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The Social and Ethics Committee

During the public hearings on the Companies Bill conducted by the Portfolio Committee on Trade and Industry in 2007, a proposal was made to include a requirement in the new Act to oblige certain companies to appoint a member of a trade union as a board member (director). The Portfolio Committee rejected this proposal, but presented a compromise. It was argued that there is a definite need in the South African context to encourage large companies (especially those companies that have a significant impact on the public interest) not only to act responsibly, but also to be seen doing so and to account, from the public interest perspective, for their decision-making processes and the results thereof.

In essence, it was argued that these companies should be obliged to develop a social conscience, and behave like responsible corporate citizens. As such, the Companies Act now provides the Minister of Trade and Industry with the authority to require certain companies to have a Social and Ethics Committee, having regard for the impact such companies have on the public interest.

However, regardless of the requirement to appoint a Social and Ethics Committee, the directors and prescribed officers of ALL companies are bound to act in accordance with an acceptable standard of conduct. In terms of this standard, directors and prescribed officers are obliged to act in the best interest of the company. In this regard, the Act subscribes to the "enlightened shareholder value approach" – which requires that directors are obliged to promote the success of the company in the collective best interest of shareholders, which includes, as appropriate, the company's need to take account of the legitimate interests of other stakeholders including among others, the community, employees, customers and suppliers.

In terms of section 72 of the Companies Act (read with Companies Regulation 43), the following companies should have appointed a Social and Ethics Committee within one year after the Act became effective (i.e. by 30 April 2012):

- Every state owned company;
- Every listed public company; and
- Any other company that has, in any two of the previous five years, had a public interest score of at least 500 points.

The Social and Ethics Committee must comprise not less than three members. These members may be directors or prescribed officers of the company, however, at least one must be a director who is not involved in the day-to-day management of the company's business – a non-executive director – and must not have been so involved during the previous three financial years.

In terms of Companies Regulation 43, a Social and Ethics Committee has to monitor the company's activities with regard to matters relating to:

- Social and economic development, including the company's standing in terms of the goals and purposes of:
  - The 10 principles set out in the United Nations Global Company Principles;
  - The OECD recommendations regarding corruption (refer to the Organisation for Economic Co-operation and Development (OECD) website for further details (www.oecd.org));
  - The Employment Equity Act, No 55 of 1998;
  - The Broad-Based Black Economic Empowerment Act, No 53 of 2003;
- Good corporate citizenship, including the company's:
  - Promotion of equality, prevention of unfair discrimination and measures to address corruption;
  - Contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and
  - Record of sponsorship, donations and charitable giving;
- The environment, health and public safety, including the impact of the company's activities and of its products or services;
- Consumer relationships, including the company's policies and record relating to advertising, public relations and compliance with consumer protection laws; and
- Labour and employment matters.

If one considers the requirements of King III with respect to ethical leadership and ethical behaviour, it appears advisable to assign to the Social and Ethics Committee some of the responsibilities in this regard. The additional functions may include:

- Reviewing the adequacy and effectiveness of the company's engagement and interaction with its stakeholders;
- Considering substantive national and international regulatory developments, overseeing their operationalisation as well as practice in the fields of social and ethics management;
- Reviewing and approving the policy and strategy pertaining to the company's programme of corporate social investment;
- Determining clearly-articulated ethical standards (code of ethics), and ensuring that the company takes measures to achieve adherence to these in all aspects of the business, thus facilitating a sustainable ethical corporate culture within the company;
- Monitoring that management develops and implements programmes, guidelines and practices congruent with the company's social and ethics policies;
- Reviewing the material risks and liabilities relating to the provisions of the code of ethics, and ensuring that such risks are managed as part of the company's risk management programme;
- Reviewing the company's performance in implementing the provisions of the code of ethics and the assertions made in this regard;
- Obtaining independent external assurance of the company's ethics performance on an annual basis, and including in the Integrated Report an assurance statement related to the ethics performance of the company; and
- Ensuring that management has allocated adequate resources to comply with social and ethics policies, codes of best practice and regulatory requirements.

The Social and Ethics Committee must report to shareholders at the Annual General Meeting. At least one member of the Committee must attend the Annual General Meeting of the company to report back to shareholders on the activities of the company. Although there is no legislative requirement for the Committee to issue a written report, it is recommended that the a written report be included in the company's Integrated Report, Director's Report or its Governance report, whichever is the most appropriate in the circumstances.

Management of the ethics performance of the Company

A Social and Ethics Committee constitutes a formal structure which can facilitate appropriate attention to the soft, but very important, dimensions of how a company actually goes about its business, specifically its value system with regard to ethical standards.

It is clearly of pivotal importance that the professed and advertised value system and ethical standards of conduct of the company are in fact applied and lived in practice. Ongoing recent well-publicised international corporate deficiencies in actual ethical performance and the profound continuing negative consequences should serve as a salutary warning to boards of directors of the importance of getting this right, also in South Africa.

King III provides a principle-based framework on the basis of which a company should establish an ethical culture and good corporate citizenship. The two principles relevant for this purpose are articulated as follows:

- **Principle 1.1:** The board should provide effective leadership based on an ethical foundation.
- **Principle 1.3:** The board should ensure that the company's ethics are managed effectively.

For all three of the periods surveyed, a very significant proportion of companies limit the description of their approach to the management of their ethics performance to three aspects only;

- The appropriate values, including that of integrity and ethical conduct, are emphasised, articulated and positioned;
- The assertion is made that a code of conduct has been developed, approved and disseminated to all employees;
- Readers are informed that a fraud or whistle blowing "hotline" has been established and, in some cases, high level feedback about incidents logged via this medium is provided.

Whereas these aspects are certainly part of important building blocks in facilitating ethical behaviour, they are – in the absence of other measures – clearly deficient in meeting the applicable principles required by King III, as noted above, as well as the proper discharging of the responsibilities of boards in this regard.

While it is true that the concept of effectively managing, and reporting on, ethics performance is a new (and somewhat soft) formal requirement, the application of a comprehensive framework covering all the applicable dimensions will assist in complying with the requirements. However, more importantly, it also significantly reduces the likelihood of ethical failure and the attendant potential disastrous consequences for the company and its directors.

In order to provide practical guidance, we suggest the following framework elements (with a brief description of possible high level components for each) to facilitate the effective management of ethics performance:

- Clear ethical standards need to be set
  - The values of the company, including those relating to ethics, should be articulated and approved by the board.
  - An appropriate code of conduct should be developed and similarly approved.
  - The respective roles of the board, executive management, employees and, where applicable, stakeholders should be clearly described. The opportunity to establish ethics as a matter "beyond mere compliance" should be used.
- Adequate practical arrangements must be in place to support the meeting of ethical standards
  - The role of the board (including that of the Social and Ethics Committee), executive management and a single, senior, designated responsible person (chief ethics officer) and their relationships should be determined, documented and approved.
  - Specific ethics risks and opportunities in relation to the company's operating context should be formally and rigorously identified and documented.
  - The adequacy of resources to properly perform on the responsibilities allocated should be considered.
  - The establishment of a hotline that is anonymous and effective.
- Maintaining and building ethical awareness
  - The establishment of training programmes (including using e-learning and education about ethical dilemmas), the design of communication programmes and the initiation of awards;
  - Content of exco and board agenda.
- Measuring and monitoring ethical status
  - Conducting surveys and interpreting their results, analysing the root cause of relevant incidents (including those emanating from the hotline), board evaluations, peer reviews;
  - Formal reports.
- Effective leadership and the management of ethics
  - Tone at the top (including that of the board);
  - Effective pro-active and re-active leadership and management.
- Reporting on actual ethical performance
  - Regular and accurate internal written feedback and assessment of the state of ethical performance to executive management and board;
  - Annual written assessment for external purposes;
  - Standard item on the board agenda.
- Obtaining, and furnishing, acceptable assurance on ethical performance
  - Adopting a combined assurance approach to ethics performance which reduces the risk of incorrect information, and the existence of an inappropriate ethical culture, to an acceptable minimum;
  - Establishing and maintaining the trust of stakeholders by the furnishing of appropriate external and independent assurance.

It is possible that there might be an overlap between the types of issues dealt with by the Social and Ethics Committee and other board committees (audit, risk, sustainability, etc.).

It is important for the members of the Social and Ethics Committee to understand the role and function of this committee vis-à-vis the other board committees. The key function of this committee is to act as the social conscience of the business and to ensure that the company behaves like a responsible corporate citizen. This function should cover all aspects of the business, including its sustainability, impact on the environment, relationship with all its stakeholders, interaction with and impact on the community within which it operates, the treatment of and investment in its employees, its health and safety practices, black economic empowerment, the ethical corporate culture, and so on.

It is important that this committee assumes the responsibility to ensure that the board sets the appropriate tone, and that the behaviour and messages of the board and the directors support and contribute to the company's ethical corporate culture. As such, the Social and Ethics Committee will inevitably have to ensure open communication channels with the audit, risk, executive, nomination, remuneration and sustainability committees. It will have to involve itself in the approach of the other board committees to operational and business decisions in order to ensure consistent behaviour from a social and ethics point of view.

Of course, each committee has a very particular mandate, and will approach agenda items from a very specific perspective. For this reason it is important that the board, as a collective, coordinates and integrates the different perspectives to ensure effective, responsible and ethical business decisions.

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