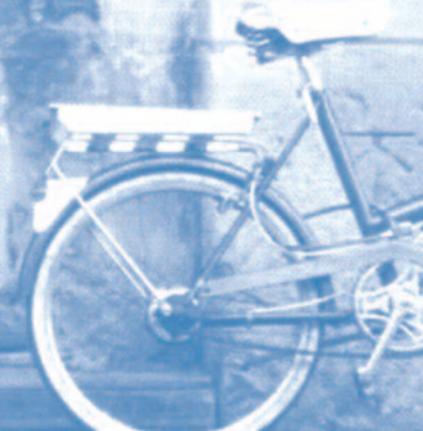
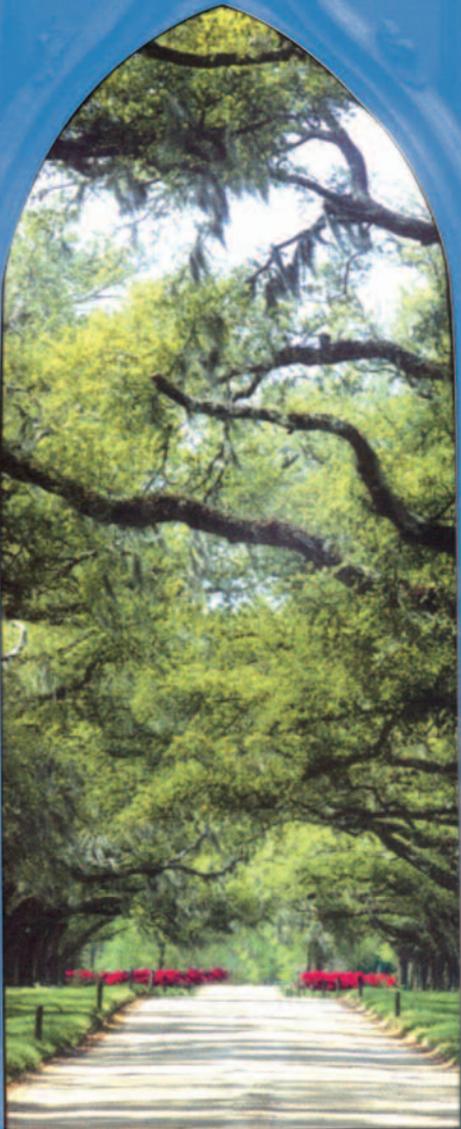




# Audit Committee Forum<sup>TM</sup> Alert 2

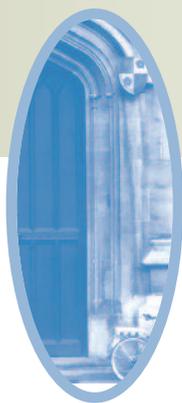
Issue Date: December 2009

**Establishment and membership of audit committees in terms of  
the new Companies Act and King III**



The Audit Committee Forum<sup>TM</sup> is proudly sponsored by KPMG.

# Establishment and membership of audit committees in terms of the new Companies Act and King III



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*This Alert is being issued ahead of the relevant effective date<sup>1</sup> of King III as a guideline to inform entities and afford them the opportunity to prepare themselves for these requirements.*

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**This is the first in a series of alerts that the Audit Committee Forum (ACF) will be issuing to highlight upcoming governance requirements from both King III<sup>2</sup> and the Companies Act<sup>3</sup>.**

Other topics covered in other alerts include:

- Responsibilities of the audit committee with regard to integrated reporting
- The audit committee's role with regard to the finance function and internal audit – King III
- The audit committee's role in the risk management process – King III
- The audit committee's role with regard to external audit
- The audit committee report to be included in the annual report
- The audit committee charter.

<sup>1</sup> The effective dates are: King III effective 1 March 2010; Companies Act no notice of effective date yet.

<sup>2</sup> The "King Report on Governance for South Africa" and the "King Code of Governance Principles": These extracts have been reproduced with the permission of the Institute of Directors for Southern Africa.

<sup>3</sup> The Companies Act, No. 71 of 2008.

	Companies Act	King III – Chapter 3
<b>Which entities</b>	<p><b>Sections 94(2) and 84(1)</b></p> <p>Entities affected are:</p> <ul style="list-style-type: none"> <li>■ Public company (Ltd)</li> <li>■ State-owned company (SOC), except if the Minister has granted an exemption</li> <li>■ Any other company that has voluntarily determined to have an audit committee to the extent that the company’s Memorandum of Incorporation (MOI) provides for one</li> <li>■ Possibly any company that is required by the Act to have its financial statements audited (owing to drafting inconsistencies, there is uncertainty around this provision).</li> </ul>	<p><b>Paragraph 4</b></p> <p><i>“Private companies, not for profit companies and personal liability companies should voluntarily appoint an audit committee.”</i></p>
<b>Exclusion</b>	<p><b>Section 94(2)</b></p> <p>If the company is a subsidiary of another company that has an audit committee and that audit committee will perform the functions required on behalf of the subsidiary company.</p>	<p><b>Paragraph 3</b></p> <p><i>“This does not apply where a company is a subsidiary company of another company that has an audit committee and the audit committee of the holding or parent company will perform the functions required by Section 94 of the Act on behalf of that subsidiary.”</i></p>
<b>Inclusion in Memorandum of Incorporation (MOI)</b>	<p><b>Section 34(2)</b></p> <p>A private company (Pty), personal liability company (Inc) or non-profit company (NPC) is not required to have an audit committee except to the extent that the company’s MOI provides otherwise.</p>	<p><b>Paragraph 4</b></p> <p><i>“The Memorandum of Incorporation of these companies should be carefully considered and drafted setting out the composition and duties of the audit committee.”</i></p>
<b>Who should appoint</b>	<p><b>Sections 94(2), 94(3) and 94(6)</b></p> <p>New companies’ first audit committee members may be appointed by the incorporators of the company or by the board within 40 business days after the company’s incorporation.</p> <p>Thereafter they are elected by shareholders at each AGM.</p> <p>The board must appoint a person to fill any vacancy on the audit committee within 40 business days after the vacancy arises.</p>	<p><b>Paragraph 3</b></p> <p><i>“The shareholders of a public company and a state-owned company must elect the members of an audit committee at each AGM.”</i></p> <p><i>“The nomination committee (or other board committee tasked with this) should present shareholders with suitable candidates for election or re-election as audit committee members.”</i></p> <p><b>Paragraph 17</b></p> <p><i>“The board must appoint a person to fill a vacancy on the audit committee should such vacancy arise. Such an appointment must be ratified by the shareholders at the subsequent AGM.”</i></p>
<b>How many members</b>	<p><b>Section 94(2)</b></p> <p>Must comprise at least three members</p>	<p><b>Paragraph 10</b></p> <p><i>“The audit committee should consist of at least three members”</i></p>

Independent non-executive	Section 94(4)	Paragraph 9
	<p>Each member of an audit committee must be a director of the company.</p> <p>Audit committee members may not be:</p> <ul style="list-style-type: none"> <li>■ Involved in day-to-day management of the company's business or have been so involved at any time during the previous financial year</li> <li>■ A prescribed officer, or full-time employee, of the company or any other related or inter-related company, or have been such an officer or employee at any time during the previous three financial years</li> <li>■ A material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship.</li> </ul> <p>Not be related to any person who falls within any of the criteria set out above.</p>	<p><i>"All members of audit committees of a public company and state owned company must be independent non-executive directors."</i></p> <p><b>Chapter 2, Paragraphs 65 and 67</b></p> <p><i>"Independent non-executive directors should be independent in fact and in the perception of a reasonably informed outsider. Although independence of mind is essential, perceptions of independence are important."</i></p> <p><i>"An independent non-executive director is a non-executive director who–</i></p> <ul style="list-style-type: none"> <li>■ <i>is not a representative of a shareholder who has the ability to control or significantly influence management or the board</i></li> <li>■ <i>does not have a direct or indirect interest in the company (including a parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue</i></li> <li>■ <i>does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth</i></li> <li>■ <i>has not been employed by the company or the group of which it forms part in any executive capacity, or appointed as the designated auditor or partner in the group's external audit firm, or senior legal advisor for the preceding three financial years</i></li> <li>■ <i>is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity</i></li> <li>■ <i>is not a professional advisor to the company or the group, other than as a director</i></li> <li>■ <i>is free from any business or other relationship (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company</i></li> <li>■ <i>does not receive remuneration contingent upon the performance of the company."</i></li> </ul>



Companies Act		King III – Chapter 3
<b>Chairman</b>	The Act does not address the role of the chairman.	<p><b>Paragraph 18</b></p> <p><i>“The board should appoint the chairman of the audit committee.”</i></p> <p><b>Paragraph 11</b></p> <p><i>“The chairman of the board should...not be eligible for appointment as an audit committee member but may attend audit committee meetings by invitation.”</i></p> <p><b>Paragraph 19</b></p> <p><i>“The chairman of the audit committee should understand the function of the audit committee and be able to lead constructive dialogue with the management, the internal and external auditors, other external assurance providers and the board. The chairman should be afforded sufficient time to participate in and agree the audit committee agenda before meetings are convened.”</i></p> <p><b>Paragraph 20</b></p> <p><i>“The chairman of the audit committee should be present at the AGM to answer questions, through the chairman of the board, on the report on the audit committee’s activities and matters within the scope of the audit committee’s responsibilities.”</i></p>
<b>Qualification requirements</b>	<p><b>Section 94(5)</b></p> <p>Minimum qualification requirements may be prescribed by the Minister as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions.</p>	<p><b>Paragraph 12</b></p> <p><i>“There should be a basic level of qualification and experience for audit committee membership, even though the members may have been appointed by the shareholders. The nomination committee (or other board committee tasked with this) and the board should evaluate whether collectively (but not necessarily individually) the audit committee has an understanding of:</i></p> <ul style="list-style-type: none"> <li>■ <i>integrated reporting, which includes financial reporting</i></li> <li>■ <i>internal financial controls</i></li> <li>■ <i>external audit process</i></li> <li>■ <i>internal audit process</i></li> <li>■ <i>corporate law</i></li> <li>■ <i>risk management</i></li> <li>■ <i>sustainability issues</i></li> <li>■ <i>information technology governance as it relates to integrated reporting</i></li> <li>■ <i>the governance processes within the company.”</i> <p><b>Paragraph 13</b></p> <p><i>“The collective skills of the members of the audit committee should be appropriate to the company’s size and circumstances, as well as its industry.”</i></p> </li></ul>



Companies Act		King III – Chapter 3
<b>Specialists</b>	<p><b>Section 94(11)</b></p> <p>A company must pay all expenses reasonably incurred by its audit committee, including, if the audit committee considers it appropriate, the fees of any consultants or specialists engaged by the audit committee to assist in the performance of its functions.</p>	<p><b>Paragraph 15</b></p> <p><i>“The audit committee is allowed to consult with specialists or consultants engaged by the audit committee to assist it with the performance of its functions, subject to a board-approved process. Such specialists or consultants should not be considered to be members of the committee and should not be entitled to vote on any matters.”</i></p>
<b>Duties of board vs duties of audit committee</b>	<p><b>Section 94(10)</b></p> <p>Neither the appointment nor the duties of an audit committee reduce the functions and duties of the board or the directors of the company, except with respect to the appointment, fees and terms of engagement of the auditor.</p>	<p><b>Paragraph 22</b></p> <p><i>“Legal opinion indicates that the audit committee takes primary responsibility for and has the ultimate decision-making ability regarding its statutory duties. If differences of opinion should arise between the board and the audit committee where the audit committee’s statutory functions are concerned, the audit committee’s decision will prevail.”</i></p>

## Contact details:

### Thinglemony Pather

Director  
KPMG  
thingle.pather@kpmg.co.za  
011 647 5037

www.acf.co.za

### Parmi Natesan

Senior Manager  
KPMG  
parmi.natesan@kpmg.co.za  
011 647 5963

www.acf.co.za





