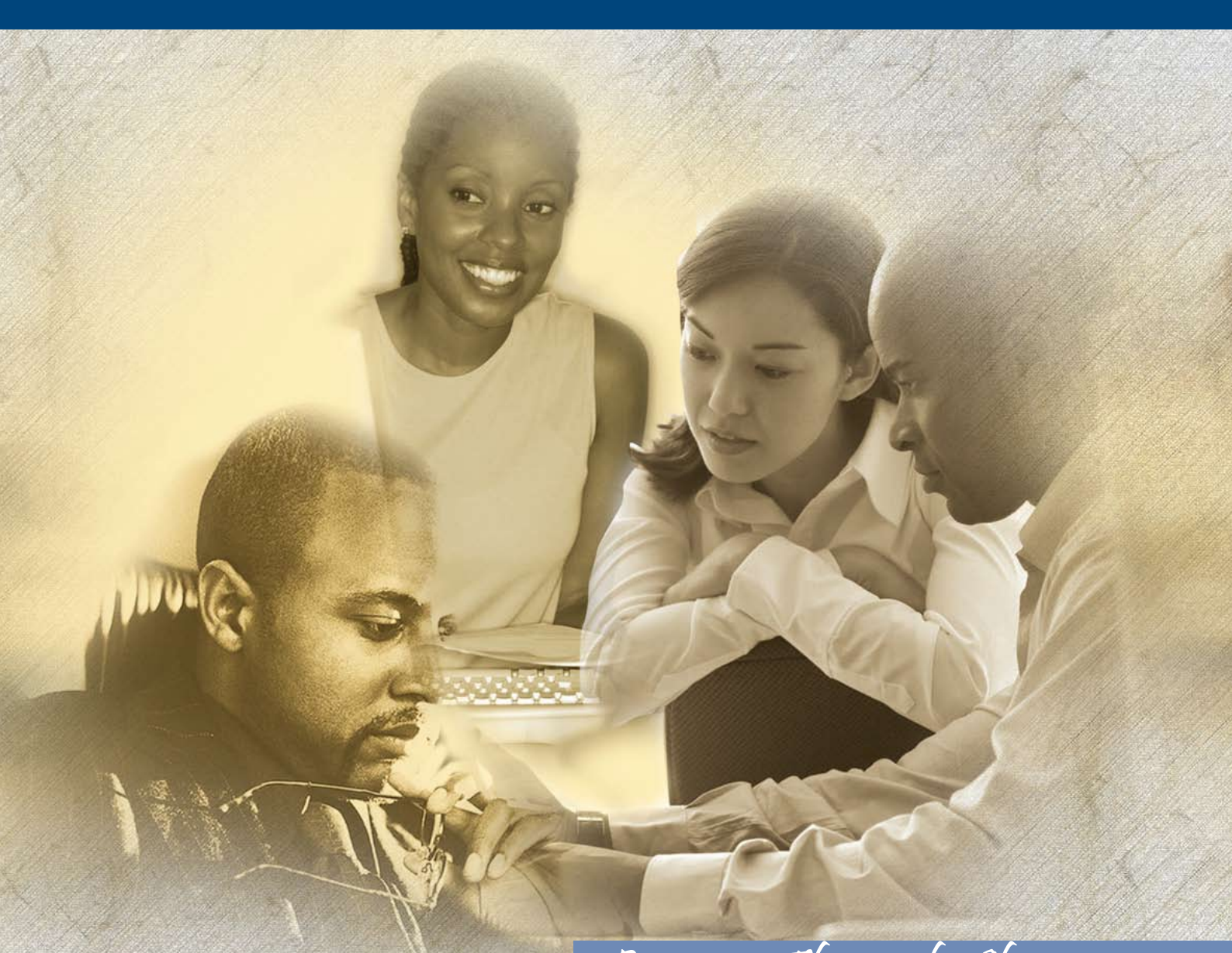


CORPORATE GOVERNANCE INDEX 2015



**The Institute of
Internal Auditors
South Africa**



Progress Through Sharing

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**The Institute of
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Progress Through Sharing

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The information contained in this report is intended to provide the reader with general information and guidance and may not be applicable in all circumstances.

The information herein should not be regarded as professional or legal advice or the official opinion of the Institute of Internal Auditors of South Africa (IIA SA).

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FOREWORD



It is my pleasure to present the IIA SA's third edition of the Corporate Governance Index – *An Internal Audit Perspective*.

While I am pleased to see that where the Index does not show a decline against last year's overall score, the fact that we have not regained ground against the 2013 results is very concerning. I do hope that we will be able to recover and that the 2.9 score will not become the new yardstick.

Corporate governance, previously considered a mere aspiration, is becoming increasingly important within all economic spheres and the CAE's role is proving to be one of great importance in promoting good governance principles. CAEs have the ability to be catalysts, as a trusted advisor, for ensuring that corporate governance within their organisations is at the forefront of the executive team's strategic agenda.

This report measures the perception of CAEs regarding the state of corporate governance as it currently stands within their respective organisations. The research not only provides insight into current perceived strengths and weaknesses, but also a comparative of previous results, thus tracking the progress of the implementation of best practise corporate governance principles as per the King Codes of Governance.

I believe that this Index has wide application. It offers a barometer on the state of governance in South African organisations and is also a great tool which provides leaders with the ability to measure their organisations against the South African norm. It is important that leaders do not become complacent when they find themselves on par with the norm, but rather strive to score a four in each dimension: Boards, Audit Committees, Management and/or Executive committees and other oversight bodies should use the various dimensions of the Index as discussion points on how governance should improve in their organisations.

It is clear from the report that the area where organisations in South Africa struggle the most is in the dimension of external risk. Given the context of a fast changing world and increasing complexity which leaders have to contend with, this is a significant finding with negative implications for the South African economy. The less vigilant organisational leaders are, the more vulnerable the South African economy becomes. Leaders must therefore understand their vigilance/negligence in the context of the impact on their organisations and the health of the economy.

The research methodology underpinning the Corporate Governance Index has been facilitated by our research collaboration with the Centre for the Study of Governance Innovation (GovInn) at the University of Pretoria, headed up by Professor Lorenzo Fioramonti. I would like to sincerely thank Professor Fioramonti and his team for their efforts and insights. My thanks also extend to all CAEs who participated in the survey. Without your willingness to share your views, this valuable Index would not have been possible.

I hope to hear from you, whether it is in terms of thoughts, suggestions or ideas, your feedback is always welcome.

*Dr Claudelle von Eck
Chief Executive Officer
The Institute of Internal Auditors South Africa
August 2015*



EXECUTIVE SUMMARY

The IIA SA's Corporate Governance Index reflects the views of Chief Audit Executives (CAEs), who are well positioned to provide a relatively impartial view of the state of corporate governance in South Africa.

The third edition of the Index builds on the second edition released in 2014 and is intended to provide a comparative analysis of the perceived performance of South African organisations in certain key dimensions of corporate governance. The Index, which was developed through the methodological assistance of the Centre for the Study of Governance Innovation (GovInn) at the University of Pretoria, provides a baseline for the measurement of performance for the entire country since it surveys all economic sectors¹. The research methodology which was crystallised in the second edition of the Index includes an increased number of dimensions measured and has been applied in the third edition of the Index. The following critical dimensions were covered by the survey - Ethics, Compliance, Leadership, Risk Management (Operational and External Risks), Performance and Internal Audit.

1. The overall Country Index for Corporate Governance in South Africa has remained constant at 2.9 in both 2014 and 2015 (out of a maximum score of 4). This consistency may be viewed in two lights, namely, that there is a perception of stability regarding the core well-performing dimensions and further that there is a perception that the dimensions which require further elevation have remained stagnant over the last year. In addition, the score remains lower than the 2013 overall score of 3. Despite the overall score remaining constant, there have been slight increases in 5 of the 7 dimensions, with 2 remaining constant and no overall score decreases noted².
2. Adherence to ethical principles (3.4) continues to remain the best performing dimension, with Internal Audit (3.3) closely following. The improvement in the ethics dimension should be looked at in relation to the drop in 2014 against the 2013 results. The overall 3.4 score is on par with the 2013 score. There is a perception gap between the tone being set (66%) and the actual culture (60%), amongst those who rated the two categories in the ethics dimension 'strongly agree'. This suggests that leaders should also focus on whether the tone being set does actually filter down throughout the whole organisation.
3. The areas of concern raised by respondents remain Performance and Risk Management (in particular with regard to External Risk). A fast changing world that brings increased complexities as a result of factors such as evolving socio-economic and political contexts, shifting economic and political power, changing consumer concerns and buying behaviour, emerging technology, cyber-attacks, climate change, shifting regulations, increasing convergence and competition, globalisation and emerging energy crises, necessitates a greater emphasis on risk management. The fact that organisations are clearly not placing enough emphasis on risk management is very concerning. It is however noted that despite the fact that they remain low performing dimensions, there have been marginal increases in the scores of Performance and Risk Management (both internal and external). This suggests some improvement in the perception of CAEs around these dimensions.
4. Overall, the perception of CAEs regarding all questions answered has either improved slightly or remained constant, save for dimensions relating to External Risk, Compliance and Performance which have seen slight declines in strongly agree responses not exceeding 4%.
5. In respect of the questions posed, the most favourable response received was that 70% of CAEs strongly agreed that Internal Audit was afforded a "sufficient degree of independence" within their organisation. The least favourable response was in respect of External Risk, with only 13% of CAEs indicating a strongly agree view regarding this question (a 4% decline from 2014).

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1. The Centre for the Study of Governance Innovation (GovInn) is directed by Prof. Lorenzo Fioramonti and is located at the University of Pretoria. More information about GovInn can be found at www.governanceinnovation.org
 2. The growth in dimensional scores did in fact increase the overall Country Index (from 2.87 to 2.92), however it was a marginal increase which amounted to less than a tenth of a percent and accordingly was not reflected in the rounded off figure for the official Country Index.



RESEARCH METHODOLOGY

The core dimensions of corporate governance were identified and appropriate questions relating to each dimension were crafted. The survey consisted of three demographics-related questions, 23 multiple choice questions and one open-ended question. The 23 single response multiple choice questions were designed to cover the following dimensions of corporate governance: Ethics, Compliance, Leadership, Risk Management (i.e. Operational Risk and External Risk), Performance and Internal Audit. Each of the following potential responses was assigned a value as follows in order to aggregate scores into an Index that will be tracked over time:

0= strongly disagree; 1=slightly disagree; 2=neither agree nor disagree; 3=somewhat agree; 4=strongly agree

The survey was directed at Six hundred (600) Chief Audit Executives (CAEs) on the IIA SA database, which took the form of a self-administered web-based questionnaire. CAEs at professional services firms were specifically requested to report on a typical client, rather than on their own firms. It was critical that the survey elicited the most honest responses possible. Consequently, no personal demographic data was asked for. Over a period of eight weeks during March, April and May 2015, a total of Two hundred and seventy one (271) respondents completed the survey.

THE INSTITUTE OF INTERNAL AUDITORS AT A QUICK GLANCE

The Institute of Internal Auditors South Africa (IIA SA) is a Section 21 non-profit organisation, affiliated to the global Institute of Internal Auditors Inc. (IIA Inc) as a National Institute. Established in 1941, the IIA Inc. has more than 180 000 members worldwide. It serves as the internal audit profession's global voice, recognized authority, acknowledged leader, principal educator, and chief advocate. The Institute is the creator and custodian of the universal International Standards for the Professional Practice of Internal Auditing. The IIA SA sets the career path standards for internal auditors in South Africa, promotes the Profession in the country as well as promotes adherence to the IIA standards. IIA SA members are accountable to the Institute in terms of their conduct as prescribed in the IIA Code of Ethics.

The IIA SA's over 8000-strong membership represents the third largest affiliate in the world, second only to the USA & Canada, and the United Kingdom. South Africa has representatives on all the major IIA Inc international committees and in the process makes a significant contribution to the direction of the Profession globally.

An internal auditor's function is to evaluate the controls that an organisation has in place to counter any risks that may prevent the organisation from achieving its objectives. To ensure this, the internal auditor tests controls, examines processes, and builds models of best practice. In recent years the expectations placed on internal auditors have increased dramatically. This is mainly due to the increased complexity and volatility in the market, which results in increased risks, that organisations are now continually faced with. In addition, King III has placed a greater emphasis on the importance of internal audit. The Institute's primary role is to support its members in meeting market expectations. Membership support revolves around professional advice, training and many other services.

Membership of the IIA SA speaks to the credibility of the internal auditor as the individual is required to work in accordance with the International Standards (IPPF) and is being held accountable against a the Code of Ethics. Are the internal auditors in your organisation members of the IIA SA? To verify, do a member search on our website www.iiasa.org.za.

SURVEY RESULTS

OVERALL RESULTS

Figure 1: Corporate Governance Index per dimension



Table 1: Index Scores

Dimension	2015	2014	% change
Ethics	3.4	3.3	3.0%
Compliance	3.0	3.0	0.0%
Leadership	3.0	3.0	0.0%
Operational Risk	2.9	2.8	3.6%
Internal Audit	3.3	3.2	3.1%
Performance	2.6	2.5	4.0%
External Risk	2.2	2.1	4.8%
COUNTRY CGI	2.9	2.9	0.0%

Scale: 0 (lowest) to 4 (highest)

It is noted that the overall Country Index has remained constant at 2.9 in both 2014 and 2015 but remains below the 3.2 score attained in 2013. There have been marginal increases (between 3% and 4.8%) in all dimensions apart from Compliance and Leadership but not enough to alter the overall average. This indicates a slightly more positive perception amongst CAEs in that there has not been any indication of a further decline on any of the variables in corporate governance against the 2013 results.

Ethics continues to remain the strongest variable with Internal Audit in close second. Further, perceptions around both variables have improved slightly. External Risk and Performance continue to remain areas of concern, however they are both noted as the highest variable percentage increases from 2014 to 2015, being 4.0% and 4.8% respectively.

- The growth in dimensional scores did in fact increase the overall Country Index (from 2.87 to 2.92), however it was a marginal increase which amounted to less than a tenth of a percent and accordingly was not reflected in the rounded-off figure for the official Country Index.



Table 2: Index per Economic sector

Sector	Index
National Government	2.7
Provincial Government	3.1
Municipal (Metro)	3.3
Municipal (District)	2.2
Municipal (Local)	2.1
State owned company	2.8
Publicly held company	3.3
Privately held large company	3.1
SMME	3.0
Non profit company	3.0
Professional services firm*	2.7

Scale: 0 (lowest) to 4 (highest)

*CAEs from Professional Services firms reported on their clients

Table 3: Index per Industry sector

Sector	Index
Agriculture/Forestry/Fishing	3.3
Health/Pharmaceuticals	3.5
Manufacturing (incl. Packaging & Printing)	3.2
Education and Training	2.8
Banking/Finance/Insurance	3.2
Logistics (Transportation/Building..)	2.6
Defence/Security	2.9
Wholesale and Retail	3.3
Mining/Quarrying/Energy/Oil/Chemical	3.1
Services (Community/Professional...)	2.8
Public Administration: public service	2.4
Tourism/Hospitality/Clothing/Food & Bev...	3.1
Technology (ICT/Telecom/Electronics)	2.9
Other	3.0

CAEs within publicly held companies and metro municipalities were most positive about their organisations' overall corporate governance culture and performance. This differs from 2014, where CAEs at non-profit companies attained the top ranking score (3.3). Municipalities at local and district level (2.1 and 2.2 respectively) are perceived by respondents as being weakest at corporate governance. This correlates with the Auditor-General's reports on municipalities. In terms of the industry sectors of our economy, the Health/Pharmaceuticals industry (3.5) is the top performer according to respondents who work within this sector. This differs from 2014, where respondents in the Tourism/Hospitality/Food and Beverage/Recreation industries scored these industries the highest at a rating of 3.6. Public service respondents gave their sector the poorest rating which stands at 2.4, this was also the case in 2014 with this industry sector having been scored 2.3.

Demographic data – i.e. economic sectors (%)

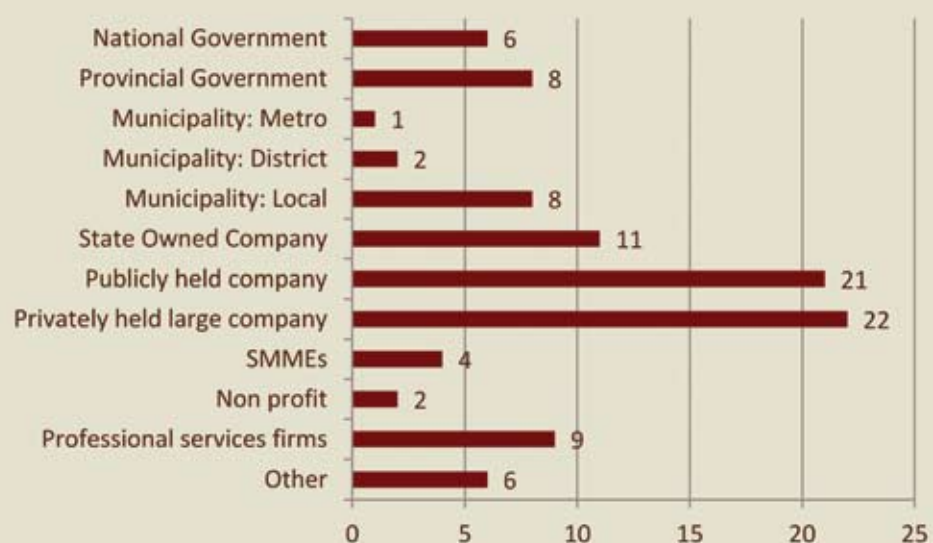


Figure 2: Economic sectors respondents work in (%)

RESULTS PER DIMENSION

(In this section some results are highlighted. The full list of questions and responses are on pages 16 and 17)

ETHICS

Typical question: Ethics is an important part of your organisational culture

Figure 3: Breakdown of various responses (%)

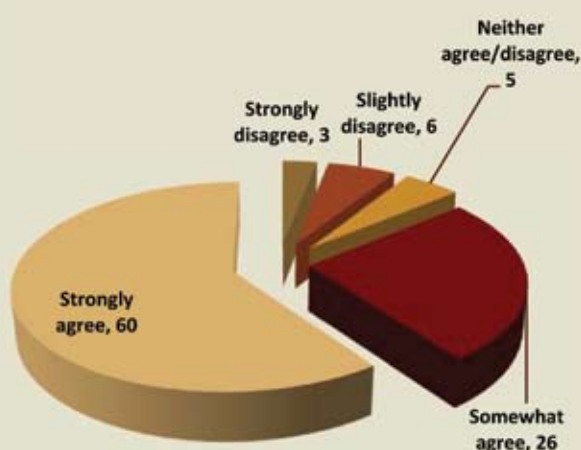
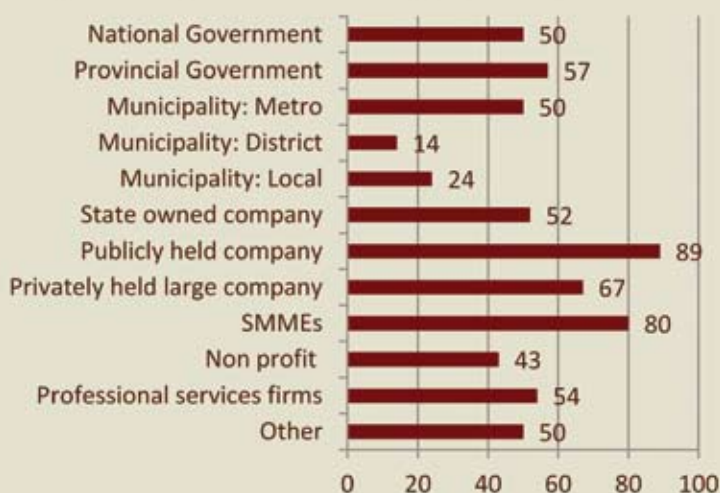


Figure 4: Respondents who strongly agree (% per sector)



Respondents rated Ethics overall as the most positive aspect of organisational governance (3.4), this core dimensions rating is higher than it was in 2014 (3.3), but on par with the 2013 results. Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures increased in 7 of the 12 economic sectors. It is noted that in 2014 the highest percentage of respondents who strongly agreed with this question were from within the publicly held company sector (76%). This continues to remain the case with the percentage figure for 2015 indicating a 13% increase. This could very well be as a result of the JSE requirements including a focus on corporate governance and these organisations facing greater scrutiny. The highest percentile increase of respondents who strongly agreed with this question is within the national government sector, evidencing a 29% increase from the 21% recorded in 2014.

Corruption, and in particular the impact it has on the South African society, has become increasingly commonplace in the discourse of South Africans. Quoted numbers on how the South African economy has been impacted upon are staggering. In October 2011 Willie Hofmeyr, then head of the Special Investigating Unit (SIU) told South Africa's Parliament that between R25-billion and R30-billion of government's annual procurement budget alone was lost to corruption, incompetence and negligence. The Washington research group, Global Financial Integrity said in a report that South Africa had suffered an illegal outflow of R185-billion due to corruption in both the public and private sectors between 1994 and 2008. (Corruption Watch). Institute of Accountability director Paul Hoffman estimates that corruption has cost South Africa R700-billion over the last 20 years. World Audit ranks South Africa 52nd out of 150 countries on its corruption list, while Transparency International ranks the country 67th out of 175 countries.

In this context a focus on Ethics is fundamentally important as it drives the way organisations behave and make decisions. The lower the score in this dimension, the more reason there is for concern. Those organisations where the CAEs did not strongly agree that ethics is an important part for the organisational culture is a significant red flag. At 40% this group confirms that more emphasis should be placed on building ethical cultures. Although there has been an improvement in the 2015 results over the 2014 results, it should not be forgotten that there had been a decline in the 2014 results against the 2013 results. The positive change in score is therefore a mere correction and not a real improvement. The degree to which corruption is rife in a country has a significant impact on the wellbeing of its citizens and the degree to which the country attracts internal and foreign investments.



Corruption increases the cost of business, leads to waste or the inefficient use of public resources, excludes poor people from public services and perpetuates poverty, erodes public trust, undermines the rule of law and ultimately delegitimises the state (OECD). The ultimate cost of corruption should encourage leaders to proactively promote ethical cultures in their organisations and ensure that the right tone is set at the top.

COMPLIANCE

Typical question: Your organisation complies with relevant legislation, regulations and standards

Figure 5: Breakdown of various responses (%)

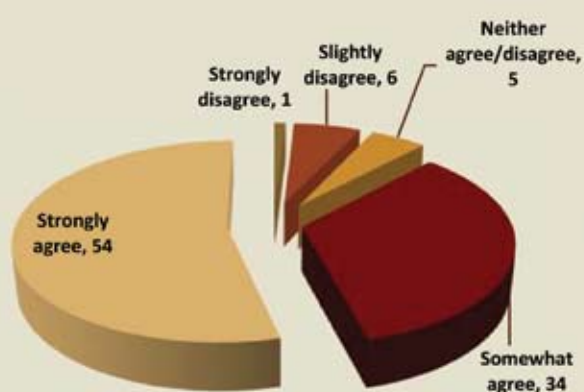
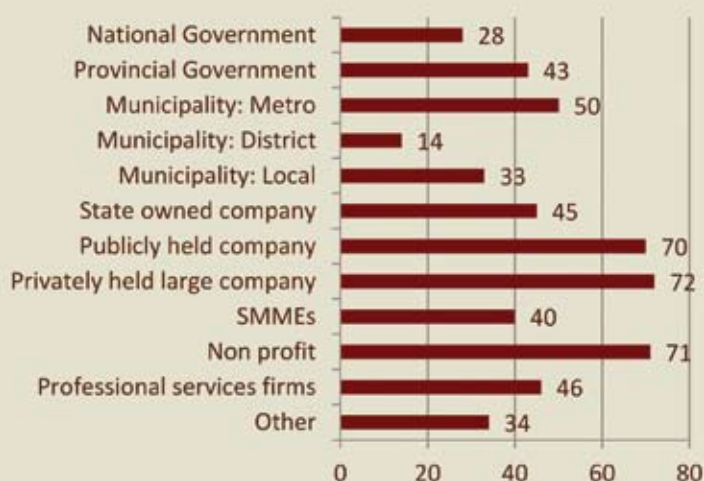


Figure 6: Respondents who strongly agree (% per sector)



Compliance received an Index score of 3.0, the same score received in 2014. The main area of concern noted by respondents was the usage of a “combined assurance framework to provide a co-ordinated approach to assurance activities” with only 28% of respondents strongly agreeing that this is in fact the case (a decline of 3% from 2014). Regarding whether their organisation “goes beyond a mere tick box exercise – i.e. there is a deep understanding of the principles and philosophy of good governance”, the percentage of respondents that strongly agreed with this question increased by 9% from 2014. Following on from the position in 2014, Compliance continues to be noted as one of the top 3 areas of emerging risk, as confirmed in the open-ended question. Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures increased in 8 of the 12 economic sectors. The highest percentile increase of respondents who strongly agreed with this question is within the provincial government sector, evidencing a 22% increase from the 21% recorded in 2014. The highest percentile decrease of respondents who strongly agreed with this question is within the SMMEs sector, evidencing a 31% decrease from the 71% recorded in 2014.

Compliance as a mere tick box exercise without understanding the spirit behind legislation and regulation and best practice principles does not add any value to the organisation. That approach also tends to only really work while the organisation feels that it may be watched. Where it is seen as a necessary evil, compliance flies out of the window as soon as there is no risk of being exposed or punished.

Organisations that are governed well do not see governance as a mere compliance issue, but rather that adhering to sound governance principles is in the interest of the organisation. Where the leadership understands the principles, governance and compliance becomes a way of life.

LEADERSHIP

Typical question: Your executive team is functioning optimally in delivering the strategy of the organisation

Figure 7: Breakdown of various responses (%)

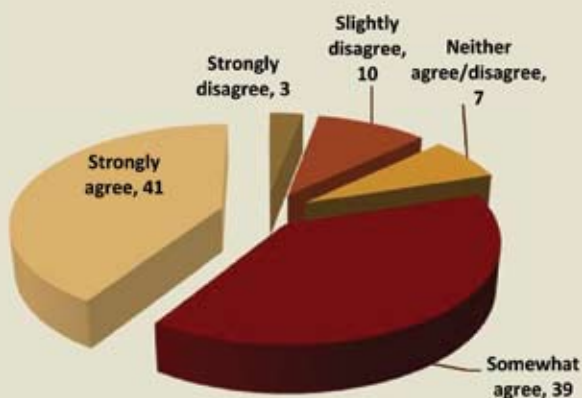


Figure 8: Respondents who strongly agree (% per sector)



The dimension of Leadership received an Index score of 3.0, the same score received in 2014. It is concerning though that this dimension has not yet recovered to the 3.2 score of 2013. Regarding the question of whether their organisation has a “social investment strategy”, only 28% of respondents strongly agreed with this question. Regarding the competency of leadership, this remains an area of concern with only a 4% increase in respondents who strongly agreed with this question being noted in 2015 (41%). The same can be said regarding leadership’s understanding of the roles of assurance providers, where only a 2% increase in respondents who strongly agreed with this question were noted in 2015 (37%). Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures either increased or remained constant in 9 of the 12 economic sectors. The highest percentile increase of respondents who strongly agreed with this question is within the district level municipality sector, evidencing a 29% increase from the 0% recorded in 2014. The highest percentile decrease of respondents who strongly agreed with this question is within the non-profit companies sector, evidencing an 18% decrease from the 75% recorded in 2014.

Leadership is the foundation of any organisation and has the ability to make or break an organisation. The degree to which an organisation performs, is ethical, is a good corporate citizen and mitigates against risk is entirely dependent on the quality of leadership displayed in the organisation. In this context reference is made to the Board of Directors, the Audit Committee and the executive team.

With leadership comes responsibility and accountability. In order to meet these two requirements, those in leadership positions must be adequately skilled. This is especially true in the context of a constantly changing environment and increasing complexity

RISK MANAGEMENT

OPERATIONAL RISK

Typical question: The process of managing risks within your organisation is adequate

Figure 9: Breakdown of various responses (%)

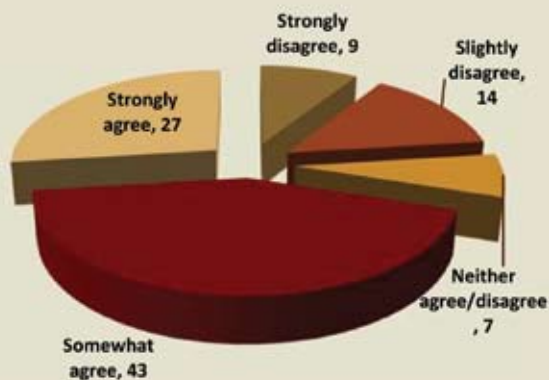
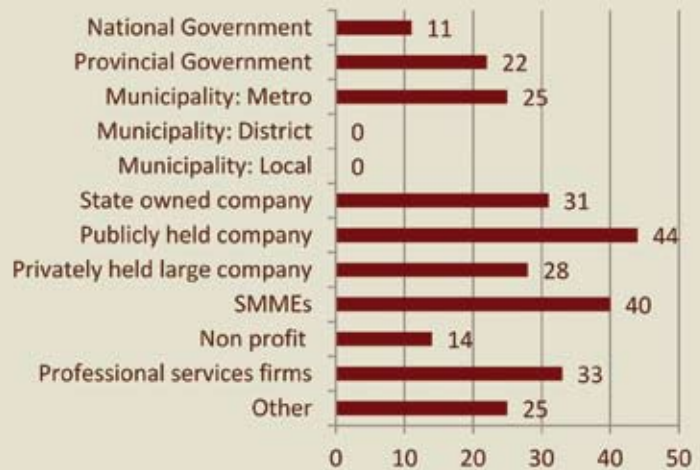


Figure 10: Respondents who strongly agree (% per sector)



The dimension of Operational Risk received an Index score of 2.9, a rating slightly higher than it was in 2014 (2.8) but still under the 2013 score of 3. The percentage of respondents that strongly agreed with this question, despite having increased by 3% since 2014, remains low and should be considered a high priority area. Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures increased or remained constant in half of the economic sectors. It is noted that whereas in 2014 the highest percentage of respondents who strongly agreed with this question were from within the non-profit company sector (50%), this figure has dramatically decreased by 36% in 2015 and is consequently noted as the highest percentile decrease. The highest percentile increase of respondents who strongly agreed with this question is within the SMMs sector, evidencing a 40% increase from the 0% recorded in 2014.

Organisations are constantly faced with the possibility of unfortunate events with negative impacts materialising and in the process harming the organisation. It is therefore important that measures be put in place to ensure that the process of minimising or mitigating those unfortunate events is managed properly. Risks within the organisation can range from major disruption of business to minor issues. Some examples include failure of major projects, deliberate sabotage by disgruntled employees, change efforts failing, systems failing, theft, fraud, corruption, etc. There are various sources of risk which include the human factor, infrastructure, technological assets, financial solvency and the like.

Organisations sometimes tend to be overconfident about their estimation of the severity and their exposure to and of the risk and the likelihood of the risk materialising. This is both with regard to strategic and operational risks. In addition, there could also be an underestimation of the ripple effect and how far reaching the consequences may be, should the risk materialise. This, coupled with the notion of seeing risk management as a nice to have instead of being an absolute necessity, leads to inadequate risk management strategies.

EXTERNAL RISK

Typical question: Your organisation utilises scenario planning to mitigate against unexpected external risks that may arise well beyond the boundaries in which the organisation operate

Figure 11: Breakdown of various responses (%)

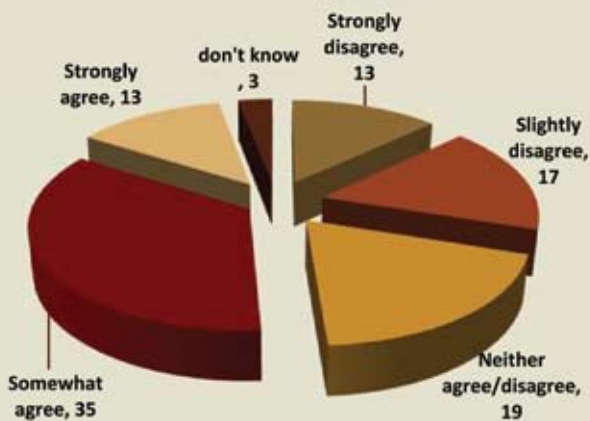
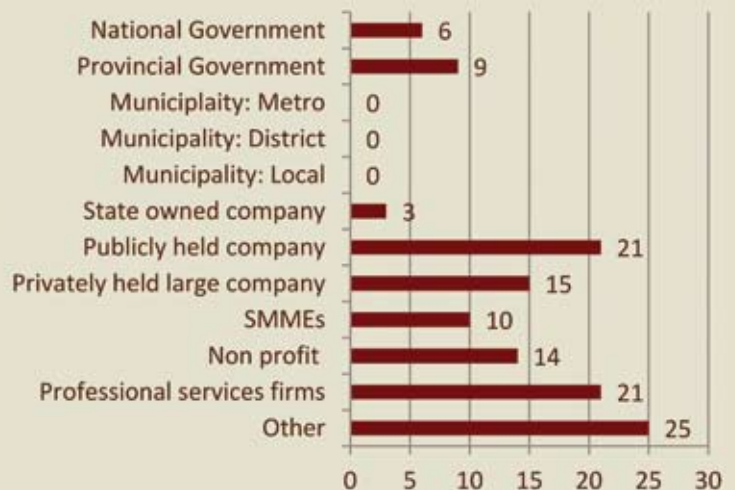


Figure 12: Respondents who strongly agree (% per sector)



External Risk management was once again noted as the poorest performing dimension despite it having received an increased score of 2.2 as opposed to the 2014 score of 2.1. The percentage of respondents that strongly agreed with this question declined by 4% since 2014. This perception suggests that effective methods of anticipating external risks needs to be prioritised within organisations. Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures increased or remained constant in only 4 of the 12 economic sectors. It is noted that whereas in 2014 the highest percentage of respondents who strongly agreed with this question were from within the non-profit company sector (50%), this figure has dramatically decreased by 36% in 2015 and is consequently noted as the highest percentile decrease. The highest percentile increase of respondents who strongly agreed with this question is within the provincial government sector, evidencing a 9% increase from the 0% recorded in 2014.

Having an eye on changing environments is fundamental to the sustainability of any organisations. The more everything becomes interconnected, the more vulnerable organisations become to outside influences. The leadership of the organisation should therefore spend enough time looking at what external factors may impact on the organisation, determine what possible scenarios may play out and ensure that mitigating measures have been put in place. These external factors may be playing out at industry, country, regional or international level. Some of the factors organisations should consider include:

- Evolving social-economic and political contexts are creating increasing complexity to the environments within which organisations find themselves in. The socioeconomic and political contexts include for example issues such as the strength of the labour market i.e. the availability of a skilled labour force as well as the potential crippling effects of union activity, youth unemployment, the growing gap between the haves and the have-nots and the potential instability that may accompany it, poor service delivery from the public sector, an ailing public health sector, inadequate infrastructure, corruption, the fact that South Africa remains a divided society, crime, micro and macroeconomic policies employed by the government of the day, etc. Organisations must have an eye on all the factors that may have a direct or indirect impact on them. They must have a view on the various future scenarios that may unfold as a result of these factors and how the organisation will counteract the potential negative impacts as well as how the organisation will take advantage of the opportunities that may arise in the process
- Shifts in global economic and political power will have an increasingly greater effect on organisations. The countries that traditionally dominated global decision making are currently mostly under economic pressure and the growth of emerging



economies such as China, India and Brazil has been accompanied by a resultant gradual shift in the global balance of power. Greater trade relations between China and a number of African states have added to what seems to be a gradual shift of reliance on the West to the East. Organisations must therefore keep an eye on how the government is responding to the shifts and how it is positioning itself in the new reality where all the power no longer lies with the traditional decision makers. For example an important question is whether African organisations have the ability to compete with the emerging powerhouses and to what degree do their governments create an enabling environment

- Changing consumer concerns and buying behaviour can have a profound impact on the organisation. Consumers are becoming more educated, sophisticated in taste and are gaining greater access to knowledge about products and services. They are starting to understand how much power they have in determining how those products and services are produced and delivered. Organisations therefore find themselves under more pressure than ever before to meet prevailing and changing expectations. Consumers attitudes toward the organisation and its brand coupled with ethical considerations can have a profound impact on their intentions to purchase. Some of the newer trends driving consumer behaviour include expectations that products and services will allow for more new experiences involving more of the senses, are quicker and sleeker, personalised as well as provide for more depth and meaning. To complicate matters further there are increasing signs that personal referencing through social media platforms can often be more effective than expensive marketing campaigns. Organisations not attuned to how these changes could potentially impact upon them, may lose customers faster than they what they can afford to.
- Dealing with emerging technologies and how their advancement, either directly or indirectly, will impact on organisations has profound implications. New technologies are revolutionising the way organisations operate and evolve. For example, how does technology enabling meetings on the web impact on the travel industry? Where technology was previously seen as the domain of the IT geeks, it is now an integral part of how organisations are run, particularly in the domain of cyberspace and computing power. The foreseeable future however promises more significant shifts as robotics as well as bio-molecular, nano and quantum technologies emerge. These will inevitably cause a social disruption and fundamentally change the way societies operate and will in the process have a profound impact on how organisations evolve and morph into entities not yet seen. Organisations not yet ready for the soon to be new realities, may find themselves irrelevant and losing ground at a rapid rate in the new future.
- As a result of an increase in activity in cyber space organisations are becoming increasingly more vulnerable to cyber-attacks. Data breaches are becoming more common and devastating in their impacts. Major corporations such as Sony and eBay, smaller organisations, NGOs and governments have all felt the pain of cyber-attacks. All organisations are potential targets, which means cyber-attacks is a risk area where no organisations can afford to put its head in the sand. Information security should therefore be at the top of the list of the organisations key vigilance areas. Organisations should determine which key assets must be safeguarded, identify the key vulnerabilities around those assets and minimise the probability of a successful attack.
- Climate change is already having an impact on ecosystems, with seasons shifting , sea levels rising and temperatures changing. This all could lead to increasing risks of droughts, fires, floods, stronger storms and increased storm damage, with resultant economic losses. One of the biggest concerns around climate change is how water resources will be affected. Water resources are in turn linked to food supply, health and ecosystem integrity. Food and water scarcity inevitable would lead to social unrest which could tear the social fabric of communities. Such a scenario does not paint a good picture for organisations.
- As a result of significant corporate failures and the global financial and sovereign debt crises, there has been a greater emphasis on regulation as regulatory bodies have often been accused of being ineffective. Shifting regulations make it more difficult for organisations to operate and bring the burden of high levels of expected compliance. Where organisations do not embrace and interweave the spirit behind regulatory principles in the organisation, compliance can come at a grudge cost. Some of the positive effects would include standardisation across jurisdictions and ensuring that the playing field is even with all players expected to play a fair game.
- Increasing convergence and competition are two of the areas that could have an immediate impact on the organisation if it is not vigilant. Having a competitive advantage, by definition means that the organisation must have a very good understanding of its capability in relation to that of its competitors. Organisations that are not vigilant could quite easily find themselves blindsided by a competitor that is first to market with a new product or first to engage new technology that significantly reduces costs. On the other hand, there is also an increasing move toward convergence of different segments across an industry, particularly



where investment efficiency and profitability are the drivers. Thus an organisation's competitor may very well change the game by engaging in converging strategies with players that traditionally were not seen as part of the competition equation.

- Globalisation has both positive and negative implications for organisations. Some negative consequences include international companies becoming increasingly more powerful with a profit motivation that can be harmful to developing countries, protectionist policies in industrialised countries harming developing countries, volatility in capital flows creating currency crises and international trade worsening inequalities. Some positive consequences include the broadening of distribution patterns with organisations being able to tap into much larger markets and increased access to capital flows and goods and services. Furthermore the impact of labour migration could have positive or negative consequences. On the one hand a country may gain scarce skills as a result of migration; on the other hand it could cause social instability. A good example is the current influx into an ill prepared Europe from North Africa, Syria and other war torn countries.
- The emerging energy crisis is becoming one of the most significant external risks organisations face. As the world is moving into a knowledge based economy, the demand for energy seems to be increasing. There has been much talk about peak oil and the end of the earth's ability to serve the world's need for oil. The same goes for the supply of coal in relation to electricity that is in addition to the local electricity utility's inability to supply enough electricity to sustain the economy. Unless alternative sources of energy are aggressively pursued, the energy crisis is set to grow even bigger with alarming consequences. Organisations that have not yet looked at the potential impact minimised their need for energy and sought alternative sources of energy may soon find themselves on the back foot.

In a fast changing world with multiple external factors playing havoc with organisations' sustainability efforts, being in a state of readiness is easier said than done. This is further aggravated by the fact that it is even more difficult to anticipate black swan events. However, a head in the sand approach will only do more harm than good. Leadership of an organisation must put measures in place which will ensure adequate focus on the external risks the organisation may face.

PERFORMANCE

Typical question: ICT is aligned to the strategic objectives of your organisation

Figure 13: Breakdown of various responses (%)

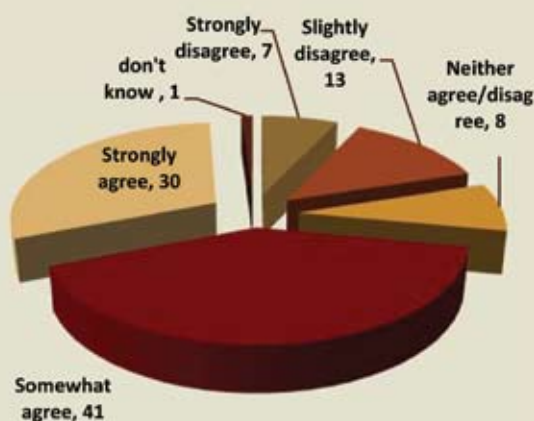


Figure 14: Respondents who strongly agree (% per sector)



Performance remains an area of concern despite it having received an increased score of 2.6 as opposed to the 2014 score of 2.5. It is noted that none of the questions relating to Performance received a percentage of strongly agree responses higher than 50%. The weakest areas of Performance were in respect of Human Resource Capital and Stakeholder Management, which noted declines in strongly agree percentage figures, the aggregated average of which is 19%.

Information Communication Technology (ICT) management was previously noted at one of the greatest weaknesses in 2014, this perception remains with no change in the percentage of strongly agree responses (30%). Once again, the open-ended question confirmed the trends noted in the responses to the multiple-choice questions, with ICT and Human Resource Capital being identified within the top 5 emerging risks. Regarding respondents within economic sectors who strongly agreed with the question posed, figures increased or remained constant in half of the economic sectors. The highest percentile increase of respondents who strongly agreed with this question is within the SMMEs sector, evidencing a 30% increase from the 0% recorded in 2014. The highest percentile decrease of respondents who strongly agreed with this question is within the non-profit companies sector, evidencing a 24% decrease from the 38% recorded in 2014.

ICT is no doubt becoming more important to the strategic objectives of organisations as technology keeps on advancing at a rapid rate. Organisations that ignore the importance of ICT are at great risk of not being able to sustainably carry on with their activities in the future. The degree to which ICT is deployed is thus central to the delivery of service and remaining ahead of the pack. How ICT is deployed determines the competitive advantage an organisation has over others.

With the increasing significance of ICT, it is important for the leadership of the organisation not to see it as the domain of the technical experts, but rather as a key element of the business that is owned and driven by the leadership. This includes the Board or oversight equivalent taking responsibility for ICT governance in the organisation. The Board should ensure that ICT governance appears on its agenda and that management is held accountable for ensuring a robust ICT strategy is in place and implemented.



Typical question: Your human capital resources are optimally utilised

Figure 15: Breakdown of various responses

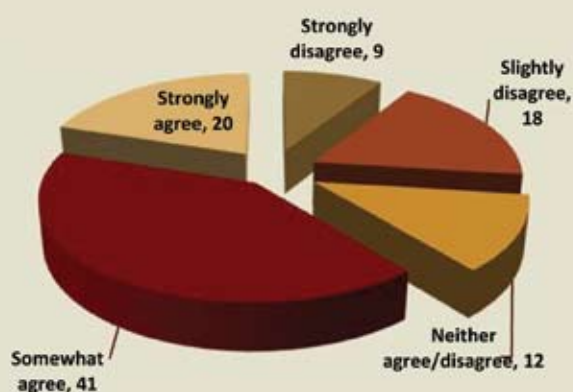
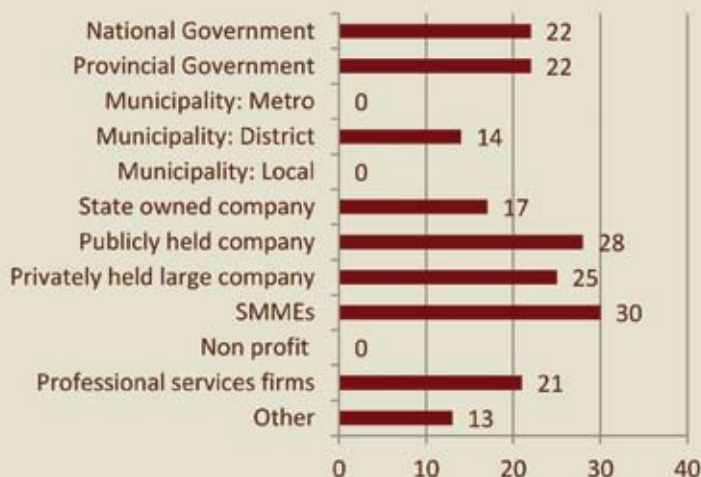


Figure 16: Respondents who strongly agree (% per sector)



Regarding respondents within economic sectors who strongly agreed with the question posed, figures increased or remained constant in 5 of the 12 economic sectors. The highest percentile increase of respondents who strongly agreed with this question is within the SMMEs sector, evidencing a 16% increase from the 14% recorded in 2014. The highest percentile decrease of respondents who strongly agreed with this question is within the metro municipality sector, evidencing a 33% decrease from the 33% recorded in 2014.

In the South African context one of the biggest challenges organisations face is the ability to attract and retain skills in an environment where the demand outstrips the supply of skills. Competition for skills is thus intense and often leads to the unfortunate consequence of individuals being paid beyond what their skills are actually worth. In addition, organisations have to implement transformation strategies which place further pressure on their ability to attract the right candidates.

The provisions in the Employment Equity and Skills Development Acts were meant to be implemented in tandem by organisations and redress the consequences of the policies of the previous regime. Sadly many organisations still see training of employees as a nice to have with very little effort being put into upskilling the workforce. Typically the training budget is one of the first areas to be cut in economic down turns. A collective effort from all organisations is needed in training and upskilling the nation. Leaders should take a long-term view and invest in their employees.



INTERNAL AUDIT

Typical question: Within your organisation Internal Audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference

Figure 15: Breakdown of various responses

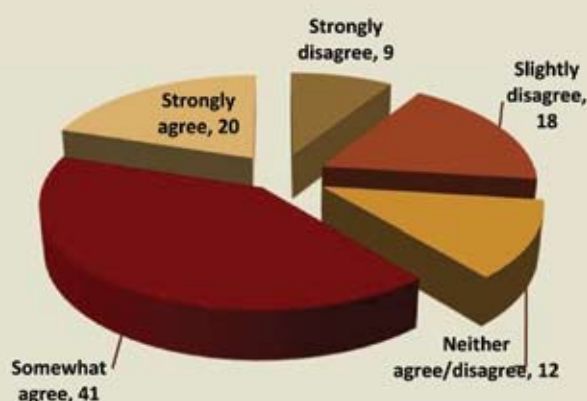
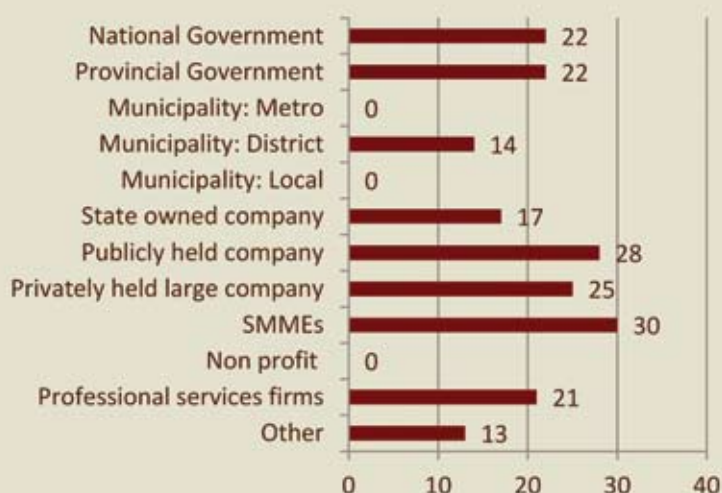


Figure 16: Respondents who strongly agree (% per sector)



Respondents rated Internal Audit overall as the second most positive aspect of organisational governance (3.3), this core dimensions rating is higher than it was in 2014 (3.2). Further, in terms of the multiple-choice questions, the independence of Internal Audit was the best performer. It is noted however that according to the responses received from the respondents, the understanding by leadership of the role of Internal Audit within the organisation continues to remain an area of concern despite a percentage increase of respondents who strongly agreed with this question, evidencing a 7% increase from the 38% recorded in 2014. This percentage increase does suggest a slight improvement in the education of the executive team around the role of Internal Audit within the organisation, however this area needs to be monitored to ensure that there is consistent improvement. Regarding respondents within economic sectors who strongly agreed with the question posed, percentage figures increased in 5 of the 12 economic sectors. The highest percentile increase of respondents who strongly agreed with this question is within the metro municipality sector, evidencing a 67% increase from the 33% recorded in 2014. The highest percentile decrease of respondents who strongly agreed with this question is within the district municipality sector, evidencing a 43% decrease from the 100% recorded in 2014.



MAIN FINDINGS

Below is a list of the most significant research findings:

1. The stability of the Country Index at 2.9 may indicate a perception that change in organisations regarding the implementation of corporate governance is slow. Nonetheless, the incremental increases in 5 of the 7 dimensions with no overall decreases being noted reflects a positive future outlook.
2. Ethics has retained the position of top achieving dimension (3.4), which is noted as an extremely positive finding owing to the fact that it is so integral to the Internal Audit profession. Further, the multiple-choice question relating to the independence of Internal Audit within organisations has received the most favourable response from respondents, another key principle for ensuring objectivity within the Internal Audit profession.
3. Despite it having retained its Index score of 3.0, Compliance was noted as an area of concern by respondents, particularly as a significant emerging risk within organisations. This is due to the perception of respondents surrounding amendments to the legislative and regulatory framework within South Africa and abroad. Emphasis is to be placed on efficient and consistent usage of a combined assurance framework within organisations.
4. Regarding Leadership, there appears to be a lack of emphasis placed on development of a social investment strategy within organisations. Further, the competency of leadership and leadership's understanding of the role of Internal Audit with the organisation remain an area of concern for CAEs. This was also expressed as an emerging risk in the open-ended question. Adequate monitoring of these areas is required in order to ensure consistent improvement.
5. Operational Risk fared better than External Risk, receiving an Index score of 2.9, however the adequacy of risk management within organisations continues to receive low percentage scores from respondents. This should be considered a high priority area.
6. External Risk was the lowest performing dimension, despite it having received an Index score of 2.2 as opposed to 2.1 in 2014. Effective methods of anticipating external risks need to be prioritised within organisations. This assertion is further bolstered by the fact that various external risk factors such as infrastructure collapse, stability of essential services and a waning economic climate were identified as significant emerging risks in the open-ended question.
7. The Index score of Performance was 2.6 as opposed to 2.5 in 2014. However, despite this increase, this dimension remains one which contains complex issues to be resolved, including Human Resource Capital, Stakeholder Management and ICT management. Further, these areas were noted in the top 5 emerging risks in the open-ended question.
8. The top 5 areas of focus over the next few years are, in order of priority: Human Resources, Compliance, Macro-Environmental Economic Risks, ICT as well as infrastructure collapse and stability of essential services.



THE WAY FORWARD

The annual Corporate Governance Index is intended to present management, boards and audit committees with a credible perspective on emerging corporate governance trends in South Africa.

The overall findings suggest that organisations are becoming more aware of the necessity of corporate governance, however progress in achieving the best practise standards as per the King Codes of Governance is slow. It is however noted that progress, regardless of its pace, is a positive finding and instilling these practises within all branches of the organisation is a timeous and challenging process. Nonetheless, for lasting foundations to be built and stand the test of time, much hard work and perseverance is required.

It is important to note that the current emerging risks which have come to the fore are not only risks which face the Internal Audit profession, but the South African economy at large. It is however the mandate of CAEs to share their concerns with leadership and facilitate conversations around the Internal Audit team's role within the organisation. Whether it be the fast moving pace of technological developments or the instability of infrastructure and the economy, the far reaching implications of such issues can be managed where there is a collaborative effort within organisations. An increased effort towards improving the external risk management tools within the organisation must be recognised.

Furthermore, the perception that certain risks are beyond the control of organisations is a real one, however through positive discourse and counteractive measures, the probability of avoidance or at the very least management of such potential pitfalls will be favourable.

You are encouraged to take note of the findings as contained in this report and internalise same, whilst being mindful that each dimension cannot be viewed in isolation. By taking cognisance of the findings in their entirety, organisations will benefit from the knock on effect of the improvement of one dimension on another. In doing so, this will elevate the state of corporate governance within the organisation to a benefit level which transcends throughout the organisation and beyond.

The IIA SA takes the survey results seriously and will address relevant findings through training programs and discussions at its various conferences. As the Index becomes more widely distributed, we expect other related professions to start their own processes of internal dialogue and debate with a view to addressing the gaps that have been identified. After all, the findings reflect our collective ability to deliver value to our shareholders and stakeholders. The real power of this report therefore lies in our ability to translate knowledge into action.

APPENDIX 1: SUMMARY OF ANSWERS TO SURVEY QUESTIONS

		Percentages (%)				
Dimension	Question	Strongly disagree	Slightly disagree	Neither agree/disagree	Somewhat agree	Strongly agree
Ethics	The Oversight body (such as the Board or Council), sets a clear tone of zero tolerance toward unethical behaviour, including fraud and corruption in your organisation.	5	4	6	19	66
	Ethics is an important part of your organisational culture.	3	6	5	26	60
Compliance	Your organisation is committed to implementing relevant good corporate governance principles (as outlined in King III or the National Treasury governance frameworks).	3	6	6	28	57
	When it comes to corporate governance, your organisation goes beyond a mere tick box exercise - i.e. there is a deep understanding of the principles and philosophy of good governance.	4	12	8	38	38
	Your organisation uses a combined assurance framework to provide a co-ordinated approach to assurance activities. *Note: 1% of respondents answered "don't know" to this question.	8	13	11	39	28
	Your organisation complies with relevant legislation, regulations and standards.	1	6	5	34	54
Leadership	Your Oversight body (such as the Board or Council) provides clear strategic direction to achieve the objectives of your organisation.	4	5	7	30	54
	The leadership of your organisation (i.e. senior and executive management as well as the Board) displays a good understanding of the varying roles of assurance providers (such as internal audit, external audit, risk management etc.)	4	9	10	40	37
	The Audit Committee is effective in its oversight role. *Note: 1% of respondents answered "don't know" to this question.	3	7	8	28	53



Leadership	The Audit Committee gives enough attention to all the dimensions within the ambit of its responsibilities. *Note: 1% of respondents answered “don’t know” to this question.	3	7	7	30	52
	Your executive team is functioning optimally in delivering the strategy of the organisation.	3	10	7	39	41
	Your organisation has a social investment strategy. *Note: 3% of respondents answered “don’t know” to this question.	10	8	17	34	28
Operational Risk	The process for identifying risks is aligned to your organisation’s strategic objectives.	3	6	8	36	47
	The process of managing risks within your organisation is adequate.	9	14	7	43	27
External Risk	Your organisation utilises scenario planning to mitigate against unexpected external risks that may arise well beyond the boundaries in which the organisation operates. *Note: 3% of respondents answered “don’t know” to this question.	13	17	19	35	13
Performance	Information and Communications Technology (ICT) is aligned to the strategic objectives of the organisation. *Note: 1% of respondents answered “don’t know” to this question.	7	13	8	41	30
	Your organisation has suitable human resource capital to execute its strategy effectively.	9	15	10	46	20
	Your human capital resources are optimally utilised.	9	18	12	41	20
	Your organisation has implemented an effective stakeholder management plan. *Note: 6% of respondents answered “don’t know” to this question.	8	16	19	35	16
	Your organisation utilises its financial capital optimally (i.e. managing finances so as to achieve best outcomes). *Note: 1% of respondents answered “don’t know” to this question.	7	6	10	35	41
	Given the current resources, your organisation’s output/delivery is at optimal levels.	7	18	10	41	24
Internal Audit	Within your organisation Internal Audit has a sufficient degree of independence to enable it to execute its duties without undue influence and interference.	4	7	4	15	70
	The leadership in your organisation (i.e. senior and executive management as well as the Board/Council) displays a good understanding of the role of internal audit.	6	6	6	37	45



The Institute of Internal Auditors South Africa has launched the Executive Leadership Network (ELN). The ELN has been developed to assist Chief Audit Executives (CAEs) to achieve their goals, meet and exceed the demands placed upon them and support their efforts in their capacity as pioneers in their organisations. In an increasingly competitive and complex business environment, CAEs need to ensure they keep informed of important issues and stay connected with peers who understand and face the same challenges.

The ELN is an exclusive platform for CAEs where tools, resources, information and topic discussions are at their fingertips to keep them at the cutting edge of internal audit. As leaders of the Internal Audit profession, CAEs are provided with an exclusive service to “remain on top of the game.”

With the rapid changes influencing the performance of businesses today, the ELN was developed to support CAEs in addressing the demands placed on them by such changes.

Why become a subscriber of the Executive Leadership Network?

Being a subscriber to the ELN means:

- You save valuable time searching for information and compiling audit working documents.
 - You can conveniently and economically network with other CAEs.
 - You can share concerns with other CAEs to derive at feasible solutions
- You are aware of changes in the profession and are fully equipped to deal with demands placed on you caused by changes in the market.
- You have the necessary support to strategically position the Internal Audit department as a value-add organisational resource.



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**The Institute of
Internal Auditors
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