

# **The Imperative of Good Corporate Governance in Turbulent Times**

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# IMPERATIVE OF GOOD CORPORATE GOVERNANCE IN TURBULENT TIMES

- WHAT IS CORPORATE GOVERNANCE?
- CG PRINCIPLES, CODES & STANDARDS
- MENA REGION CG DEVELOPMENTS
- WHY DOES CG MATTER MORE FOR MENA & EMES?
- MOVING BEYOND CG: INTEGRATED REPORTING & ESG
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# Great Financial Crisis has focused attention on mal-governance

- **Great Financial Crisis has put corporate governance back on the policy agenda in the same way that the Asian crisis, the dotcom-bubble and the demise of Enron & WorldCom prompted policy responses.**
- **Arab Firestorm highlighted mal-governance in government and provision of public services, lack of transparency & accountability, graft, bribery, corruption**
- **Turbulent times require strategic focus on fundamentals and on sustainable performance**

***“The financial crisis was and is a failure of governance and executive management took excessive risk for corporations while risking almost nothing for themselves.” Robert Monks***

# Corporate Governance definitions

- No single accepted international definition. Concept is evolutionary and responsive to new circumstances. Crises have led to reforms.
- Cadbury Report (1992): *“Corporate governance is the system by which companies are directed and controlled. The boards of directors are responsible for the governance of their companies. The shareholder’s role in governance is to appoint the directors and the auditors to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board’s actions are subject to laws, regulations and the shareholders in general meeting.”*
- OECD (2005): *“Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making”*
- *OECD principles included in 12 Key Standards for Sound Financial Systems*

# OECD Principles (2005)

- I. Ensuring the Basis for an Effective CG Framework :** CG framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
- II. Rights of Shareholders and key Ownership Functions:** CG framework should protect and facilitate the exercise of shareholders' rights.
- III. Equitable Treatment of Shareholders:** CG framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

# OECD Principles cont'd

- IV. Role of Stakeholders in CG:** CG framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- V. Disclosure and Transparency:** CG framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
- VI. Responsibilities of the Board:** CG framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

# South Africa King Code III (2009)

3 Basic Principles underlying SA King Code III:

1. ***Good governance is essentially about effective leadership.***

*Leaders should rise to the challenges of modern governance. Such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency and based on moral duties. Responsible leaders direct company strategies and operations with a view to achieving sustainable economic, social and environmental performance.*

2. ***Sustainability is the primary moral and economic imperative of the 21 century.*** It is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that should be understood by decision-makers. Most importantly, current incremental changes towards sustainability are not sufficient : we need a fundamental shift in the way companies and directors act and organise themselves.

3. The concept of ***corporate citizenship flows from the fact that the company is a person and should operate*** in a sustainable manner.

# South Africa King Code III (2009)

1. Ethical leadership and corporate citizenship
2. Boards & Directors
3. Audit Committees
4. Governance of Risk
5. Governance of Information Technology
6. Compliance with laws, rules, codes and standards
7. Internal Audit
8. Governing Stakeholder Relationships
9. Integrated reporting & disclosure

# 4. Governance of Risk

- 4.1. The board should be responsible for the governance of risk
- 4.2. The board should determine the levels of risk tolerance
- 4.3. The risk committee or audit committee should assist the board in carrying out its risk responsibilities
- 4.4. The board should delegate to management the responsibility to design, implement and monitor the risk management plan
- 4.5. The board should ensure that risk assessments are performed on a continual basis
- 4.6. The board should ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks
- 4.7. The board should ensure that management considers and implements appropriate risk responses
- 4.8. The board should ensure continual risk monitoring by management
- 4.9. The board should receive assurance regarding the effectiveness of the risk management process
- 4.10. The board should ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders

# 5. The Governance of Information Technology

- 5.1. The board should be responsible for information technology (IT) governance
- 5.2. IT should be aligned with the performance and sustainability objectives of the company
- 5.3. The board should delegate to management the responsibility for the implementation of an IT governance framework
- 5.4. The board should monitor and evaluate significant IT investments and expenditure
- 5.5. IT should form an integral part of the company's risk management
- 5.6. The board should ensure that information assets are managed effectively
- 5.7. A board risk committee and audit committee should assist the board in carrying out its IT responsibilities

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# World's Avalanche of CG Guidelines since GFC

At least 40 countries since the fall of Lehman Brothers have issued new or amended CG codes

## CG Developments 2008-2012 (MENA)

### UK – Financial Reporting Council

corporate governance and Stewardship codes; Walker report on corporate governance in banks and other financial institutions

**European Commission** Green Paper on corporate governance in financial institutions and corporate governance review

**US Dodd-Frank** proposals on corporate governance, sequel to Sarbanes-Oxley

**Basel Committee on Banking Supervision** have issued their Principles for Enhancing Corporate Governance

### Bahrain

CG Code issued in 2010

### UAE

- CG Code mandatory from April 2010 (issued in 2007)
- Draft Guidelines for Bank Boards by CBUAE (issued in 2010)
- SMEs CG Code September 2011
- RERA Developers Code 2011

### Qatar

CG Code issued in 2009

### Oman

- In 2010, The Capital Market Authority set up a corporate governance unit to ensure implementation of the CG Code (issued in 2002)
- CBO issued CG Guidelines to banks and have updated to reflect Basle requirements

### KSA

- In 2010, the Capital Market Authority set up a corporate governance unit to ensure implementation of the CG Code
- SAMA issued CG Guidelines to banks

### Kuwait

Capital Market Authority set up in 2010

# MENA-wide Codes

COUNTRY	CODE TYPE	YEAR	Compliance
Algeria	Code for FOEs & SMEs	2009	V
Bahrain	Code for Joint Stock Companies	2010	C
Egypt	Code for Listed Companies	2005/2011	C
Egypt	Code for the Public Enterprise Sector	2006	V
Egypt	Guidelines for FOEs	2008	V
Jordan	Code for Banks	2007	M
Jordan	Code for Listed Shareholding Companies	2007	C
Jordan	Code for Private Shareholding Companies, Limited Liability Companies, Non Listed Public shareholding Companies	2012	C
Jordan	Code for Insurance Companies	2006	M
Lebanon	Code for Joint Stock Companies	2006	V
Lebanon	Guidelines for Listed Companies	2010	V
Lebanon	Guidelines for FOEs	2010	V
Morocco	Code of Corporate Governance	2008	V
Morocco	Code for FOEs and SMEs	2008	V
Morocco	Code for Listed Companies	2011	V
Oman	Code for Listed Companies	2002	M
Pakistan	Code for Listed Companies	2002/2012	M
Pakistan	Code for Public Sector Enterprises	2012	M
Palestine	Code for Listed Companies	2009	M
Qatar	Code for Public and Listed	2009	C
Qatar	Guidelines for Banks and Financial Institutions	2008	C
Saudi Arabia	Regulations for Listed Companies	2006/2010	M
Syria	Code for Financial Intermediaries	2008	M
Syria	Code for Joint Stock Companies	2009	M
Tunisia	Code of Best Practice of Corporate Governance	2008	V
UAE	Code For Banks	2008	M
UAE	Code for Joint Stock Companies	2010	M
UAE	Code for Real Estate Developers	2012	C
UAE	Code for SMEs (9 Pillars)	2011	V
Yemen	Guidelines on Corporate Governance for FOEs	2010	V

# Hawkamah SME CG Code

**A. Corporate Governance policies and procedures**

**B. Transparency and Shareholder Relations**

**C. Board of Directors**

**D. Control environment (internal controls, audit and risk management)**

**E. Stakeholder Relations**

**F. Family Governance**

# Hawkamah SME Code: The 9 Pillars

## Pillar 1:

Companies should adopt a **formal corporate governance framework** outlining the roles of the key bodies such as partners, shareholders, board of directors and management.

## Pillar 2:

Companies should formulate a **succession planning process**.

## Pillar 3:

Companies should establish timely, open and transparent **flow of information** with shareholders.

## Pillar 4:

Companies should strive to establish an **effective board**.

## Pillar 5:

Boards should have **clear mandates** with sufficient resources.

## Pillar 6:

Companies should maintain **credible books of accounts**, annually audited by an external auditor.

## Pillar 7:

Companies should set up an **internal control** framework in place and conduct a regular review of risk.

## Pillar 8:

Companies should recognize **stakeholder** needs.

## Pillar 9:

Family-controlled companies should establish **family governance** mechanisms that promote coordination and mutual understanding amongst family members, as well as organize the relationship between family governance and corporate governance.

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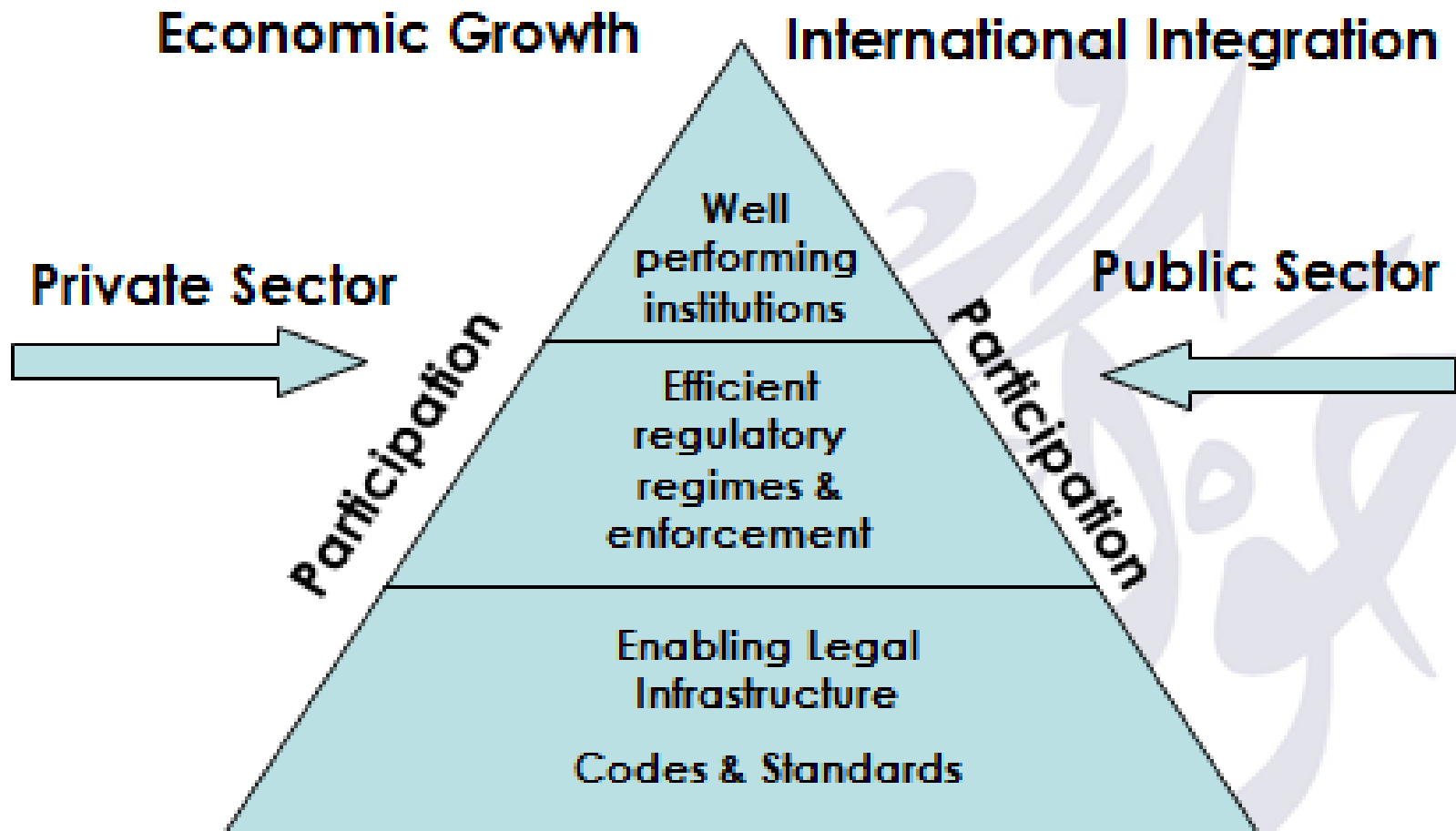
# Investment in MENA suffers because of lack of good governance

- MENA region has been a significant capital exporter for decades. But we have not attracted inward capital flows or retained and deployed our own capital resources for economic development and sustaining economic growth, except in exploiting energy resources.
- The region is overlooked by global investors despite its location, natural resources, positive demographics and promising growth prospects.
- **This marginalization of MENA is largely due to a perceived lack of good governance, lack of transparency, disclosure and accountability.**
- **GCC is dominated by SOEs and FOEs, which coupled with weak financial market development & judiciary institutions has meant an absence of incentives to invest in corporate governance**

# Why Does Corporate Governance matter more for MENA & EMEs?

- Economic development & sustained growth require deepening the region's financial markets, changes in banking relations, building institutions and generalised openness towards trade & investment—these all require good corporate governance.
- Well performing institutions, enabling legal & physical infrastructure, effective regulatory regimes and enforcement, “good governance” are major contributors to economic growth & prosperity and accountability.
- Companies with good corporate governance outperform and survive crises- including family succession crises
- “Good governance” is required by both the public sector and the private sector in the MENA: applicable to SMEs, FOEs & SOEs

*Governance is integral element of sustainable economic growth & development: it is an imperative*



# Survey: Investors in Emerging Market Economies value Governance

Statement read to 29 emerging market investment decision-makers	Percentage of respondents who agreed with statement
My firm would pay a larger governance premium for emerging market companies than for developed market companies	100%
My firm would pay a premium of at least 10 percent for good governance in an emerging market company	55%
My firm would pay a premium of at least 20 percent for good governance in an emerging market company	38%
My firm considers governance a threshold for an emerging market investment decision, and for how much of a premium we would be willing to pay	41%

## What Investors look for in EME companies

Governance characteristics	Very important	Moderate importance	Little importance
Disclosure	100%	0%	0%
Related party transactions	90%	10%	0%
Board structure/ board independence*	3%	48%	48%
Shareholder rights, such as "tag-along rights"	83%	17%	0%
Board process	0%	3%	97%
Separate Chairman and CEO	52%	41%	7%

IFC Emerging Market Investor Survey

# Investors in Emerging Market Economies value Governance

Governance Characteristic	Very important
Disclosure in general	100%
Disclosure in English	31%
Quarterly disclosure	59%
Willingness of senior management to meet	100%
Motivations of controlling group/management	100%
Succession planning and compensation structure	59%

IFC Emerging Market Investor Survey

## Main conclusions:

- Corporate governance is a critical factor in emerging market investment decisions
- Investors are willing to pay a premium for better-governed emerging market firms
- Investors often do not invest in emerging market companies with poor governance
- Lack of transparency & related party transactions area red flags for emerging market investors
- Shareholder rights & protection more important than Board independence for emerging market investors

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# The Value of ESG & its Failure/Neglect



# Value of ESG & its Neglect/Failure



# Investment & ESG

- Environment, Social & Governance (ESG) factors are increasingly a significant source of investment risk for investors who want to diversify into growth assets such as developed market equity, emerging market equity and corporate bonds
- A bottom-up perspective suggests that ESG factors should be integrated into investment research in order to minimize extreme risks, particularly in emerging market equity
- ESG risk-optimized strategic asset allocation can improve expected portfolio performance: reduce extreme (tail risks) and improve risk-return profile of portfolios

Source: Risklab, GmbH

# Portfolio Optimisation with ESG factors reduces tail risks & improves risk/return tradeoffs

Return/Risk Metric	Average values p. a. over 20 years			
	Expected Return	Volatility	CVaR <sup>3</sup> 95 % (12M)	
Equity Developed	+ ESG Equity World	7.5%	15.2%	-25.7%
	Neutral ESG Equity World		20.2%	-38.1%
	- ESG Equity World		25.8%	-52.7%
Equity Emerging Markets	+ ESG Equity Emerging Markets	8.5%	19.2%	-38.8%
	Neutral ESG Equity Emerging Markets		27.9%	-64.5%
	- ESG Equity Emerging Markets		37.3%	-91.2%
Corporate Bonds	+ ESG Corporate Bonds	5.3%	4.8%	-4.9%
	Neutral ESG Corporate Bonds		6.1%	-8.1%
	- ESG Corporate Bonds		7.6%	-11.5%

Note: Quantification of selected sustainability criteria (ESG factors) related to expected (extreme) risks of the asset classes with the same level of expected returns; CVaR 95 % (12M) = Conditional Value at Risk at a confidence level of 95 % and a time horizon of 12 months. Source: risklab GmbH

# Hawkamah/S&P ESG Pan Arab Index

- Hawkamah in partnership with Standard & Poor's and with the support of the International Finance Corporation launched an exchange tradable Environmental, Social and Corporate Governance (ESG) Index for the MENA region.
- The **S&P/Hawkamah ESG Pan Arab Index is the first Pan Arab Index of its kind**. It ranks and tracks the performance, transparency and disclosure of **50 regional companies** on ESG issues.
- The constituents of this Index are filtered/derived from 450 listed companies from 11 countries' stock exchanges: Bahrain, Egypt, Jordan, Lebanon, Kuwait, Morocco, Oman, Qatar, Saudi Arabia, Tunisia and the UAE.
- Liquidity screen of a minimum average daily value traded of US\$ 100,000, measured over one calendar year.

# Hawkamah-S&P ESG Index criteria

## **127 Corporate Governance (G) disclosure indicators identified**

- ▶ Shareholder rights
- ▶ Audit Process
- ▶ Financial and operational indicators
- ▶ Board and management profile
- ▶ Ownership structure
- ▶ Business Ethics

## **70 Environmental and Social (ES) disclosure indicators identified**

- ▶ Environment
- ▶ Employees
- ▶ Community
- ▶ Customers/Product

# Hawkamah-S&P ESG Index methodology

The index employs a unique methodology that quantifies a company's ESG practices and translates them into a scoring system which is then used to rank each company against their peers in the MENA markets.

- **Quantitative Score.** Each company is assigned a quantitative ranking based on three factors – transparency and disclosure on corporate governance, environment, and social governance as per the company's published information.
- **Qualitative Score.** The top companies with the highest quantitative score are selected for qualitative scoring on the basis of independent sources of information such as news stories, websites, and CSR filings.
- **Composite Score.** A composite score is calculated for each company by summing the qualitative and the quantitative score.

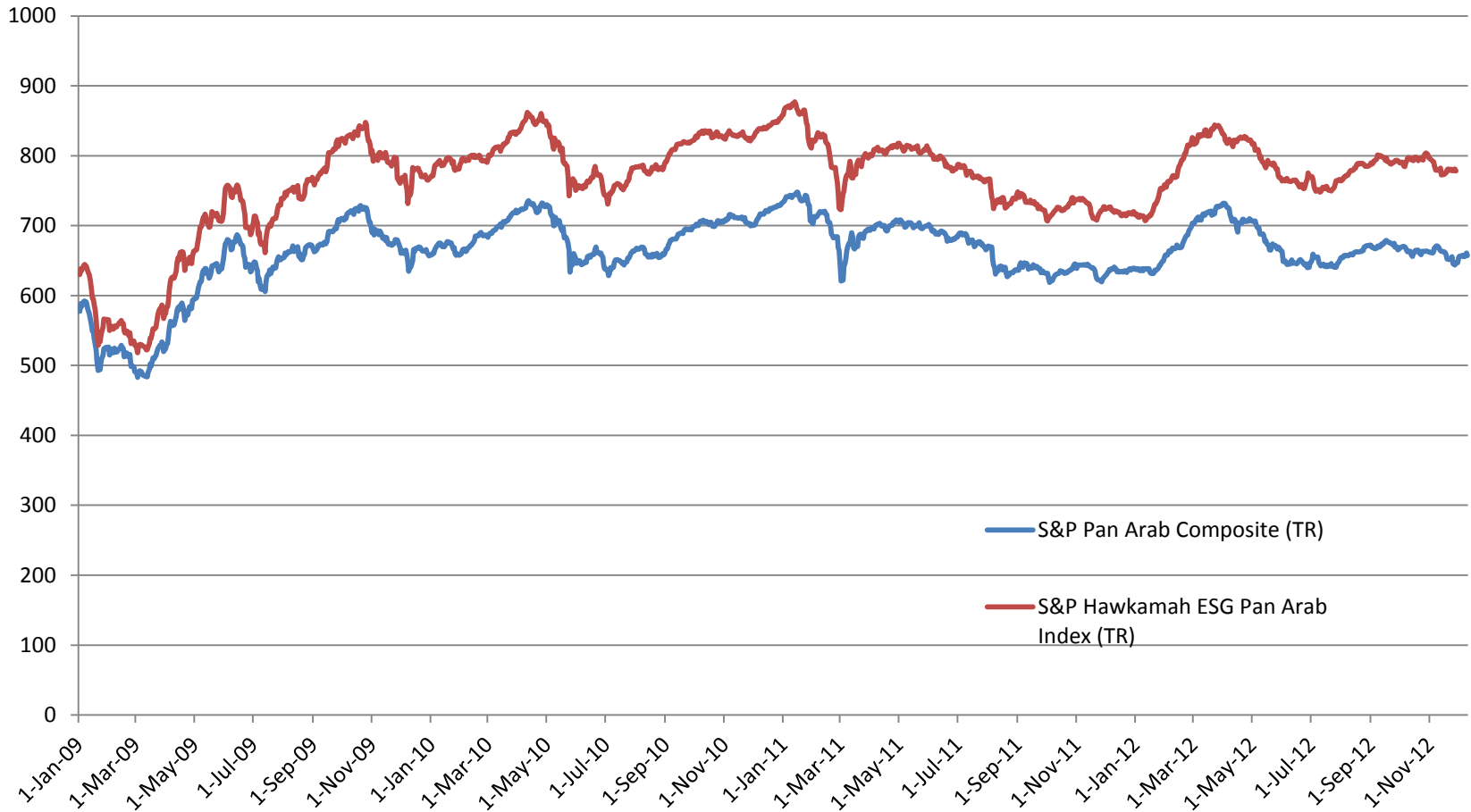
# ESG is a Tool for Investors

- Addresses the ‘elephant’ in the room
- Provides an extra layer of assurance by using tried & tested ESG methodology
- Facilitates investment in the region by “patient capital” institutional investors such as pension funds, SWFs
- Hawkamah-S&P Index helps investors who lack resources or know-how to adopt a passive ESG policy.
- Indexing is a low cost strategy which requires relatively little monitoring and management on the part of the asset owner, and the use of specialised indices is seen as a relatively easy way to incorporate ESG factors into a passive mandate.

# What the ESG Index means for companies

- An Index relates companies ESG performance to stock market performance
- Allows companies to compare themselves to ESG Index companies
- An Index can create incentives for companies to improve ESG performance
- An index has assets attached to it, raising the cost of capital for those that are not on the index
- An index creates a public list of leaders and therefore laggards, driving companies to be on “the list”
- A badge of honor, demonstrating leadership on ESG

# Hawkamah-S&P ESG Index companies have outperformed the market



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# MENA GOVERNANCE: THE NEXT STEPS

- **Revision & Strengthening of CG Codes**
- **Establishment by regulators of CG units.**
- **Board members should be accredited:** Supervisors should ensure that boards are staffed with competent individuals, who receive on-going professional development - Mudara Institute of Directors
- **Regulators need to embrace good governance themselves** – they need to have clear roles, mandates and lines of accountability, and staffed with competent personnel. Above all, they need to be effective, transparent and predictable.
- **Banks, SWFs, investment funds & asset managers should incorporate corporate governance/ESG criteria** into their investment and lending criteria. They can play a central role in instilling a culture of good corporate governance in the region.

# MUBADALA & CG: Some Practical Steps

- Adopt SME Code for smaller investments
- Include ESG factors and criteria in undertaking investment decisions and asset portfolio analysis
- Undertake ESG ranking of existing assets & investments
- Formally adopt Integrated Reporting for all investments

## Moving forward: some takeaways

- Good CG is about Leadership, Sustainability & Corporate Citizenship
- Value of good CG increases in turbulent times
- Investors in EMEs put higher valuations on countries & companies with good CG
- MENA countries & companies need to massively invest in CG frameworks & implementation to support economic & financial development
- Mubadala & its asset companies should adopt integrated reporting and use ESG criteria for self-evaluation

**Thank you**

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# Appendix

- South Africa King Code III (2010)

# 1. Ethical leadership and corporate citizenship

1.1 The board should provide effective leadership based on an ethical foundation

1.2. The board should ensure that the company is and is seen to be a responsible corporate citizen

1.3. The board should ensure that the company's ethics are managed effectively

## 2. Boards & Directors

- 2.1. The board should act as the focal point for and custodian of corporate governance
- 2.2. The board should appreciate that strategy, risk, performance and sustainability are inseparable
- 2.3. The board should provide effective leadership based on an ethical foundation
- 2.4. The board should ensure that the company is and is seen to be a responsible corporate citizen
- 2.5. The board should ensure that the company's ethics are managed effectively
- 2.6. The board should ensure that the company has an effective and independent audit committee
- 2.7. The board should be responsible for the governance of risk
- 2.8. The board should be responsible for information technology (IT) governance
- 2.9. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards
- 2.10. The board should ensure that there is an effective risk-based internal audit
- 2.11. The board should appreciate that stakeholders' perceptions affect the company's reputation

## 2. Boards & Directors

- 2.12. The board should ensure the integrity of the company's integrated report
- 2.13. The board should report on the effectiveness of the company's system of internal controls
- 2.14. The board and its directors should act in the best interests of the company
- 2.15. The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is "financially distressed"
- 2.16. The board should elect a chairman of the board who is an independent non-executive director. The CEO of the company should not also fulfill the role of chairman of the board
- 2.17. The board should appoint the CEO and establish a framework for the delegation of authority
- 2.18. The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent
- 2.19 Directors should be appointed through a formal process

## 2. Boards & Directors

2.20. The induction of and ongoing training and development of directors should be conducted through formal processes

2.21 The board should be assisted by a competent, suitably qualified and experienced company secretary

2.22 The evaluation of the board, its committees and the individual directors should be performed every year

2.23. The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities

2.24. A governance framework should be agreed between the group and its subsidiary boards

2.25. Companies should remunerate directors and executives fairly and responsibly

2.26. Companies should disclose the remuneration of each individual director and certain senior executives

2.27. Shareholders should approve the company's remuneration policy

# 3. Audit Committees

- 3.1. The board should ensure that the company has an effective and independent audit committee
- 3.2. Audit committee members should be suitably skilled and experienced independent non-executive directors
- 3.3 The audit committee should be chaired by an independent non-executive director
- 3.4. The audit committee should oversee integrated reporting
- 3.5. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities
- 3.6. The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function
- 3.7. The audit committee should be responsible for overseeing of internal audit
- 3.8. The audit committee should be an integral component of the risk management process
- 3.9. The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process
- 3.10. The audit committee should report to the board and shareholders on how it has discharged its duties

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- 5.6. The board should ensure that information assets are managed effectively
- 5.7. A board risk committee and audit committee should assist the board in carrying out its IT responsibilities

## 6. Compliance with laws, rules, codes and standards

6.1. The board should ensure that the company complies with applicable laws and considers adherence to nonbinding rules, codes and standards

6.2. The board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business

6.3. Compliance risk should form an integral part of the company's risk management process

6.4. The board should delegate to management the implementation of an effective compliance framework and processes

## 7. Internal audit

7.1. The board should ensure that there is an effective risk based internal audit

7.2. Internal audit should follow a risk based approach to its plan

7.3. Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls & risk management

7.4. The audit committee should be responsible for overseeing internal audit

7.5. Internal audit should be strategically positioned to achieve its objectives

## 8. Governing stakeholder relationships

- 8.1. The board should appreciate that stakeholders' perceptions affect a company's reputation
- 8.2. The board should delegate to management to proactively deal with stakeholder relationships
- 8.3. The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company
- 8.4. Companies should ensure the equitable treatment of shareholders
- 8.5. Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence
- 8.6. The board should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible

# 9. Integrated reporting and disclosure

9.1. The board should ensure the integrity of the company's integrated report

9.2. Sustainability reporting and disclosure should be integrated with the company's financial reporting

9.3. Sustainability reporting and disclosure should be independently assured