Crisis, Organisation for Economic Co-operation and Development, 2009

16 The Global Economic Crisis: Systemic Failures and Multilateral Remedies, United Nation

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