CORPORATE GOVERNANCE INDEX 2016

The Institute of Internal Auditors South Africa

CONTENTS

FOREWORD

In reflecting on the results of the IIA SA's fourth edition of the Corporate Governance Index – An Internal Audit Perspective, I am once again reminded of the important role internal audit plays in providing assurance on the governance processes and the state of governance in our organisations. In this context, internal audit, be it directly or indirectly, plays a very important role in protecting the interest of the public. When I look at all the factors that culminate into our current volatile environment, coupled with increasing reports of fraud and corruption, I am certain that there is a great need to protect our institutions. At the time of preparing this report, South Africa was gearing up for its local government elections. Elections are generally always accompanied by increased political noise that can create distractions and a lot of angst. Political noise however is not our greatest threat. If our institutions that are vitally important to the health and wealth of our country flounder, then it is time to press the panic button. At the heart of keeping our institutions strong is the application of sound governance principles and keeping governance structures intact.

I do not believe that anyone is better placed to put an independent finger on the pulse of our organisations, and give us a view on whether it is time to press the panic button or not, than internal audit. The Chief Audit Executive's (CAE) role in promoting good governance principles is proving to be one of great importance. CAEs have the ability to not only advise on best practice principles to lead to improving the productivity of their organisations, but contribute to increasing the adoption rate of corporate governance principles throughout South Africa's economic structures.

Each year we tap into the insights provided by Chief Audit Executive's (CAEs) so as to garner their views around the current state of governance within their organisations. We have singled the CAEs out as we wanted to a) avoid more than one response per organisation which would skew the results and b) ensure that we hear the voice of those who see governance in action from a bird's eye view. I am really excited about this fourth version of the Index as it is now becoming more interesting to watch how the trends are developing in the various sectors. We are now in a position to see which sectors are improving and which ones are losing ground. In the South African context, the market regards the King Code as the beacon of governance, hence our strong focus on the King Code in the Index. We of course anticipate that we may need to tweak the Index in 2017 to ensure alignment with the anticipated King IV.

The two dimensions that have consistently been scored lower over the last three years are Operational and External Risks. It is no different in this report. It still remains the dimensions where CAEs feel that organisations just seem not to be getting it right. This remains a worrying factor for us as the volatility in the market shows no signs of easing up. As a matter of fact, the environment is becoming increasingly more unpredictable, which necessitates a constant focus on risk and built-in adaptability. I am also concerned about the fact that, although the Ethics dimension remains one of the dimensions with the highest overall rating, when we dig a bit deeper, we see a decreasing trend in that a lesser percentage of CAEs strongly agree that ethics is an important part of their organisation's culture than in previous years. This is an area we cannot afford to slip in as ethical culture plays an important role in the strength of our institutions.

This Report would not have been possible without my dedicated staff, our Policy Committee and 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 them all for their tireless work in producing this Report. I do of course also need to express my gratitude toward all the CAEs who have contributed to the Report by completing our survey.

This year we have added a new element to the Report in that we have video interviewed some thought leaders in the governance space. Their insights add to the Report and I thank each of our interviewees for their willingness to participate.

I encourage all leaders to use the Index as a tool to benchmark their organisations against, but also to use it to encourage meaningful discourse on governance in their organisations.

Dr Claudelle von Eck
Chief Executive Officer
The Institute of Internal Auditors South Africa
August 2016

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.

EXECUTIVE SUMMARY

The IIA SA's Corporate Governance Index reflects the views of two hundred and forty two (242) Chief Audit Executives (CAEs), who are well positioned to provide a relatively impartial view of the state of corporate governance in South Africa. A total of 27 questions were posed to the respondents.

The fourth instalment of the CGI report, developed through the technological assistance of the Centre for the Study of Governance Innovation (GovInn) at the University of Pretoria , provides a baseline for the measurement of Governance for South Africa in all economic sectors. The research methodology focused on a quantitative approach which emphasized objective measurements rating seven (7) Dimensions: *Ethics, Compliance, Leadership, Risk Management (Operational and External Risks), Performance and Internal Audit out of a rating of four (4).* One (1) scoring very low and four (4) scoring very high in Corporate Governance. The 2016 research study has indicated the following:

1. The overall Country Index for Corporate Governance in South Africa has not changed and remains constant at 2.9. While it is pleasing to note that our Country Index has not dropped in its rating, we note that the Index has not moved from this score over the past three years and is still lagging behind the overall 3.2 rating achieved in 2013.
2. There are a number of areas where less than 30% of the CAEs strongly agreed that their organisation adhered to the relevant governance principle. These are:
    a. The organisation going beyond a mere tick box approach on implementing good governance principles (27%);
    b. The process of risk management being adequate (25%);
    c. Organisations mitigating against external risks (14%);
    d. The organisation having suitable human resources (26%);
    e. Human capital being used optimally (17%);
    f. The organisation having implemented an effective stakeholder management plan (19%); and
    g. The organisation's output/delivery being at optimal level given the resources it has (20%).
3. The areas where more than 50% of the CAEs strongly agreed that their organisation adhered to the relevant governance principle are:
    a. The leadership setting a clear tone of zero tolerance toward unethical behaviour (63%);
    b. Internal auditing having a sufficient degree of independence (67%)
    c. The organisation being committed to implementing good governance principles (58%);
    d. The Audit Committee being effective (56%);
    e. Ethics being an important part of the culture (55%);
    f. The oversight body giving clear strategic direction (53%);
    g. The Audit Committee gives enough attention to all dimensions within its ambit (53%); and
    h. The organisation complies with relevant legislation, regulations and standards (52%).
4. The survey contained an open ended question to ascertain the issues CAEs are most concerned about. The top three areas of concern raised by respondents, and reported as areas of focus for them, are Human Resources, Corruption and Compliance.
5. Table 1 summarises the overall ratings and best and worst scores of each sector in the highlighted results as well as the scores with regard to internal audit's independence.

Table 1 Summary of highest and lowest per sector*

		Percentage of CAEs who strongly agreed with statement		
Sector	**Index**	**Best performing area**	**Worst performing area**	**Internal Audit has a sufficient degree of independence**
National Government	2.7	Ethics an important part of culture/ Executive team is functioning optimally (35% each)	Organisation utilises scenario planning to mitigate against external risk (10%)	75%
Provincial Government	2.8	Ethics an important part of culture/ Executive team is functioning optimally (40% each)	Organisation utilises scenario planning to mitigate against external risk (5%)	80%
Municipal (Metro)	3.0	Executive team is functioning optimally (67%)	Organisation utilises scenario planning to mitigate against external risk/Human resources used optimally (17% each)	83%
Municipal (District)	2.8	Complies with legislation, regulation and standards (80%	Process of managing risk is adequate/Organisation utilises scenario planning to mitigate against external risk/Human resources used optimally (0% each)	80%
Municipal (Local)	2.8	Complies with legislation, regulation and standards (45%)	Organisation utilises scenario planning to mitigate against external risk/Human resources used optimally (14% each)	82%
State owned company	2.8	Complies with legislation, regulation and standards (46%)	Human resources used optimally (10%)	74%
Publicly held company	3.1	Ethics an important part of culture (78%)	Organisation utilises scenario planning to mitigate against external risk (14%)	67%
Privately held large company	3.1	Ethics an important part of culture (76%)	Organisation utilises scenario planning to mitigate against external risk/Human resources used optimally (18% each)	61%
SMME	2.4	Ethics an important part of culture/ Complies with legislation, regulation and standards (50% each)	Human resources used optimally (0%)	37%
Non-profit company	2.7	Complies with legislation, regulation and standards (44%)	Process of managing risk is adequate/ICT is aligned to strategic objectives/Human resources used optimally (11% each)	44%
Professional services firm	2.9	Ethics an important part of culture (60%)	Organisation utilises scenario planning to mitigate against external risk/Human resources used optimally (20% each)	40%
Other	2.9	Ethics an important part of culture (55%)	Organisation utilises scenario planning to mitigate against external risk (0%)	55%

*These are indicators. Further studies are needed to understand the drivers and root causes in each sector

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, 26 multiple choice questions and one open-ended question. The 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

Over Six hundred (600) Chief Audit Executives (CAEs) on the IIA SA database were targeted for the survey, which took the form of a self-administered Quantitative web-based questionnaire in order to effectively and efficiently capture numeral data. It was critical that the survey elicited the most honest responses possible. No personal demographic data was asked for and the survey was strictly anonymous. The survey was opened over a period of three months (3) from April to July 2016. A total of Two hundred and forty two (242) respondents completed the survey.

INTERPRETATION OF THE RESULTS

For purposes of this report, the results have been interpreted under the following premises.

- For ease of reference the Index scores at both the country and industry levels have been rounded off.
- While the country results for all questions asked in the various dimensions have been presented at the end of this report, analysis at industry level has been limited to only a selected number of questions. The pattern followed is the same as in previous years to allow for comparisons to be made across the various versions of the Index. Industry results on questions not highlighted will be dealt with in the industry reports.
- The Index seeks to measure the degree to which South African organisations adhere to governance principles. As the ideal is 100% implementation of the governance principles, only the percentage of CAEs who strongly agreed with a statement has been focused on. In this context the scores are considered to be:
    - Excellent if above 70%;
    - Fair between 50 and 70%;
    - Much room for improvement between 30 and 50% ; and
    - Poor below 30%.
    - An increase or decrease in score of 10% or more against the 2015 results is considered significant.

SURVEY RESULTS

OVERALL RESULTS

Figure 1: Corporate Governance Index per dimension

Table 2: Index Scores (rounded off)

Dimension	2016	2015	% change*
Ethics	3.2	3.4	-2.97%
Compliance	3.0	3.0	-1.31%
Leadership	3.0	3.0	0.0%
Operational Risk	2.9	2.9	1.03%
Internal Audit	3.2	3.3	0.61%
Performance	2.6	2.6	0.38%
External Risk	2.2	2.2	3.20%
COUNTRY CGI	2.9	2.9	0.0%

Scale: 0 (lowest) to 4 (highest)
**Percentage change when taking ratings into consideration before they were rounded off*

The overall Country Index has remained constant at 2.9 from 2014 to 2016 but remains below the 3.2 score attained in the first research conducted in 2013. The Index indicates that there have been slight increases in four dimensions, decreases in two and one that has remained unchanged. (Taking the scores into consideration before rounding off).

Although Internal Audit and Ethics remain the two top performing dimensions this year, it is notable that the Ethics dimension has lost some ground as it has decreased in rating since 2015 (3.3 in 2015 and 3.2 in 2016). Although there has been a slight increase, year on year from 2014, in the external risk dimension, it still remains the area of greatest concern.

The previous versions of the Index (2013 to 2015) are available on the Institute of Internal Auditors South Africa's website at www.iiasa.org.za and therefore easily accessible to the reader for comparison purposes.

Table 3: Index per Economic sector

Sector	Index
National Government	2.7
Provincial Government	2.8
Municipal (Metro)	3.0
Municipal (District)	2.8
Municipal (Local)	2.8
State owned company	2.8
Publicly held company	3.1
Privately held large company	3.1
SMME	2.4
Non-profit company	2.7
Professional services firm	2.9
Other	2.9

Scale: 0 (lowest) to 4 (highest)

Table 4: Index per Industry sector

Sector	Index
Agriculture/Forestry/Fishing	3.3
Health/Pharmaceuticals	3.1
Manufacturing (incl. Packaging & Printing)	3.2
Education and Training	2.4
Banking/Finance/Insurance	3.3
Logistics (Transportation/Building)	2.5
Defence/Security	2.9
Wholesale and Retail	3.1
Mining/Quarrying/Energy/Oil/Chemical	3.1
Services (Community/Professional…)	2.9
Public Administration: public service	2.8
Tourism/Hospitality/Clothing/Food & Bev…	2.7
Technology (ICT/Telecom/Electronics)	3.1
Other	2.8

In the public sector, other than National Government's score which remained the same, there have been fluctuations against the 2015 scores. Provincial Government and Metros have both seen a 7.5% decrease in their scores against the 2015 results. In contrast, District and Local Municipalities have seen a significant increase of 15% and 17.5% respectively. State owned companies' score has remained constant.

In the private sector the winners are privately held large companies and professional services firms with a marginal increase in scores of 2.5% and 5% respectively. Publicly held companies, which are generally under more governance scrutiny, have seen a 2.5% decrease against their 2015 score. Non-profits slipped by 7.5%, but SMMEs created the greatest concern with a significant decrease of 15% against the 2015 score.

The industries where there has been a significant decrease in the score (10%) against the 2015 results are Health/Pharmaceuticals, Education and Training and Tourism/Hospitality/Clothing/Food and Beverages. The only industry that showed a significant increase in score (10%) is Pubic Administration: Public Service.

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

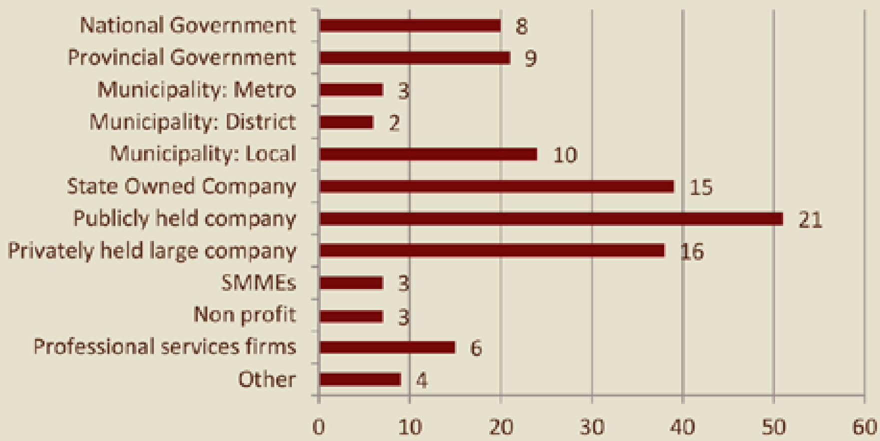


Figure 2: Economic sectors respondents work in (%)

RESULTS PER DIMENSION

(In this section only some results are highlighted. The full list of questions and responses are on pages 20-21)

ETHICS

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

Figure 3: Breakdown of various responses (%)

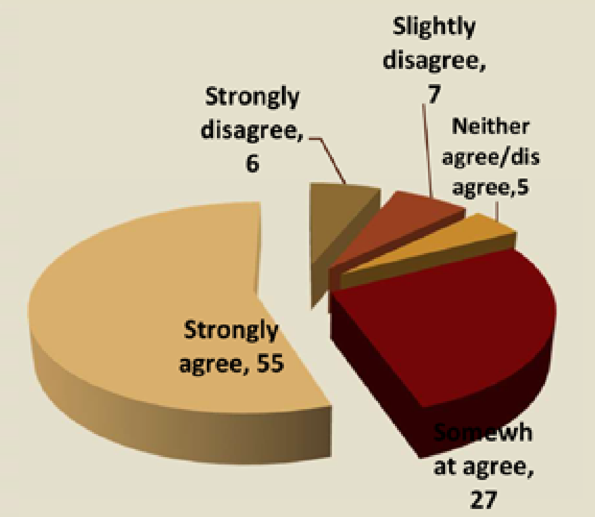
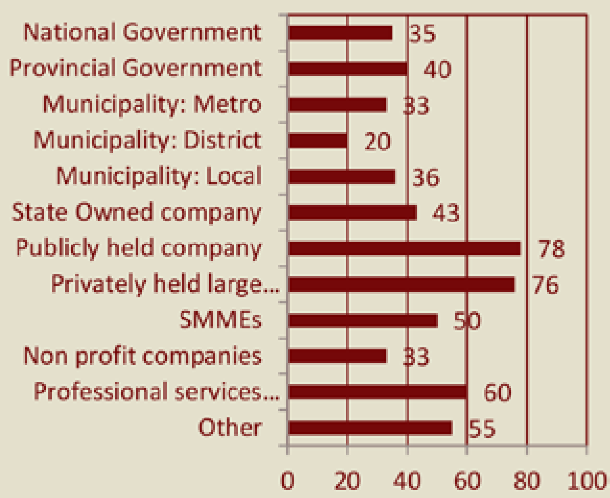


Figure 4: Respondents who strongly agree (% per sector)



Although respondents have rated Ethics highly, in comparison with the other dimensions, in all four versions of the Index, it important to note that there has been an overall declining trend in the percentage of respondents who have strongly agreed that Ethics is an important part of the organisational culture despite a small spike in 2015 (66% in 2013, 55% in 2014, 60% in 2015 and now 55% in 2016). This trend raises concerns in the light of the increasing reports around corruption in the country. In the open ended questions, the CAEs rated corruption among the top three areas of focus for them. The first edition of the SA Risk Report (as reported in 2015 by the Institute of Risk Management SA has Corruption as the number 1 risk facing South Africa today with a focus on leadership particularly in Government. . It is of course important to note that ethics is not just about fraud and corruption, but includes all behaviour that may harm others, either directly or indirectly, such as abuse of power, manipulation, harming the environment, making decisions that negatively impact on stakeholders, discrimination etc.

The results show that there is still no clear congruence between the tone set at the top and the culture unfolding throughout the organisation. This is a red flag for leaders. Saying the right things does not automatically culminate into employees following. Leaders can therefore not afford to live under the assumption that once the tone has been set, their job is done. Setting the tone includes walking the talk, and visibly so, as well as having measures in place to ensure that the tone filters throughout the organisation.

Ethics training should be an ongoing imperative, as is ensuring that there are safe channels to report fraud and corruption and that whistle blowers are protected. These are however the base as a minimum. Leaders should ideally go further and ensure that they have periodic conversations around ethics and identify the ethical dilemmas the organisation as well as the employees may face in executing their duties. Training should therefore not only include ethics awareness, but also endeavour to build ethics intelligence in both leadership and the staff. This includes the ability to identify ethical implications in situations and decisions as well as the ability to deal with ethical dilemmas. In addition, managers should be trained on how to deal with situations when ethical issues are reported to them. Leaders should also be mindful of the fact that in the very diverse South African context, people tend to have differing values and principles based on their backgrounds. It is therefore necessary to advocate for an inclusive ethics policy within organisations which ensures that all

employees have a common understanding of ethics and the organisation's values. Key also is an environment where stakeholders feel that they can safely and confidently report on corrupt behaviour without the threat of intimidation.

The sectors that have seen the greatest improvement in Ethics being an important part of the culture, in terms of the percentage of CAEs strongly agreeing, are District Municipalities (14% in 2015 and 20% in 2016), Privately held companies (67% in 2015 and 76% in 2016) and Professional services firms (54% in 2015 and 60% in 2016). The ones that showed the greatest decline are SMMEs (80% in 2015 and 50% in 2016), Provincial Government (57% in 2015 and 40% in 2016), National Government (50% in 2015 and 35% in 2016), Metros (50% in 2015 and 33% in 2016), Publically held companies (89% in 2015 and 78% in 2016) and Non-profit companies (43% in 2015 and 33% in 2016).

It is worth noting that for all public sector entities the percentage of CAEs strongly agreeing that ethics is an important part of the culture is below 50% and, except for non-profit companies, the percentage of CAEs strongly agreeing in the private sector is 50% and above.

COMPLIANCE

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

Figure 5: Breakdown of various responses (%)

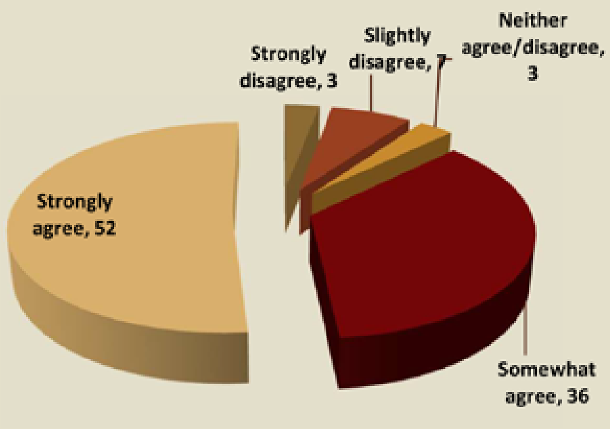
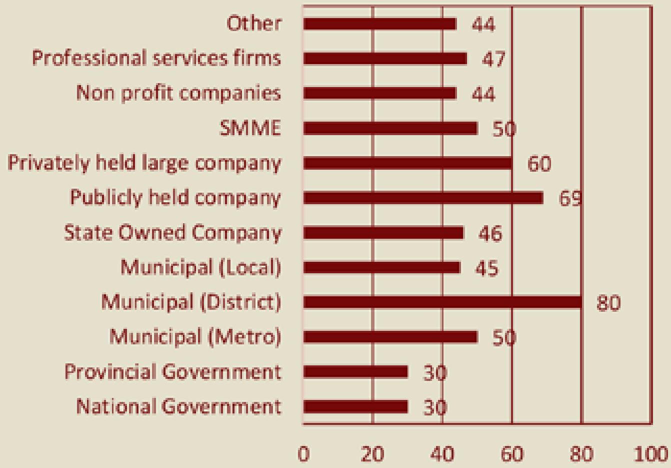


Figure 6: Respondents who strongly agree (% per sector)



In comparing the results to the previous report it is clear that there has been a slight downward change in compliance with relevant legislation, regulations and standards. In 2015 54% of the CAEs strongly agreed that their organisations comply while 52% strongly agreed in the 2016 survey. The South African legislative and regulatory universe is very wide. This coupled with constant changes may contribute to a degree of uncertainty in application as well as organisations not always being aware of what is applicable to them. This should be considered in the context of the fact that the newer legislation often tend to include penalties.

The biggest concern in this dimension is however that only 27% of CAEs strongly agreed that the organisation displays a deep understanding of the governance principles and do not apply a mere tick box approach. This is a significant drop from the 38% (which was already low) in 2015. It is a red flag and a challenge to the professions whose members tend to occupy leadership positions. It begs the question whether enough is being done to ensure that these professionals truly understand the spirit behind the need for good corporate governance as opposed to it being a necessary evil or a grudge cost to operations. It is left to be seen whether King IV, which is intended to be more principles based, will create a shift in understanding of the value of governance. It also begs the question whether enough is being done at tertiary level to not only teach the theory, but already at that level instil the principles and a deep understanding of the spirit behind good governance.

For the question on compliance with relevant legislation, regulation and standards, the sector that showed the biggest increase in percentage of CAEs strongly agreeing is District Municipalities, from 14% in 2015 to 80% in 2016. The other entities in the public sector did not show such a big deviation with the Local Municipalities showing the next biggest increase from 33% to 45%. Provincial government has however contracted from 43% in 2015 to 30% in 2016. The one that raises the biggest concern is Non-profit organisations that fell from 71% in 2015 to 44% in 2016. Privately held companies fell by 12% year on year, which is also a concern.

LEADERSHIP

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

Figure 7: Breakdown of various responses (%)

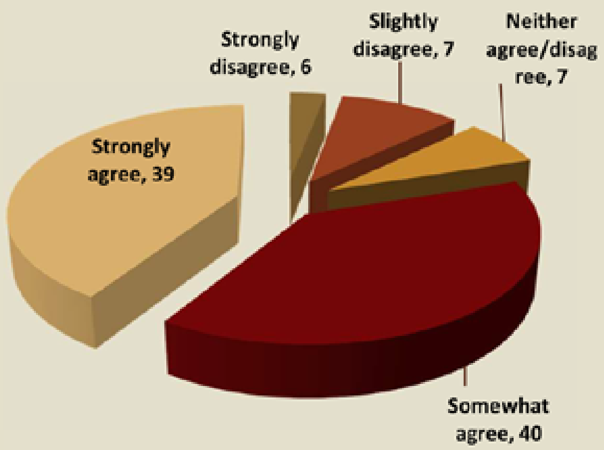
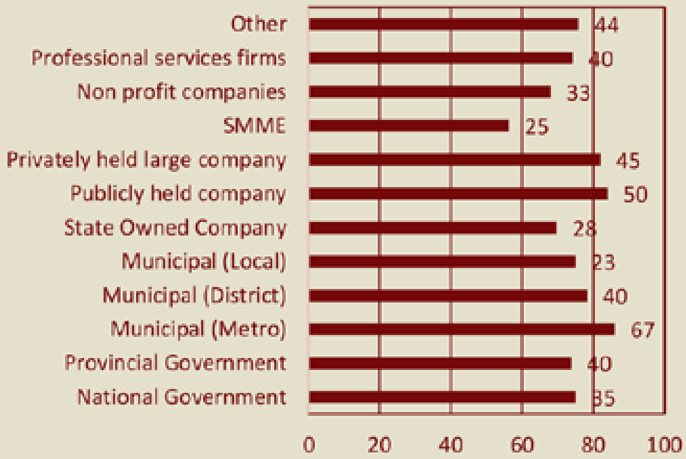


Figure 8: Respondents who strongly agree (% per sector)



The various elements in the leadership dimension have remained stable with marginal differences between the 2015 and 2016 results. However, the three areas where less than 50% of the CAEs strongly agreed with the statement were in the leadership's understanding of the varying role of assurance providers (38%, up from 37% in 2015), the executive team functioning optimally in delivering the strategy (39%, down from 41% in 2015) and the organisation's social investment strategy (lowest at 31%, but up from 28% in 2015).

It is noted that only 39% of the CAEs strongly agree that the executive team is functioning optimally in delivering the strategy of the organisation. This tallies with the low scores in the performance dimension. The sector that shows the greatest improvement in this area is the Municipal Metros with a significant increase in CAEs strongly agreeing with this statement from 25% in 2015 to 67% in 2016. District Municipalities increased from 29% in 2015 to 40% in 2016 and Provincial Government from 26% in 2015 to 40% in 2016. This against a decrease in National Government from 44% in 2015 to 35% in 2016. Other than Non-profit companies that decreased from 57% in 2015 to 33% in 2016, the other areas only saw marginal fluctuations.

Leadership is key to the success of any organisation. The results of this survey do indicate that the CAEs think that there is room for improvement in a number of South African organisations in both the private and public sector. Given the current economic conditions, globalisation, rapid changes in the environment etc., it is imperative that South African organisations are led by strong leadership. It is also important that the executive team be held accountable in terms of their performance against the objectives of the organisation. What the Board measures has a greater propensity of receiving the right level of attention. The Board should therefore apply its mind on whether the executive team has the right combinations of skills, remains up to date with leading practices, stays on top of developments in the industry and globally as well as whether they are walking in tandem.

One of the key issues that may hamper effectiveness of the executive team is politics and resultant infighting. This could have an adverse effect on their ability to implement the strategy as well as on the culture and the morale of the staff.

RISK MANAGEMENT

OPERATIONAL RISK

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

Figure 9: Breakdown of various responses (%)

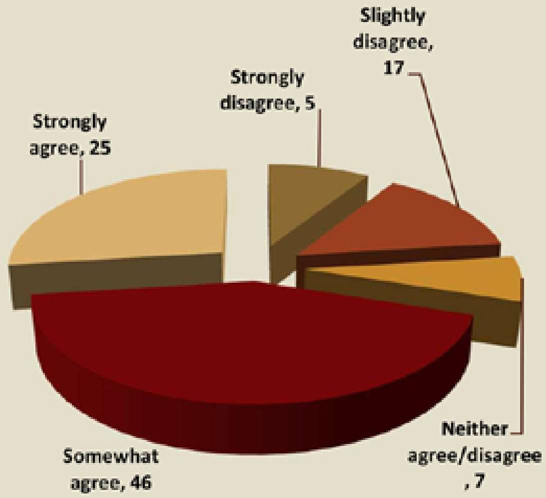
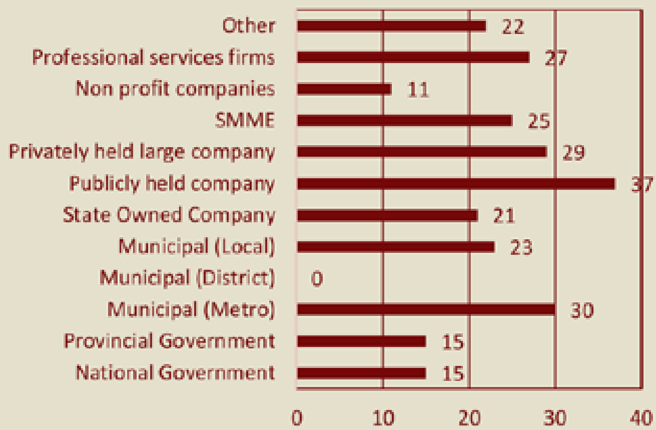


Figure 10: Respondents who strongly agree (% per sector)



This dimension remains one of the areas of greatest concern. Although the overall rating in this dimension has remained the same, there has been a decrease in the percentage of CAEs who strongly agree that the process of managing risks within organisations is adequate (27% in 2015 and 25% in 2016). Given the increasing complexities leaders face, this is certainly not a dimension wherein there is room for a decrease, especially not in the light of the fact that it is already coming off a low base.

The only sector which shows a noteworthy increase in CAEs strongly agreeing that the process of managing the risks in the organisation is adequate is Local Municipalities that increased from 0% in 2015 to 23% in 2016. Given the disheartening reports from the Auditor-General that is produced every year, this shift is a welcome one and it is hoped that it will continue on an upward trajectory. Of concern are the Publically Held Companies which decreased from 44% in 2015 to 37% in 2016, SMMEs which decreased from 40% in 2015 to 25% in 2016, Professional Services Firms which decreased from 33% in 2015 to 27% in 2015 and Provincial Government which decreased from 22% in 2015 to 15% in 2016.

Although it is pleasing to see that there has been a marginal increase in CAEs strongly agreeing that the process for identifying risks is aligned to the organisation's strategic objectives (47% in 2015 and 49% in 2016), it remains an area in need of improvement.

A robust risk management strategy is intrinsically linked to the sustainability of the organisation. The context for business operations has become more volatile in recent years. This increases the number of risks and the likelihood that they may negatively impact on performance. It is therefore important that the ownership of managing risk does not only rest with management and the risk function, but that every single individual in the organisation understands the concept and are 'mini risk managers' in their areas of operation.

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 (%)

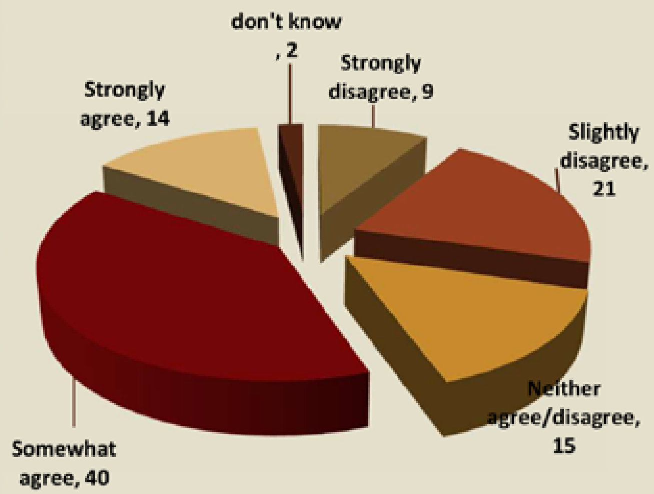
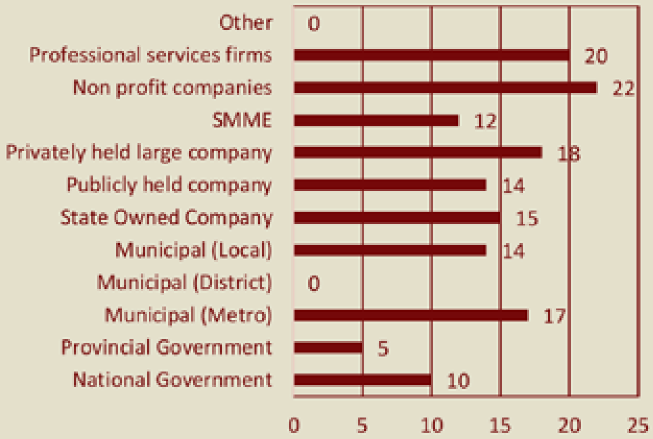


Figure 12: Respondents who strongly agree (% per sector)



Out of all the dimensions, external risk is the one area where South African organisations fare the worst. Although the overall rating has picked up slightly from 2.1 in 2015 to 2.2 in 2016, it still remains the one that lags the furthest behind. Only 14% of the CAEs strongly agree that their organisations utilise scenario planning to mitigate against unexpected risks (up from 13% in 2015). With the volatility and uncertainty in the environment accelerating, Brexit being but one example, South African organisations cannot afford to not keep an eye on external risks nor not being in a state of preparedness for the eventuality of unexpected events unfolding. The survey very specifically formulated the question around scenario planning to test the degree to which organisations are applying a process of thinking through the multiple potential futures that may unfold as well as whether they are in a state of readiness for any form the future may take. In the same vein, it is also important that organisations ensure that they have an adaptive strategy in place as to not be caught unaware and unable to navigate through unexpected developments. This does of course calls for flexibility, but also very importantly, a workforce that is not only able to adapt, but also able to function in the midst of ambiguity.

The sectors that showed the greatest positive change in the percentage of CAEs strongly agreeing that they utilise scenario planning are Municipal Metros from 0% in 2015 to 17% in 2016, Local Municipalities from 0% in 2015 to 14% in 2016 and Non-profit organisations which are up from 14% in 2015 to 22% in 2016. The sector where there has been a significant decrease year on year is Publically Held Companies which moved from 21% to 14%. This is quite worrying given the impact these organisations have on the economy.

PERFORMANCE

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

Figure 13: Breakdown of various responses (%)

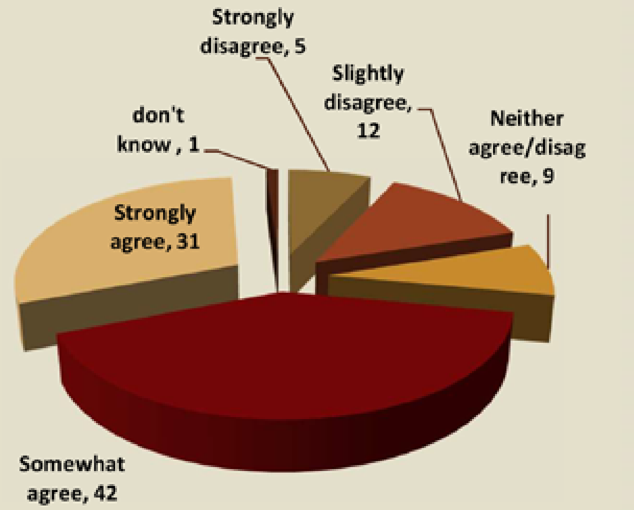
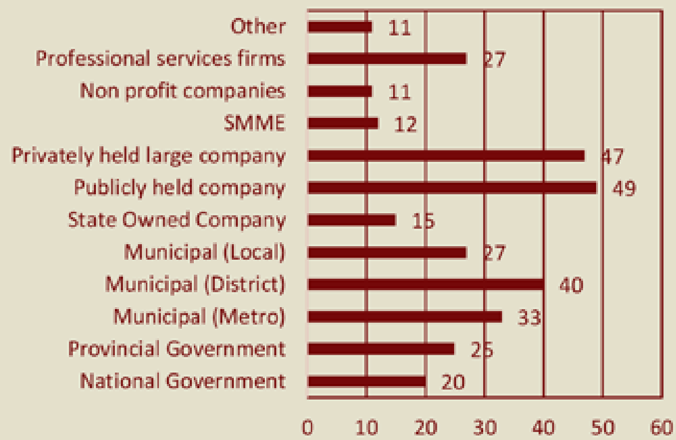


Figure 14: Respondents who strongly agree (% per sector)



In a tough economic climate, Performance is an important dimension for any organisation in terms of sustainability. The Performance dimension rating has stayed the same year on year in comparison with the 2015 results, but remain the second worst performing dimension after the external risk dimension. In two of the categories a lower percentage of CAEs have strongly agreed that the organisation performs well compared to the 2015 results, i.e. human capital being optimally utilised (20% in 2015 and 17% in 2016) and the organisations' output being at optimal level given their current resources (24% in 2015 and 20% in 2016). Organisations are evidently not doing enough to ensure that in order to thrive economically and grow sustainably and improve on overall performance and more focus being placed on utilising the six capitals (human, manufactured, intellectual, natural, financial, and social and relationship) more effectively.

ICT, which is becoming an increasingly more important factor, has only seen a very slight increase in CAEs strongly agreeing that it is aligned to the strategic objectives of organisations (30% in 2015 and 31% in 2016). Given the strategic importance of ICT and its related risks, the 1% shift upwards is rather disappointing. The sectors which has seen the greatest improvement in the number of CAEs strongly agreeing that there is alignment with the strategy are District Municipalities (40%, up from 14% in 2015) and Local Municipalities (27%, up from 5%). The sectors where there has been a significant drop against the previous year are SMME (12%, down from 30% in 2015) and State owned companies (15%, down from 28% in 2015). Technological advancements are impacting on organisation performance and overall long term sustainability. Oversight bodies are now required to focus more on ICT governance with increased investment in and adoption of ICT, emerging trends (e.g. cloud computing, outsourcing, etc.), and emerging risks such as cyber-crime on the increase. Technology can be a significant disruptor, impacting negatively or positively on performance and it is up to the organisations to carefully balance the optimal use of technology and still maintain a sustainable measurement of stability.

Typical question: Your human capital resources are optimally utilised

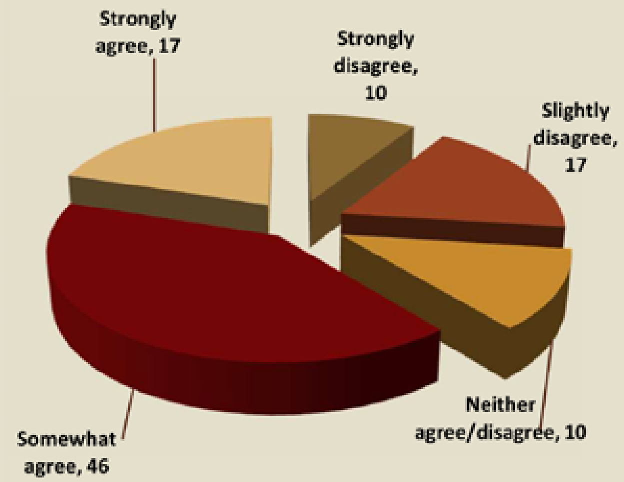


Figure 15: Breakdown of various responses

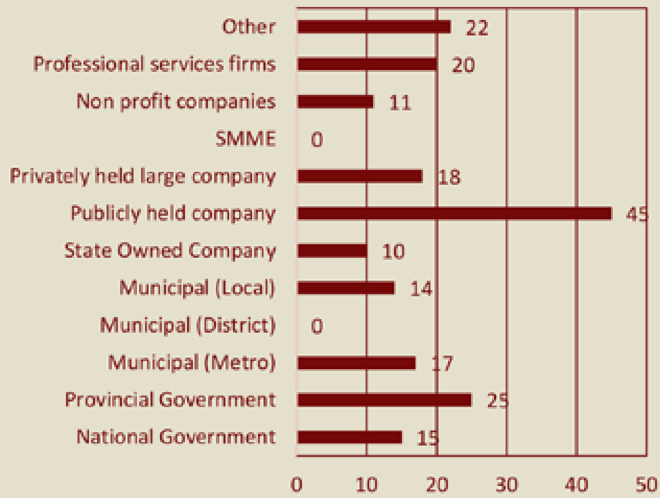


Figure 16: Respondents who strongly agree (% per sector)

Skills shortages remains a concern for most of the CAE respondents. This is particularly prevalent in the research open ended questions where it was indicated that Human capital, and in particular lack of skills, is one of the top risks. Leadership needs to ensure that there is no disconnect between the organisational strategy, available resources and the optimal use of resources. What is key is that organisations measure the impact of its output in terms of its value creation activities. With the economic downturn there is a fine balance now for organisations with key personnel dependency in a skills deficient environment while guarding against burn out.

The optimal utilisation of human capital has a significant impact on the organisation's ability to deliver on its strategy. It is therefore very worrying that only 17% of CAEs strongly agreed that their organisations utilise human capital optimally. This is a decrease against 2015's 20%. This is particularly worrying if compared to the 26% (up from 2015's 20%) of CAEs who strongly agreed that their organisations have suitable human resource capital to effectively execute their strategies. Thus the increase in suitable resources has not resulted in increased utilisation of human capital. The sectors where there has been a significant increase in the percentage of CAEs strongly agreeing that the human capital is being used optimally are Publically held companies (45%, up from 28% in 2015), Local Municipalities (14%, up from 0% in 2015), Metros (17%, up from 0% in 2015) and Non-profit companies (11%, up from 0% in 2015). The sectors where there have been the biggest decreases are SMMEs (0%, down from 30% in 2015) and District Municipalities (0%, down from 14% in 2015).

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 17: Breakdown of various responses (%)

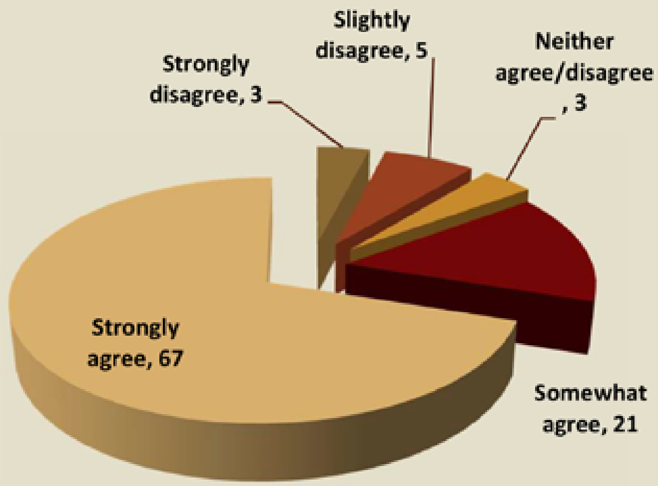
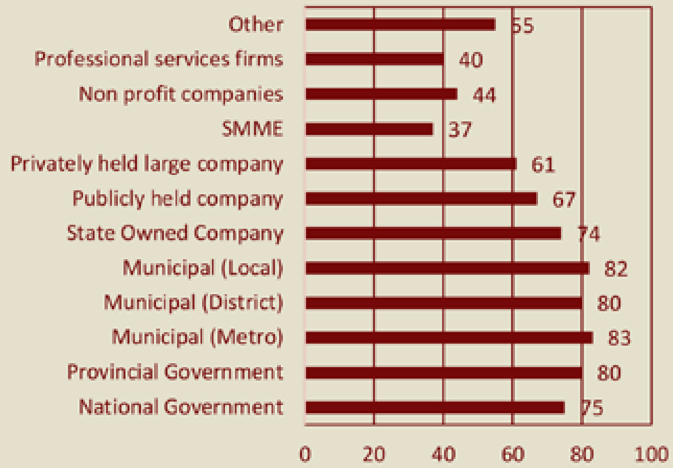


Figure 18: Respondents who strongly agree (% per sector)



Although the Internal Audit dimension falls within the two highest ranking dimensions, there has been a decrease of CAEs strongly agreeing in both the categories that speak to the independence of internal audit (70% in 2015 and 67% in 2016) and the leadership displaying a good understanding of the role of internal audit (45% in 2015 and 38% in 2016). Although it was pleasing to see the high rating for internal audit, these decreases are worrying. Organisations can only truly derive the value of internal audit if there is a clear understanding of the role of internal audit and it is unfettered in its ability to execute that mandate. As internal audit has a major role to play in the governance sphere with it being one of the pillars of governance, it is imperative that its mandate is understood. It is of course also a challenge to the profession to do more to ensure that its mandate is understood with clarity, but also that internal auditors themselves ensure that they live up to the expectations of that mandate.

MAIN FINDINGS

Our key research findings are:

1. The **Country Index** static scoring at 2.9 for the past three years indicate that the CAEs sense that overall Corporate Governance in South Africa is indeed stable and not on the decline.
2. The decline in the **Ethics** dimension is a significant red flag in a country where corruption has been on the rise in the last number of years. Notably this decline is in both the public and private sector, negating the perception many hold that corruption is primarily a public sector problem.
3. The combination of a low rating, on top of a decline, in the executive team functioning optimally as well as worrying indicators in the **Performance** dimension, is lethal for South African organisations already dealing with a sluggish economy and the dark cloud of a possible country downgrade to junk status.
4. **Operational Risk and External risk** remain a challenge for South African organisations. There is simply not enough effort going into identifying, preparing for and managing risk. With increasing volatility and complexity, these low scores indicate that South African organisations are not in a position to stand strong in the face of devastating winds.
5. The combination of a declining trends seen in the **Ethics, Leadership, Performance** and **Risk** dimensions is an indicator that South African organisations are vulnerable. This places a question mark on their ability to contribute to turning the Countries woes around.
6. **Human resources** and particular **skills, non-compliance** and corruption are the three top issues currently keeping CAEs awake at night.

THE WAY FORWARD

The intention of the IIA SA Corporate Governance Index is to highlight our shortcomings, emphasise the good progress made and look at the gaps that emerge so as to gain an immediate reaction and response from Boards, Audit Committees, CEO's, Executives and Government Leadership. This report highlights some worrying trends and it is hoped that organisational leaders will take heed and start to have the right conversations around how to ensure that they improve in those areas where their organisations may be lacking.

It is also a challenge to internal auditors. Are internal auditors asking the right questions and raising findings and offering recommendations that will assist the organisation moving in the right governance direction?

We encourage leaders across all governance spheres and hierarchies in their organisations to use this report to not only benchmark the organisation, but to use it to start the right conversations. Moving forward will however take a fair measure of brutal honesty within the leadership and political will and determination to improve the scores currently seen in the Index, particularly in those areas such as risk, where the scores are too low for comfort.

APPENDIX 1: SUMMARY OF ANSWERS TO SURVEY QUESTIONS (%)

Dimension	Question	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
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	5	2	24	63	1
	Ethics is an important part of your organisational culture.	6	7	5	27	55	0
Compliance	Your organisation is committed to implementing relevant good corporate governance principles (as outlined in King III or the National Treasury governance frameworks).	4	5	6	26	58	1
	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.	5	12	7	48	27	1
	Your organisation uses a combined assurance framework to provide a co-ordinated approach to assurance activities.	8	12	10	39	31	0
	Your organisation complies with relevant legislation, regulations and standards.	3	7	3	36	52	0
Leadership	Your Oversight body (such as the Board or Council) provides clear strategic direction to achieve the objectives of your organisation.	3	7	4	33	53	0
	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	11	7	39	38	1
	The Audit Committee is effective in its oversight role.	3	5	8	26	56	2
	The Audit Committee gives enough attention to all the dimensions within the ambit of its responsibilities.	1	9	7	27	53	3
	Your executive team is functioning optimally in delivering the strategy of the organisation.	6	7	7	40	39	1
	Your organisation has a social investment strategy.	13	12	11	28	31	5

Operational Risk	The process for identifying risks is aligned to your organisation's strategic objectives.	2	9	5	35	49	0
	The process of managing risks within your organisation is adequate.	5	17	7	46	25	0
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.	9	21	15	40	14	2
Performance	Information and Communications Technology (ICT) is aligned to the strategic objectives of the organisation.	5	12	9	42	31	1
	Your organisation has suitable human resource capital to execute its strategy effectively.	9	16	10	39	26	0
	Your human capital resources are optimally utilised.	10	17	10	46	17	0
	Your organisation has implemented an effective stakeholder management plan.	8	14	22	35	19	2
	Your organisation utilises its financial capital optimally (i.e. managing finances so as to achieve best outcomes).	7	10	5	35	43	0
	Given the current resources, your organisation's output/delivery is at optimal levels.	8	16	10	46	20	0
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.	5	3	3	22	67	0
	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.	4	11	7	39	38	1

The process of compiling the Corporate Governance Index is overseen by the IIA South Africa's Policy Committee. We thank them for their tireless dedication to the project. They are:

Paresh Lalla | Claudelle von Eck | Sikkie Kajee | Andrew Nortier | Berenice Francis | Joe Lesejane | Oupa Mbokodo
Karin Barac | Phillip Ntsimane

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The Institute of Internal Auditors
South Africa