CGI

The Institute of Internal Auditors
South Africa

CORPORATE GOVERNANCE INDEX

2017

PROGRESS THROUGH SHARING

The institute of Internal Auditors South Africa (IIA SA) is part of an international network representing the interests of internal auditors worldwide and is the internationally recognised authority, standard setter, principal educator and acknowledged leader in certification, research and technological guidance for the profession of internal audit. The IIA SA provides internal auditors with the support and opportunities to develop to their fullest potential.

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The Institute of Internal Auditors South Africa

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FOREWORD

I am pleased to present to you the 5th edition of the Corporate Governance Index. When we kick started the process in 2013 we could not imagine how important this Index would become as a barometer of the state of Governance in South Africa. I still strongly believe that its credibility and importance lies in the fact that the survey is completed by the one group of people who have both insight in the state of governance in their organisations and are independent assurance providers. They can therefore give an objective view, while for all other relevant groupings it would be a self-assessment to a large degree.

Two things have happened since the release of the 4th edition that are worth mentioning. The one is the release of King IV and the second the significant scandals which came with far reaching implications, with the #Guptaleaks being a significant forerunner.

I must say that I was very pleased to see King IV not only further emphasising the notion of principle based governance, that expects application of mind from governing bodies, but also greater emphasis is placed on what I call the 'higher order issues' such as integrated thinking and corporate citizenry, with the related responsibilities. We naturally felt that it was important that we align the Index to King IV as it was previously aligned to King III. Some of the questions were refined as a result and a few new questions were added. We did of course have the difficult task of ensuring that we do not add too many questions to the various dimensions, lest we ended up we a lengthy questionnaire which survey weary South Africans would loathe to complete.

The #Guptaleaks heightened concerns around corruption in South Africa and it appears that the collateral damage, as the South African public reacts to the likes of KPMG, is going to be enormous. The result of revelations around KPMG is that the whole of the external auditing and chartered accountancy professions are affected. I am concerned that internal audit will not come out of it unscathed. This is therefore a time for professional bodies to step up as an important line of defence in the South African society and hold their members accountable.

The areas that pleased me the most in this edition of the CGI include:

- Significant improvements in both the operational and external risks dimensions when one drills down to the sector results. The external risk dimension in particular had been of grave concern since the inception of the Index. It appears that South African organisations are becoming a lot more conscious of the increasing risks in the environment and those that affect their organisations internally.
- Although the ratings weren't particularly high, I was pleased to see the progress made in the application of Integrated Thinking and Reporting principles. This is still a fairly new concept and it is therefore understandable that it will take some time to become entrenched in how our organisations are run. Integrated Reporting was first crystallised in South Africa. It is therefore important that South African organisations lead the way in the implementation thereof.
- There seems to be a sense that there has been an improvement in the tone that is being set by oversight bodies indicating zero tolerance toward unethical behaviour. I would just like to see some more emphasis on ensuring that it filters down in the organisation as there seems to be some disconnect between that tone being set and what plays out in the culture of the organisations.

The areas that gave me grey hairs include:

- A trend that points to a decline in ethics in organisations. On the question of whether ethics is an important part of the organisational culture we have seen a drop in CAEs strongly agreeing from 66% in 2013 to 53% in 2017. This may have been influenced by the constant negative news in the media, but the question was very directly pertaining to their own organisations. One of my biggest concerns in the ethics dimension is that South Africans often only associate ethics with fraud and corruption and do not always include issues such as inequality in remuneration policies, anti-competitive behaviour, exploitation of staff, sexual harassment, discrimination based on issues such as gender or race, harming the environment and communities etc., when they rate organisations on ethics. I have to wonder whether respondents had taken all facets of ethics into consideration when they answered the question and whether the ratings could potentially be worse.
- Although I have mentioned above that I am pleased to see the improvements in the risk dimensions, I am still concerned about the CAEs sentiment in these areas. Given the volatility, uncertainty, complexity and ambiguity that has become standard in our current reality, we have to see a greater emphasis on risk identification and management of risk.
- With the speed at which technology is evolving, I would expect organisations to be a lot more attuned to ensuring that their ICT strategy is relevant and aligned to the organisation's objectives. ICT governance is an oversight body's responsibility. It is therefore important that those in leadership positions ensure that they stay abreast with technology developments and ask the right questions around the organisation's technology readiness.
- There are significant decreases, in a number of sectors, in the percentages of CAEs who strongly agreed that internal audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference. The biggest drop is in the 'other' group (55% in 2016 and 16% in 2017), followed by local municipalities (82% in 2016 and 46% in 2017), and followed by state owned companies (74% in 2016 and 46% in 2017). Given the adverse findings in the Auditor-General's reports on local government and the cloud of corruption over a number of state owned entities, this makes me feel very uneasy as a South African.

The Index is intended to be a tool that is used by the leadership in organisations to benchmark themselves against and have in-depth discussions around the various dimensions, and in particular how they can improve. I trust that you will not only enjoy reading the Index report, but that you will find value in utilising it in your organisation.

Dr Claudelle von Eck
Chief Executive Officer
The Institute of Internal Auditors South Africa
November 2017

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 190 000 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 and the UK. 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, The King Report 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 2017 reflects the views of two hundred and eighty one (281) Chief Audit Executives (CAEs), the most number of respondents the survey had since it was published in 2013. These CAE's are well positioned to provide a relatively impartial view of the state of corporate governance in South Africa, across industries and economic sectors. The 2017 CGI Survey Questionnaire was revised to include the new King IV code of governance principles.

This edition, the fifth for the IIASA, was developed through the technology and research assistance of the University Of Johannesburg School Of Accounting. The research methodology focused on a quantitative approach which emphasized objective measurements rating seven (7) Governance Dimensions viz; Ethics, Compliance, Leadership, Risk Management (Operational and External Risks), Performance and Internal Audit out of a rating scale of four (4). One (1) scoring very low and four (4) scoring very high.

The 2017 research study has indicated the following:

1. The consistent 2.9 increased to a 3 rating scale out of 4. We do note, however, that the highest rating achieved was in 2013, which was a 3.2.
2. There are a few areas where **less** than 30% of the CAEs **strongly agreed** that their organisation adhered to the relevant governance principle. These are:
   a. The leadership is familiar with and utilises all the Integrated Reporting principles in the organisation's value creation process. (29%);
   b. Your organisation has suitable human resource capital to execute its strategy effectively and optimally. (28%);
   c. Your organisation's human resource capital is optimally utilised. (24%);
   d. Given its current resources, your organisation's output/delivery is at optimal level. (28%);
3. The areas where **more** than 50% of the CAEs **strongly agreed** that their organisation adhered to the relevant governance principle are:
   a. The oversight/governing body (such as the board, regulator, audit committee etc.) sets a clear tone of zero tolerance toward unethical behaviour, including fraud and corruption in your organisation. (68%);
   b. Ethics is an important part of your organisational culture. (53%)
   c. Your audit committee is effective in all the dimensions within the ambit of its responsibilities. (54%)
   d. Your oversight/ governing body ensures accountability of organisational performance through accurate reporting and disclosure to the organisation's stakeholders. (52%);
   e. Within your organisation Internal Audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference. (72%);
4. The CAEs were asked in open ended questions to indicate what they believe the top three key risk areas will be for their organisations. The following themes emerged as the top ten (in order of frequency of mentions):
   » Financial capital. In particular adequate funding for strategic initiatives.
   » Compliance with regulations and legislative changes. Including the cost of onerous requirements.
   » Fraud and corruption. Within organisations as well as in the broader society.
   » ICT. Including digitisation and disruptors.
   » Cybercrime and security.
   » Human capital. Including lack of skills.
   » Political instability
   » Sustainability
   » Lack of leadership skills
   » The economy and market conditions
5. The following themes are also worth mentioning. Although not in the top ten, they came through as clear areas of concern:
   » Reputational risk
   » Political interference
   » Food and water security
   » Competition (including new entrants from outside SA)
   » The environment – climate change

TABLE 1

SUMMARY OF THE MOST NOTABLE INSIGHTS PER SECTOR

Sector	2017 Index	2016 Index	Notable insights	Percentage of CAEs who strongly agreed with statement: 2017 Internal Audit has a sufficient degree of independence	Percentage of CAEs who strongly agreed with statement: 2016 Internal Audit has a sufficient degree of independence
National Government	2.6	2.7	On the question whether their organisation has suitable human resource capital to execute its strategy effectively and optimally, the national government sector had the lowest percentage of CAEs strongly agreeing (8%).	44%	75%
Provincial Government	2.9	2.8	The area where CAEs in provincial government had the lowest percentage strongly agreeing is on the question whether the leadership is familiar with and utilises all the Integrated Reporting principles in the organisation's value creation process (15%)	56%	80%
Municipal (Metro)	2.9	3.0	The CAEs in the metro municipalities rated most of the areas fairly high (60% strongly agreeing in most of the featured questions) and therefore stood out as an outlier.	60%	83%
Municipal (District)	2.0	2.8	On the question whether ethics is an important part of their organisational culture, districts municipalities, had 0% CAEs strongly agreeing	57%	80%
Municipal (Local)	2.8	2.8	On the question whether internal audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference, local municipalities had the biggest decrease in the percentage of CAEs strongly agreeing in the identifiable groups (82% in 2016 and 46% in 2017)	46%	82%
State owned company	2.8	2.8	On the question whether the process for identifying and managing risks is adequate and aligned to your organisation's strategy the state owned companies had the second lowest increase in percentage of CAEs strongly agreeing, after publically held companies (21% in 2016 and 30% in 2017)	46%	74%
Publicly held company	3.3	3.1	On the question whether the organisation continually considers multiple potential futures to ensure an adaptive strategy to mitigate against unexpected external risks that may arise beyond the boundaries within which the organisation operates, publically held companies had the greatest improvement in the percentage of CAEs strongly agreeing (up from 14% in 2016 to 48% in 2017)	60%	67%
Privately held large company	3.3	3.1	On the question whether ethics is an important part of their organisational culture the second highest percentage of CAEs strongly agreeing were in privately held companies (73%)	47%	61%
SMME	2.9	2.4	On the question whether the leadership is familiar with and utilises all the integrated reporting principles in the organisation's value creation process, SMMEs together with non-profit organisations, had the lowest percentage of CAEs strongly agreeing (14%)	57%	37%
Non-profit company	3.1	2.7	On the question whether their organisations' Information Communication Technology (ITC) strategy is aligned to the strategic objectives of their organisations, the non-profit sector had the lowest percentage of CAEs strongly agreeing (14%)	71%	44%
Professional services firm	3.1	2.9	On the question whether the ICT strategy is aligned to the strategic objectives of the organisation, professional services firms had the greatest improvement in the percentage of CAEs strongly ageeing (27% in 2016 and 53% in 2017)	46%	40%
Other	2.4	2.9	On the question whether internal audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference, the 'other' group had the biggest decrease in the percentage of CAEs strongly agreeing (55% in 2016 and 16% in 2017)	16%	55%

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, 33 multiple choice questions and three open-ended question. The multiple choice questions were designed and revised to incorporate the new King IV Code of Governance, to cover the following seven dimensions: 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 between March and May 2017. A total of Two hundred and eighty one (281) respondents completed the survey.

SURVEY RESULTS

OVERALL RESULTS

Figure 1: Corporate Governance Index per dimension

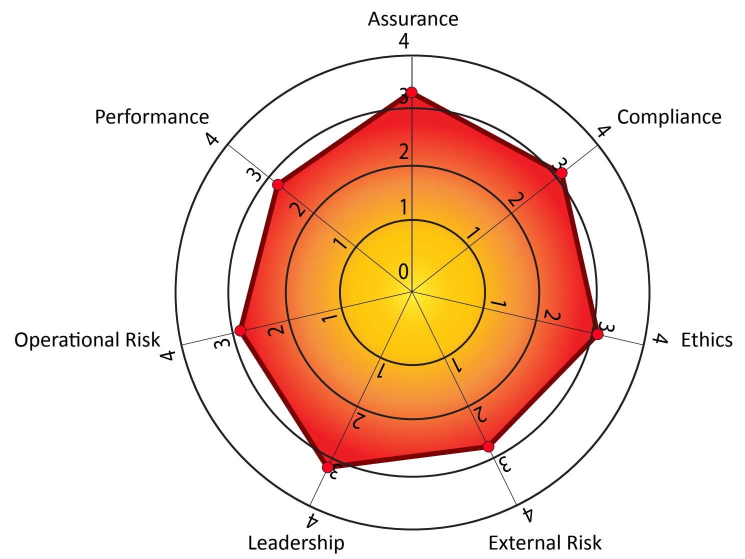


Table 1: Index Scores

Dimension	2017	2016	% change
Ethics	3.1	3.2	-3.1
Compliance	3.1	3.0	3.3
Leadership	3.1	3.0	3.3
Operational Risk	2.9	2.9	0
Assurance	3.1	3.2	-3.1
Performance	2.8	2.6	7.7
External Risk	2.8	2.1	33.3
COUNTRY CGI	3.0	2.9	3.4%
Scale: 0 (lowest) to 4 (highest)			

The overall Country Index marginally increased by 3.4% from 2.9, which had remained the same from 2014 to 2016, to a 3.0 in 2017. This does however remain below the 3.2 score attained in the first survey conducted in 2013. The Index indicates that there have been increases in four dimensions, decreases in two and one that has remained unchanged.

The External Risk dimension has seen the biggest improvement as perceived by the CAE's, with a 33.3% increase in one year and the second highest increase is the Performance dimension with a 7.7% increase in rating. Both the Ethics and Assurance dimensions have decreased in rating which is a concern in terms of governance practices in organisations in South Africa. Notable is that the Ethics dimension has been losing some ground since 2015 and is now at its lowest level since the inception of the Index.

The previous versions of the IIASA Corporate Governance Index (2013-2016) is available on the IIASA website (www.iiasa.org.za) for comparison purposes.

SURVEY RESULTS

OVERALL RESULTS

Table 2: Index per Economic sector

Sector	Index
National Government	2.6
Provincial Government	2.9
Municipal (Metro)	2.9
Municipal (District)	2.0
Municipal (Local)	2.8
State owned company	2.8
Publicly held company	3.3
Privately held large company	3.3
SMME	2.9
Non-profit company	3.1
Professional services firm	3.1
Other	2.4
Scale: 0 (lowest) to 4 (highest)	

Table 3: Index per Industry sector

Sector	Index
Agriculture/Forestry/Fishing	3.1
Health/Pharmaceuticals	3.2
Manufacturing (incl. Packaging & Printing)	3.5
Education and Training	2.3
Banking/Finance/Insurance	3.2
Logistics (Transportation/Building)	3.0
Defence/Security	1.8
Wholesale and Retail	3.3
Mining/Quarrying/Energy/Oil/Chemical	3.3
Services (Community/Professional…)	2.9
Public Administration: public service	2.8
Tourism/Hospitality/Clothing/Food & Bev…	2.4
Technology (ICT/Telecom/Electronics)	3.1
Other	2.6

The most notable positive changes to the economic sector ratings are among SMMEs (20.8%) and Non-profit companies (14.8%), while the most notable negative rating change is at District Municipal level (-28.6%). Although there is a significant improvement to the SMME rating, it has recovered to its rating 3.0 in 2015 (it was at 2.3 in 2014). The non-profit company rating was at 3.0 in 2015 and 3.3 in 2014. The rating change at District Municipal level is significant, particularly when compared to the ratings of the previous years, which were both on 2.2. The 'other' category also had a negative change (17.2%), but which sectors are being referred to, is unknown. The industry with the most notable positive change is the manufacturing industry (9.4%), the highest rating for this category compared to previous years. The most negative rating changes are in the defence/security industry (-38%), which is a far cry from the 3.1 rating in 2014, and tourism/hospitality/clothing/food and beverage (-11.1%), which has seen a steady decline from its 3.6 rating in 2014.

DEMOGRAPHIC DATA – I.E. ECONOMIC AND INDUSTRY SECTORS (%)

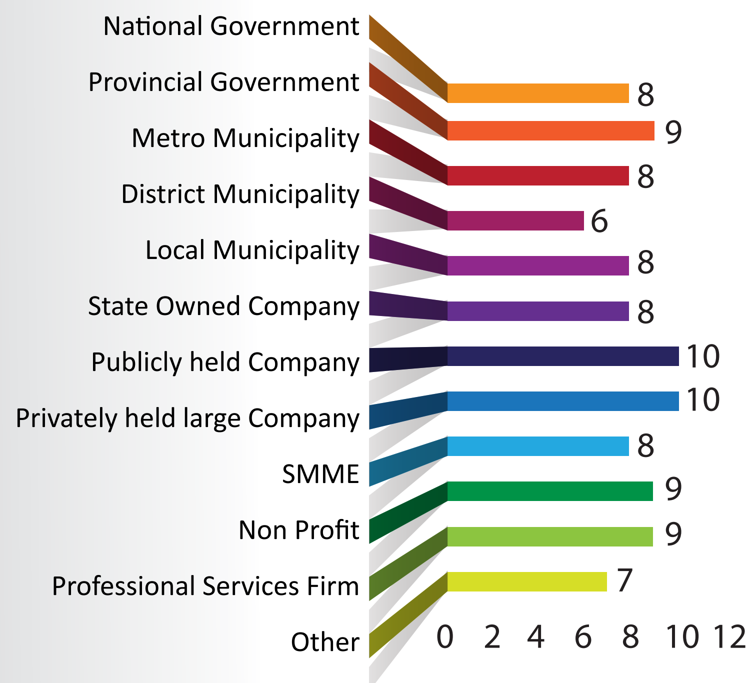


Figure 2: Economic sectors respondents (%)

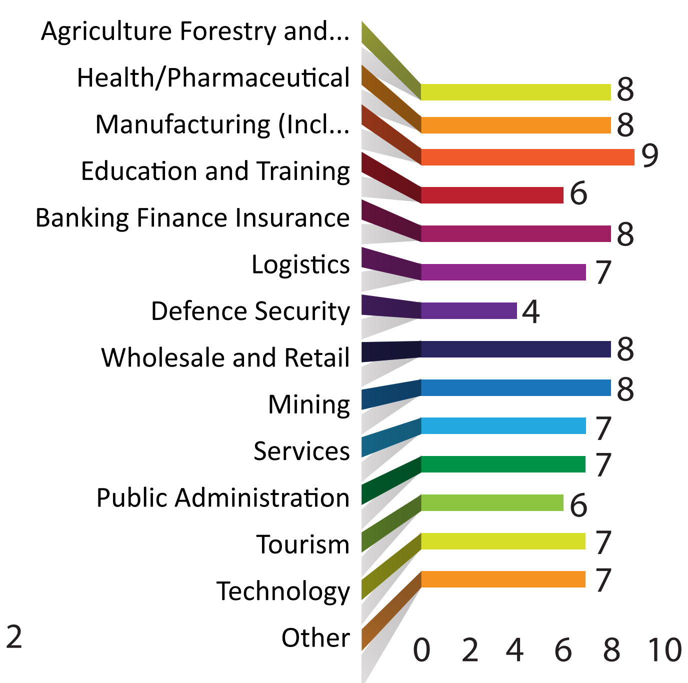


Figure 3: Industry sectors respondents (%)

(In this section some results are highlighted. The full list of questions and responses are on pages 23-25)

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

Figure 4: Breakdown of various responses

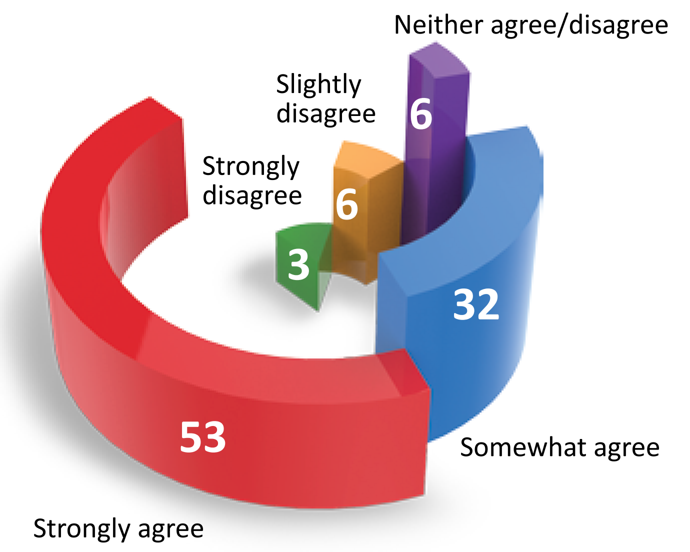
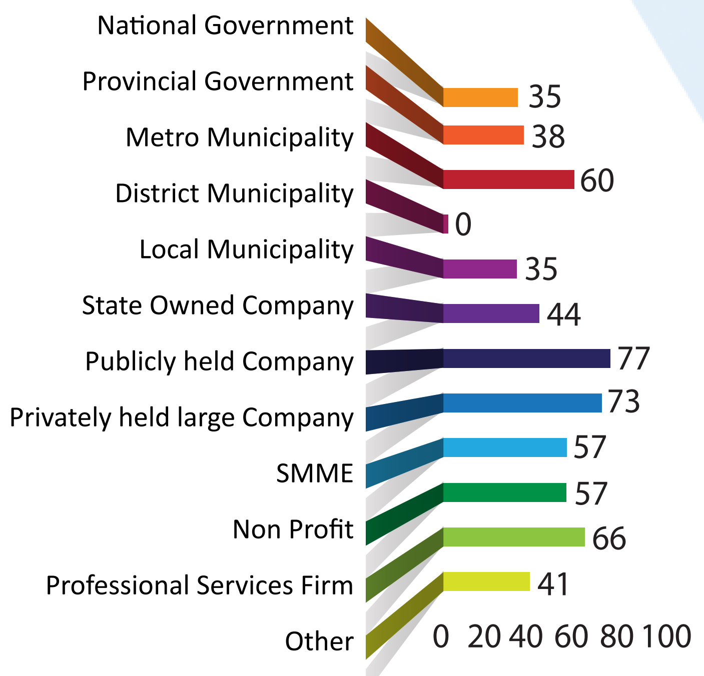


Figure 5: Respondents who strongly agree (% per sector)



The sentiment among the CAEs has seen a consistent drop in this section. In 2017 53% strongly agree that ethics is an important part of their organisation's culture. In 2016 55% strongly agreed, in 2015 it was 60%. The inaugural Index in 2013 saw the highest percentage strongly agreeing at 66%, a significant 13% higher than the current year. This downward trend does not bode well for South Africa as a decline in ethics would ultimately have a ripple effect into the economy, with the poor suffering the most likely collateral damage.

The Anti-intimidation and Ethical Practices Forum (AEPF) released its inaugural Ethics Survey in September 2017. The results are telling and when read in conjunction with this report, raise red flags that should create concern among South Africans. In extracting the responses that came from internal auditors (members of the IIA SA), in particular, from the AEPF report, the following results are worth noting:

- In expressing their opinions on the South African society only 5% strongly agreed that doing the right thing is more important than financial success. The overall agree category amounted to a very disappointing 22%. This is a very worrying statistic. Organisations recruit their employees from society. If the societal norms come off a low base, then it is reasonable to conclude that those values would carry into organisations. This certainly is a significant red flag for leaders across the board. Even non-profit organisations, which also recruit from the same society are affected, as evidenced by the fact that CAEs in that industry did not indicate a much more positive sentiment than the overall perceptions in this dimensions (57% strongly agreeing as opposed to the 53% of the overall sample strongly agreeing). Leaders therefore must be conscious of the societal influence on the state of ethics in their organisations and have action plans in place to counteract that.
- Only 34% strongly agreed that ethics is a priority in their organisations. The overall agree category amounted to 52%. This is in stark contrast with the response received from CAEs in CGI where 68% strongly agreed (an increase over the 2016 63%) that the oversight bodies in their organisations set a clear tone of zero tolerance against unethical behaviour. Only 42% in the AEPF study strongly agreed that employees were encouraged to do the right thing. The overall agree category amounted to 68%. It appears that while oversight bodies may be setting the right tone, it is not necessarily filtering down in the organisation. Setting the tone in terms of zero tolerance against unethical behaviour, must be balanced with a tone that encourages employees to do the right thing. Thus, not only a stick approach, but also a carrot approach. In order for ethics to become an important part of the organisational culture, saying the right things at the top must translate into it being a priority throughout the whole organisation, driven by executive and senior management. This should be monitored by the Social and Ethics Committee, yet only 37% of CAEs in the CGI strongly agreed that there is a committee or similar structure in place in their organisation.

Around 27% indicated that they somewhat agree that such a structure is in place, which is hopefully an indication that organisations are busy working towards putting the necessary structures in place. A dedicated focus on ethics is necessary to combat lowering norms and standards in this dimension.

- 74% strongly agreed that it is their personal duty to report unethical behaviour. The overall agree category amounted to 91%. Yet, only 30% strongly agreed that they feel comfortable reporting unethical behaviour. The overall agree category amounted to 54%. Reasons for the discomfort may be found in the fact that of those who had reported unethical behaviour, only 22% strongly agreed that it was easy to report unethical behaviour (the overall agree category amounted to 36%), while only 16% strongly agreed that the leadership took positive steps when they reported unethical behaviour (the overall agree category amounted to 33%)
- Of grave concern is the fact that 15% strongly agreed that they had been intimidated for doing the right thing (the overall agree category amounted to 24%) and 9% reported that they feared for their lives for reporting unethical behaviour (the overall agree category amounted to 15%).
- It is notable that when comparing the results in the public vs private sectors, it is clear that the sentiment of the CAEs in the public sector is much less optimistic than that of their counterparts in the private sector. Apart from Metro municipalities, less than 50% of CAEs in all the public sector entities agreed strongly that ethics is an important part of the organisational culture. The most notable changes in the percentage of CAEs strongly agreeing that ethics is an important part of the culture, compared to the 2016 results are in the metro municipalities (up from 33% to 60%), the district municipalities (down from 20% to 0) and non-profit companies (up from 33% to 57%).

RESULTS PER DIMENSION

COMPLIANCE

Typical question: Your oversight body ensures continual monitoring of the regulatory environment and compliance with relevant legislation, regulation standards?

Figure 6: Breakdown of various responses

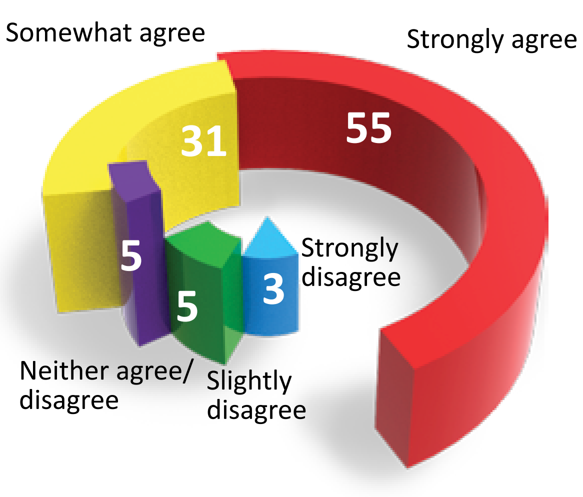
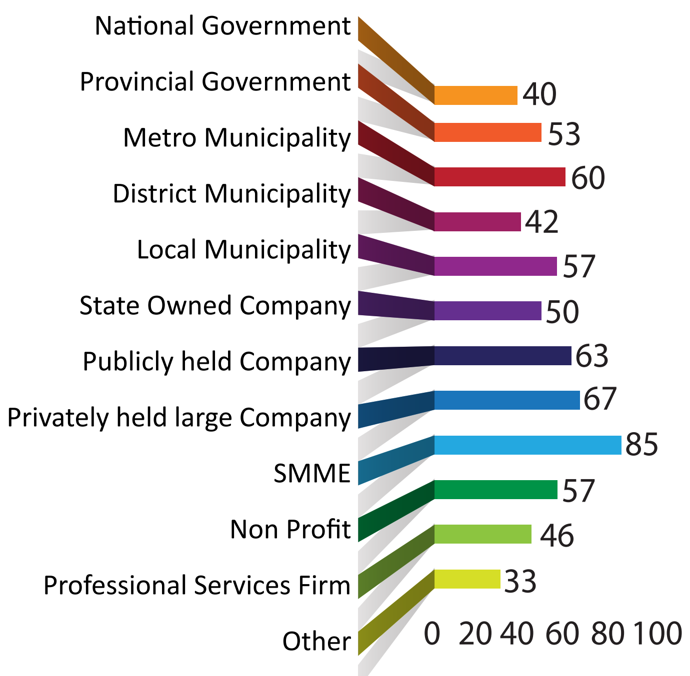


Figure 7: Respondents who strongly agree (% per sector)



There is a slight improvement in the percentage of CAEs who strongly agreed with this statement, i.e. 55% against 52% in 2016. The percentage of those who agreed somewhat have however decreased from 36% to 31%, bringing the combined agreed responses down by 3%. There have not been significant movements in this category during the life cycle of the Index.
It is to be expected that some industries, such as the financial services sector, would carry a greater compliance burden. The cost of compliance can make leaders feel like they are wasting money and effort that should be spent on production and services. Tom Thompson (2015), gives the following advice to organisations needing to lighten the load of compliance cost:

- “Identifying regulatory elements that are common to various compliance requirements and addressing them in an integrated approach.
- Mapping regulatory requirements against the organisation's internal policies and processes.
- Leveraging off technology, in particular advanced analytics.
- Ensuring that the staff undergo training on new and existing rules as this would assist in the organisation staying abreast.
- Organisations should rethink their business model and reorganise people, processes and technology to mitigate against compliance risk.
- Compare the cost of non-compliance to the cost of compliance. While the cost of compliance may be high and seen as an unnecessary burden, the cost of non-compliance could be far worse”.

In this dimension, the CAEs were also asked whether their organisations go beyond a tick box exercise in terms of corporate governance, i.e. that there is a deep understanding of and commitment to implementing the principles and philosophy of good governance. Only 34% of the CAEs strongly agreed, with 42% agreeing somewhat. It is only when the principles are truly understood that organisations move beyond a tick box exercise, with governance no longer being a grudge compliance. King IV particularly tries to address this notion by having moved to an apply-and-explain, based on principles, requirement, which is intended to motivate the leadership to apply their minds around the governance principles and not just tick boxes around rules.

The most significant changes in the percentage of CAEs strongly agreeing that the oversight body ensures continual monitoring of the regulatory environment and compliance with the relevant legislation and regulations standards, when comparing the sector results against the 2016 ratings, have been in provincial government (up from 30% to 53%) district municipalities (down from 80% to 42%), local municipalities (up from 45% to 57%) and SMMEs (up from 50% to 85%)

RESULTS PER DIMENSION

LEADERSHIP

Typical question: The Leadership is familiar with and utilises all the Integrated Reporting principles in the organisation's value creation process.

Figure 8: Breakdown of various responses

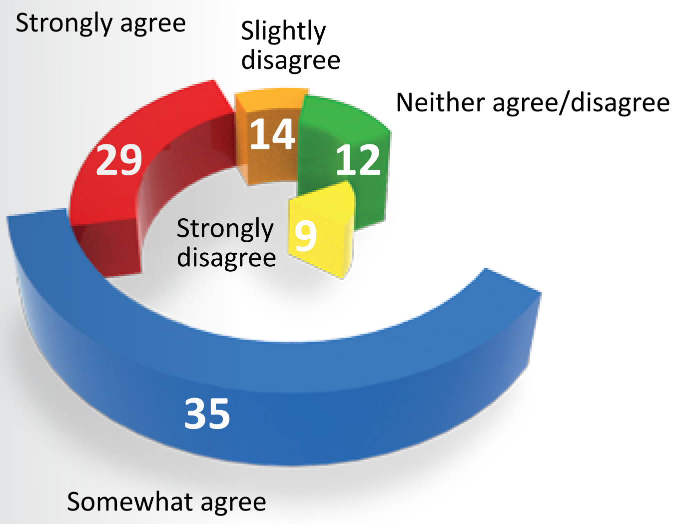
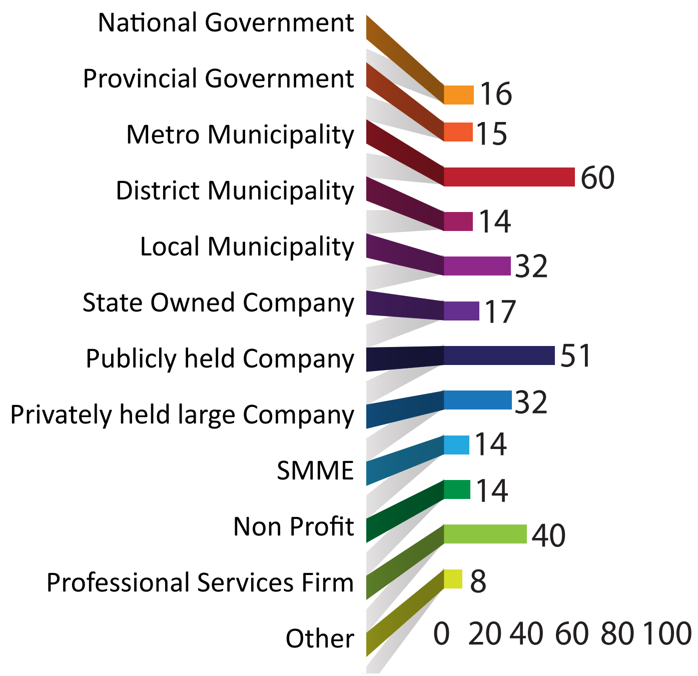


Figure 9: Respondents who strongly agree (% per sector)



This category is a new addition as a result of the alignment of the Index to King IV. The Integrated Reporting concept was first crystallised in South Africa, but is still a relatively new concept. It is therefore reasonable to expect that the responses would not yet be very positive. As could be expected, publically held companies are ahead of most in adopting Integrated Reporting. JSE listed companies started releasing Integrated Reports in 2010/2011, from where it spread to other sectors. It is however noteworthy that the highest percentage of CAEs strongly agreeing are in metro municipalities. As this category is new, no comparative data exist yet. It is however a crucial element highlighted in King IV and should be monitored going forward.

Lessons learnt in the last number of years where organisations could improve their Integrated Reports include (Leigh Roberts, July 2017):

- Disclosing the outcomes of the organisation's products, services and business activities. Organisations should disclose the positive and negative consequences on the six capitals, i.e. whether each of the capitals have increased or decreased respectively.
- More attention should be given to disclosures around governance. This includes information on the board's composition and skills, the committees and major issues discussed during the year.
- Disclosure of performance against strategic objectives. Roberts reports that public sector organisations often fare better in the area than their counterparts in the private sector. This is primarily a result of public sector entities traditionally focusing on performance against non-financial targets.
- Greater balance is needed as many organisations tend to only focus on the positive and do not contemplate in the report what the organisation is doing to mitigate against the negative.

After the question on Integrated Reporting, which is a new area that needs to be given some time to develop, the other new area in the Leadership dimension where the second lowest percentage of CAEs strongly agreed is whether there is effective collaboration among the organisation's oversight committees (41%), followed by whether there is a balanced distribution of power among the organisation's oversight committees (43%), which is also a newcomer to the Index as a result of alignment with King IV.

RISK MANAGEMENT
OPERATIONAL RISK

Typical question: The process for identifying and managing risks is adequate and aligned to your organisation's strategic objectives?

Figure 10: Breakdown of various responses (%)

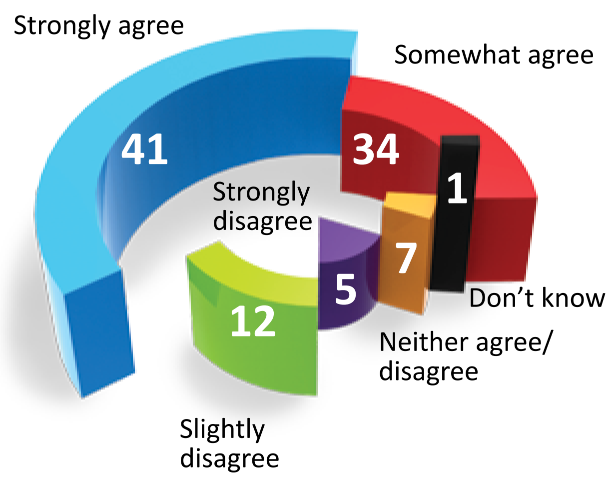
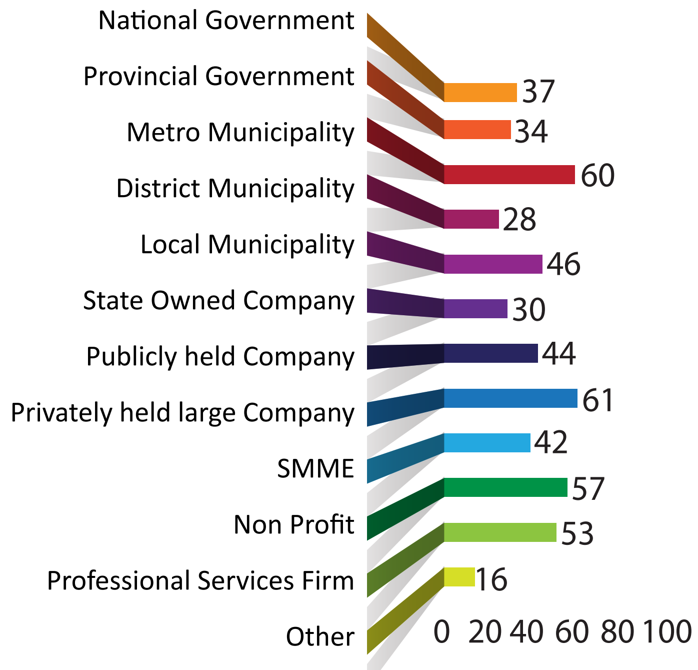


Figure 11: Respondents who strongly agree (% per sector)



As organisations have to navigate through a world of volatility, uncertainty, complexity and ambiguity (VUCA), it naturally translates into increasing complexity within the organisation, which in turn affects the ability to manage operational risk effectively. In the 2016 questionnaire the question around the process of identification and the process of managing risk were in two separate questions with the percentage of CAEs strongly agreeing being 35% and 46% respectively. Sentiment appears to have become somewhat less positive.

A new question that was added to this dimension is whether the leadership gives adequate attention to the opportunities, risks and disruptions associated with advances in technology and information. Only 31% of the CAEs strongly agreed with 41% agreeing somewhat. This seems to be somewhat correlated with the ICT alignment with strategy question in the Performance dimension where 33% of the CAEs strongly agreed that the ICT strategy is aligned to the strategic objectives of the organisation.

The obvious benefits of operational risk management include prevention of losses and objectives not achieved, optimal use of capitals, process improvements, lowering operating costs and costs of funds as well as better decision making. Establishing a risk centric culture in which each employee is risk conscious and take responsibility for the identification and mitigation of risks in their respective areas is therefore an important leadership function.

Modern analysis tools, business modelling and access to information in global networks make it easier for organisations to manage operational risks. Integrated thinking in a culture of openness and sharing of information is key.

When comparing the results on the question whether the process for identifying and managing risks is adequate and aligned to the organisation's strategic objectives to the 2016 question whether the process of managing risks within the organisation is adequate, significant increases in the percentage of CAEs strongly agreeing is observed across most sectors. The most significant increases are seen in national government (up from 15% to 37%), provincial government (up from 15% to 34%), metro municipalities (up from 30% to 60%), district municipalities (up from 0 to 28%), local municipalities (up from 23% to 46%), privately held large companies (up from 29% to 61%), SMMEs (up from 25% to 42%), non-profit companies (up from 11% to 57%) and professional services firms (up from 27% to 26%). The significant improvement may partially be ascribed to the re-wording of the question, but most likely also due to organisations being faced with more VUCA and therefore compelled to spend more energy on risk management.

RISK MANAGEMENT
EXTERNAL RISK

Typical question: Your organisation continually considers multiple potential futures to ensure an adaptive strategy to mitigate against unexpected external risks that may arise beyond the boundaries within which the organisation operates

Figure 12: Breakdown of various responses

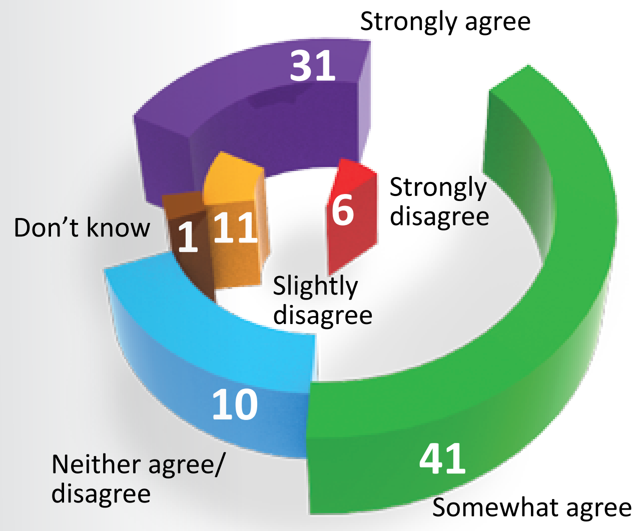
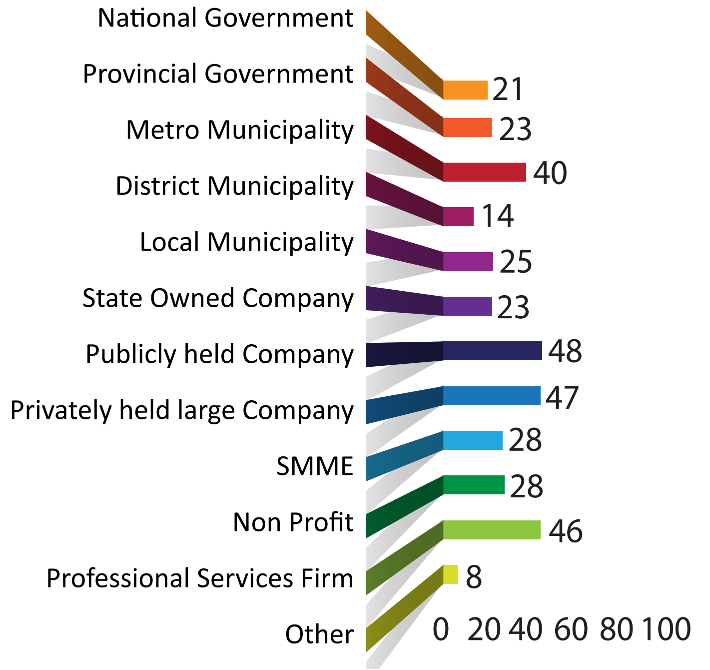


Figure 13: Respondents who strongly agree (% per sector)



A number of recent events have proven that it has become increasingly more difficult to predict the outcome of even immediate future events. The #Gupta leaks are an example of how quickly a new external risk may materialise. Most of the organisations who had distanced themselves from KPMG did not realise at the time when the survey for this year was being conducted that they would be facing reputational risk as a result of their association with KPMG. Thus constantly exploring multiple potential outcomes as a result of trends developing in the environment, and ensuring that enough agility is built into the organisation's workforce and systems to quickly adapt to change, are among the key factors the leadership should focus on.
The Institute of Risk Managers South Africa's (IRMSA) 2017 Risk Report highlights the following as South Africa's top five country level risks:

- Increasing corruption. IRMSA reports that this risk has remained the top South African risk for the second time in three years. It is also reported as the fifth highest industry risk level for 2017. The CGI bears this out in the apparent decline in sentiment in the Ethics dimension of this report. It should be noted that if this trend continues, corruption is likely to become endemic. The political noise in the system is not as big a risk as institutions failing as a result of corruption. Reports in the media are pointing to an increasing number of key South African institutions buckling under the weight of corruption. Increasing corruption is likely to affect the poor the most, such as impact on service delivery (including the cost thereof) and increasing inequality.
The sector that seems to be plagued the most by reports of corruption is the public sector. This could however be a result of public accountability demanding more transparency. Recent revelations have, however, started to highlight corruption in the private sector, with the likes of Oakbay, SAP, McKinsey, Bell Pottinger, Trillian, etc. being implicated.
- Fiscal crisis/credit rating downgrades. This risk has already partially materialised in the last year. The Reserve Bank of South Africa highlighted the following risks in its 2017 first edition of it Financial Stability Review:
  - » Further credit rating downgrades is flagged as a high risk with a significant impact on financial stability in South Africa. Exclusion from major global bond indices and sovereign ceiling downgrades inevitably lead to higher cost of and reduced access to funding. It also means more expensive funding for banks and reduced credit to the private sector.
  - » Headwinds for the South African financial system is flagged as a medium risk with medium impact on financial stability. Factors that spill over to the banking sector include higher unemployment, low growth in disposable income and individual and corporate debt positions.

- » Policy uncertainty in the USA is flagged as a medium risk for South Africa with medium impact. Factors that could impact on spill overs to South Africa include capital outflows, exchange rate volatility and increased funding and credit risks.
- » Financial systems vulnerability is flagged as medium risk for South Africa with medium impact. Slower global growth and higher financial market volatility have implications for domestic monetary policy.
- Increasing strike action. With a country that has seen increasing inequality, it is unlikely that this risk will minimise soon. This is further aggravated by disparity of salaries that runs along racial lines as a result of the South African historical context and poor education and training. Increasing strike action may often result in higher wages for workers, but may on the other hand contribute to instability in the country as well as a situation where unionised workers are secure with the unintended potential consequence of millions being prevented from entering the job market as a result.
- Profound political and social instability. The uncertainty created by infighting in the governing party is one of the greatest contributing factors to this risk materialising. This coupled with lack of quality service delivery in many parts of the country, slow transformation in the private sector, increasing corruption and increasing youth unemployment creates a recipe for political and social instability. The global analysts Eurasia Group has listed South Africa's political crisis among the 10 political events that may lead to a breakdown in international relations.
- Governance failure. A tick box approach to governance is one of the root causes of governance failures. Only 34% of the CAEs surveyed for the CGI strongly agreed that their organisations go beyond a mere tick box exercise when it comes to governance. Where there is no real deep understanding of and commitment to implementing the principles and philosophy of good governance, a real risk exists that governance will fail. In a society where financial success is more important for the majority than doing the right thing, the likelihood of the risk materialising is high.

As with Operational Risk, this dimension has also seen significant improvement in the percentage of CAEs strongly agreeing that the organisations continually consider multiple futures to ensure an adaptive strategy to mitigate unexpected external risks that may arise beyond the boundaries within which the organisation operates. The question was slightly rephrased from the previous years and that could have contributed to the improvement in sentiment. The question was previously phrased as: your organisation utilises scenario planning to mitigate against unexpected external risks that may arise well beyond the boundaries in which the organisation operates. The most notable changes in the percentages of CAEs strongly agreeing are national government (up from 10% to 21%), provincial government (up from 5% to 23%), metro municipalities (up from 17% to 40%), district municipalities (up from 0 to 14%), local municipalities (up from 14% to 25%), publically held companies (up from 14% to 48%), privately held companies (up from 18% to 47%), SMMEs (up from 12% to 28%) professional services firms (up from 20% to 46%).

Typical question: The information, communication and technology strategy is aligned to the strategic objectives of your organisation?

Figure 14: Breakdown of various responses

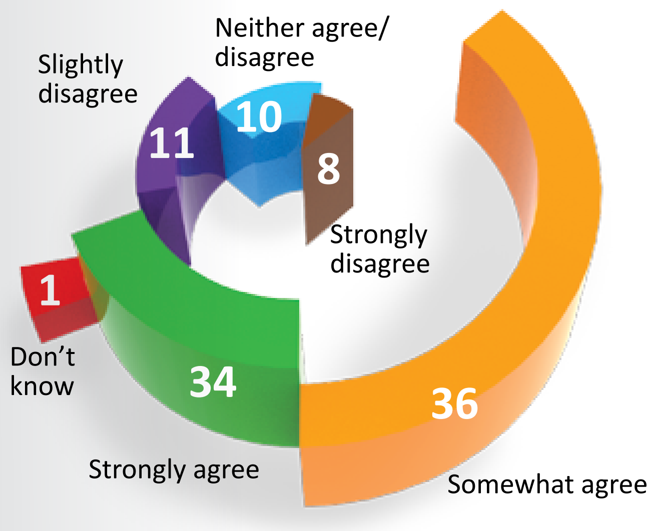
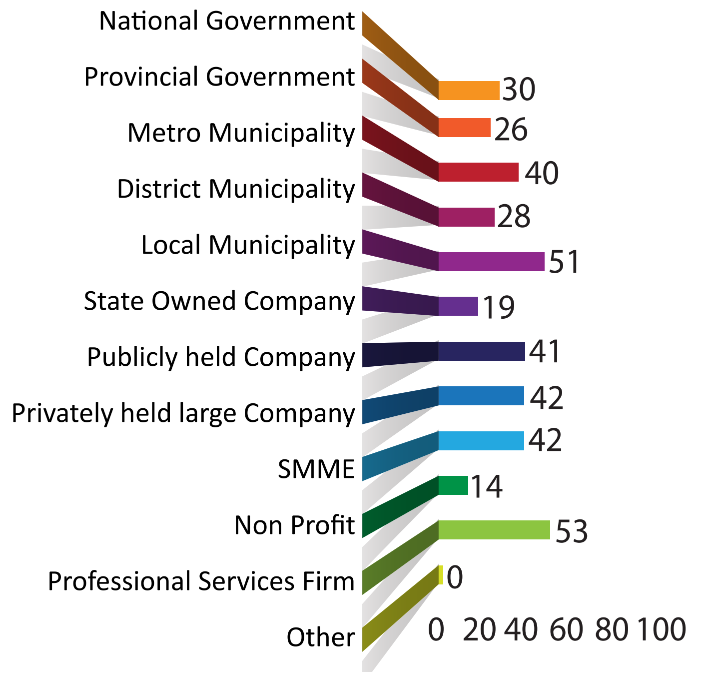


Figure 15: Respondents who strongly agree (% per sector)



There is a slight increase in the percentage of CAEs strongly agreeing that the ICT strategy is aligned to the organisation's objectives when compared to the 2016 results, 34% vs 31%. The somewhat agree percentage has however dropped from 42% in 2016 to 36%. Thus the overall agree responses have dropped by 3%. This does not bode well in an environment where technology should be a crucial part of business. Leaders have to stay abreast of the pace at which technology is advancing in order to ensure that their organisations survive in the midst of the fourth industrial revolution. The revolution is evolving at an exponential rate and creating disruptions in almost all industries. Organisations that do not ensure that they stay abreast and evolve may very well not survive over the long term.

Gartner Inc., a leading research and advisory company, lists the top 2017 technology trends as:

- Artificial intelligence (AI) and advanced machine learning. It is predicted that this technology trend will increasingly extend and augment virtually technology enabled services, things or applications
- Intelligent apps. This includes technologies like virtual personal assistants and has the potential to transform the workplace. Gartner expects that most of the world's largest 200 companies will exploit intelligent apps and utilise the full toolkit of big data and analytics tools to redefine their offers as well as improve customer experience.
- Intelligent things. The main categories are robots, autonomous vehicles, drones and Internet of Things (IoT) devices. Empowered by AI, these devices are expected to be everywhere from homes to offices, medical facilities etc.
- Digital. The digital world is creating new opportunities as it continues to blur with the physical world.
- Virtual and augmented reality. This technology will transform how individuals interact with one another and it provides the platform for remote experiences.
- Digital twins. This refers to a digital model of a physical thing or system and can be used to analyse and simulate real life conditions.
- Blockchain. It refers to a type of distributed ledger in which value exchange transactions are sequentially grouped in blocks and thus provides transparent access to information in the chain.
- Conversational system. This refers to a shift where computers "hear" and adapt to a person's desired outcome. It enables people and machines to use multiple modalities to communicate across the digital device mesh (dynamic connection of people, processes, things and services supporting intelligent digital ecosystems)
- Mesh App and Service Architecture. This is a multichannel solution architecture that leverages technologies such as cloud and server less computing to deliver modular, flexible and dynamic solutions that support multiple users in multiple roles using multiple devices over multiple networks.
- Digital technology platforms. These are building blocks for digital businesses. Gartner predicts that every organisation will have some mix of the five digital technology platforms, namely information systems, customer experience, analytics and intelligence, the Internet of Things and business ecosystems.
- Adaptive security architecture. Security in the Internet of Things is a challenge pointing to a need for fluid and adaptive security. Gartner thus predicts that multi-layered security and the use of user and entity behaviour analytics will become a requirement for just about all enterprises.

The sectors that have seen a significant change in the percentage of CAEs strongly agreeing that the ICT strategy is aligned to the strategic objectives of the organisation are local municipalities (up from 27% to 51%), professional services firms (up from 27% to 53%) and publically held companies (down from 47% to 41%. Although the drop is not very significant in terms of size of percentage, the fact that it has dropped is a concern given the current context).

PERFORMANCE

HUMAN CAPITAL

Typical question: Your organisation has suitable human resource capital to execute its strategy effectively and optimally?

Figure 16: Breakdown of responses

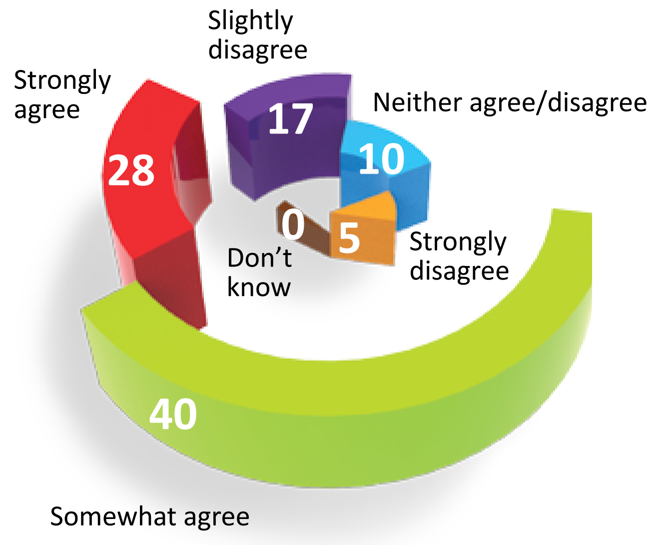
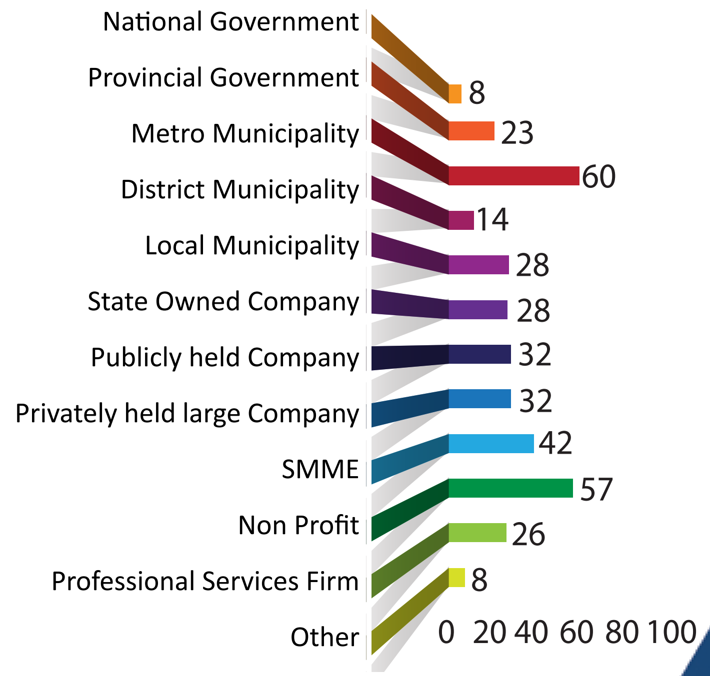


Figure 17: Respondents who strongly agree (% per sector)



The skills shortage in South Africa has been a long standing challenge across all sectors and has its roots in an inferior education system to which the majority of South Africans had been subjected. South Africa's global competitiveness largely depends on the rate at which South Africans are upskilled. The slight increase in sentiment is therefore heartening, although a far cry from what is needed to make meaningful progress. The 28% of CAEs strongly agreeing that the organisation has suitable human resource capital to execute its strategy effectively and optimally, is a slightly better result than the 26% in 2016, but still a significant drop from 2015 when it was 46%.

Current contributions to the skills shortage include lack of access to quality education for the poor, an education system that it is not attuned to the needs of industry and is not focused on creating a future fit workforce.

Changes predicted for the future workforce may alleviate the challenges organisations face in the talent for war in an environment where there is a shortage of skills, but does not bode well for a South Africa that has vast numbers of unskilled or under-skilled people. Desere Kokt, writing for the South African Board for People Practices, maintains that there is an increasing move toward an 'open talent economy' due to digitalisation and virtualisation in the workplace. This implies that organisations would be able to source talent from other parts of the world without having to deal with the hurdle of relocation costs.

The following have been listed as the top scarce and critical skills in South Africa by the Department of Labour (TeenZone, 2017):

- Air Traffic Controllers
- Aircraft pilots
- Application programmer
- Architects
- Biologist, Botanists, Zoologists
- Building architects
- Cardiologists
- Cartographers and surveyors
- Chartered Accountants
- Chemical and physical science technicians
- Chemists
- Critical care specialists
- Dentists
- Economists
- Electronic engineers and technicians
- Engineers: Civil, Chemical, Electrical, Environmental, industrial, mechanical, mining, production, water.
- Environmental and Occupational health inspector
- Financial analysts
- Financial and investment advisors
- Geologists and geophysicists
- Judges
- Legislators
- Mathematicians, Actuaries and statisticians
- Medical doctors and practitioners
- Metallurgists
- Meteorologist
- Neurosurgeons
- Nursing and Midwifery professionals
- Oncologists
- Paramedic practitioners
- Philosophers, Historians and Political Scientists
- Physicists and astronomers
- Process Control Technicians
- Radiologists
- Sociologist, anthropologists
- Software Applicants, Web and Multimedia Developers
- System Analysts
- Teachers: Maths and science
- Telecommunications engineers
- Urologists
- Veterinarians

As with previous years the area in the Performance dimension where the lowest percentage of CAEs strongly agreed is on the question of whether the organisation's human resource capital is optimally used, albeit there being an improvement from 19% in 2016 to 24% in 2017. Despite the improvement, this area remains a concern. Neck on neck in the categories where the second lowest percentage of CAEs strongly agree are on the questions whether the organisation has suitable human resource capital to execute its strategy effective and optimally (28% against 26% in 2016%) and whether the organisation's output/delivery is at optimal level given its resources (28% against 20% in 2016).

A new comer to the Performance dimension where there is significant room for improvement is the question on whether the leadership ensures that integrated thinking is integral in the structures and processes that the organisation utilises in delivering on its strategy. Only 30% of the CAEs strongly agreed, with 35% agreeing somewhat. Integrated thinking leads to better decision making in the value creation process as it provides for the active process of considering the relationships among the various functions, resources, information systems and governance structures, which in turn leads to sustainability. As organisations have to deal with increasing complexity, leaders would do well in firstly ensuring that they understand what integrated thinking is and then ensuring that the factors that hinder integrated thinking from taking place are removed, while actively work toward making it an essential element in the DNA of the culture.

ASSURANCE

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 18: Breakdown of responses (%)

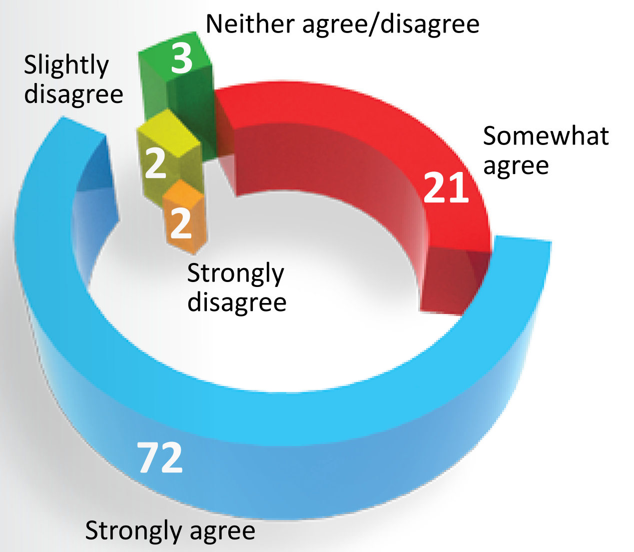
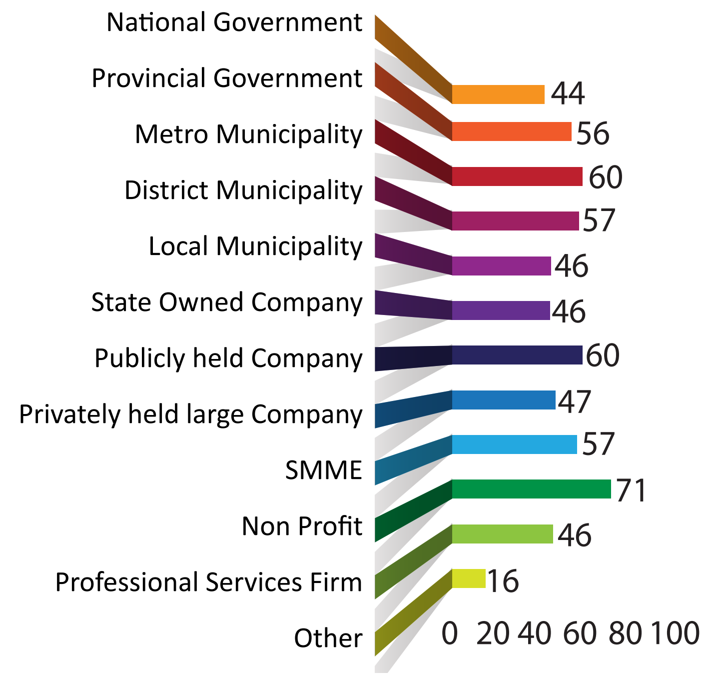


Figure 19: Respondents who strongly agree (% per sector)



Given the current climate of constant reports of corruption in South Africa, the 72% of CAEs strongly agreeing that internal audit has a sufficient degree of independence is heartening, especially as this percentage is an increase over the 67% in 2016. Despite this good result, the sentiment is much less optimistic when CAEs were asked whether the leadership in their organisations display a good understanding of the varying roles of assurance providers, including internal audit, with only 40% strongly agreeing and 41% agreeing somewhat. When asked whether they believed that internal audit has adequate resources to enable it to execute its duties effectively only 41% strongly agree with 30% agreeing somewhat.

In order to ensure that real value is extracted from the presence of internal audit in the organisation, it is imperative that the leadership understands the role and mandate of internal audit, while ensuring that it is adequately resourced.

MAIN FINDINGS

Our key research findings are:

1. The **Country Index** increased by 3.4% in the past three years from a steady rating of 2.9 to a 3.0. This, however should not be perceived as an overall indication of a positive result and should not be an indication or perception that Corporate Governance in South Africa is indeed stable and not on the decline. It should rather be seen and noted that in certain dimensions and certain economic sectors Corporate Governance has indeed improved but in other sectors and dimensions the decline in governance ratings is a concern for South African organisations.
2. **External Risk** has seen the biggest improvement with **Performance** as a second most improved dimension. This is a positive shift towards a more forward thinking approach to Corporate Governance procedures and standards within organisations.
3. Notable is the decline in **Assurance** and **Ethics** ratings particularly around issues of leadership and setting the tone at the top for the entrenchment of ethical cultures in organisations.
4. **Operational Risk** has had a steady rating with the scoring remaining at 2.9 for the past three years. CAE's are indicating that organisations are starting to prioritise risk management strategies.
5. Slight improvements were found in the leadership and compliance dimensions. This despite new areas having been brought into the leadership dimension.
6. The **top** 3 **areas of focus** indicated by the open ended question reveals that in their organisations, CAE's are concerned about Financial Capital, Compliance with Regulations and Legislative changes, and Fraud and Corruption. This was also top of mind for the improvement and development of the profession. We take this as a positive outlook and view for the future sustainability of the profession.

THE WAY FORWARD

King IV has now been through its first year of implementation. It is therefore expected that there would be a steady increase in the full adoption of all the principles and recommended practices across all industries. The Institute of Directors had taken a careful approach to ensure that all sectors were included in the process of drafting King IV and that its applicability would extend across the board, with no exceptions.

The CGI will therefore track the adoption of the principles through the views of CAEs on the state of governance in their organisations. The CGI therefore remains a valuable tool for organisations to benchmark themselves against as well as initiate meaningful conversations around the highlighted governance principles.

With South Africa being in a perfect storm of political uncertainty, an adverse economic climate, social unrest, credit ratings downgrades and increasing inequality, it is more urgent than ever that the leaders in organisations ensure that good governance principles are adhered to, chief among those is building an ethical culture. This of course means that internal auditors should be more vigilant and ensure that their audit plans are crafted to put the spotlight on the important issues that lead to well governed organisations.

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

ETHICS Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
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	4	3	2	23	68	0
Ethics is an important part of your organisational culture	3	6	5	32	53	0
Your organisation has a social and ethics committee or similar structure in place that goes beyond mere compliance and reports on organisation ethics, corporate responsibility	15	11	9	28	37	1
Your oversight / governing body ensures that there are measures in place that enable the organisation to remunerate fairly, responsibly and transparently	4	9	10	31	46	0

COMPLIANCE Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
When it comes to corporate governance, your organisation goes beyond a tick box exercise - i.e. there is a deep understanding of and commitment to implementing the principles and philosophy of good governance	5	10	9	42	34	0
Your oversight / governing body ensures continual monitoring of the regulatory environment and compliance with relevant legislation, regulation and standards	3	5	5	32	55	0

LEADERSHIP Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
Your Oversight / governing body provides clear strategic direction with the focus on long term sustainability rather than short term thinking to achieve the desired outcomes of your organisation	4	7	6	33	49	0
The leadership is familiar with and utilises all the integrated reporting principles in the organisation's value creation process	9	14	12	35	29	1
Members of your oversight / governing body are adequately diverse and skilled and act with independence of mind, in the best interest of the organisation	5	7	6	32	50	0

LEADERSHIP(CONTINUED)

Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
The composition, roles and responsibilities of your oversight / governing body and its committees are appropriate with minimal overlap and fragmentation of duties	5	5	4	39	47	0
There is effective collaboration among your organisation's oversight committees	4	9	9	38	41	0
There is a balanced distribution of power among your organisation's oversight committees	5	10	6	37	43	1
Your audit committee is effective in all the dimensions within the ambit of its responsibilities	5	7	4	30	54	1

PERFORMANCE

Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
Your organisation's executive team is functioning optimally in delivering against the strategy of the organisation	4	12	7	38	39	0
Your oversight / governing body has adopted a stakeholder inclusive approach that considers the impact of its decisions and balances the needs and interests of its stakeholders	3	8	11	37	37	2
Your oversight / governing body has adequate processes in place to measure and improve its own performance and adherence to governance principles as well as that of its Chair, committees and individual members	4	10	9	37	39	1
Your oversight / governing body ensures accountability of organisational performance through accurate reporting and disclosure to the organisation's stakeholders	4	6	7	31	52	1
The Information Communication Technology (ITC) strategy is aligned to the strategic objectives of your organisation	8	11	11	36	33	1
Your organisation has suitable human resource capital to execute its strategy effectively and optimally	5	17	10	40	28	0
Your organisation's human resource capital is optimally utilised	10	20	11	35	24	1
Your organisation utilises its financial capital optimally (i.e. managing finances) so as to achieve the best possible sustainable outcomes	6	11	8	34	40	1
Given its current resources your organisation's output / delivery is at optimal level	8	17	9	37	28	1
The leadership ensures that integrated thinking is integral in the structures and processes that the organisation utilises in delivering on its strategy	6	12	16	35	30	0

OPERATIONAL RISK

Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
The process for identifying and managing risks is adequate and aligned to your organisation's strategic objectives	5	12	7	34	42	0
The leadership gives adequate attention to the opportunities, risks and disruptions associated with advances in technology and information	6	9	13	41	31	0

EXTERNAL RISK

Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
Your organisation continually considers multiple potential futures to ensure an adaptive strategy to mitigate against unexpected external risks, that may arise beyond the boundaries within which the organisation operates	6	11	10	40	31	1

ASSURANCE

Questions

	Strongly disagree	Slightly disagree	Neither agree/ disagree	Somewhat agree	Strongly agree	Don't know
The leadership in your organisation (i.e. senior and executive management as well as the oversight/governing body) displays a good understanding of the varying roles of assurance providers. (Such as internal audit, external audit, risk management, etc.).	5	8	7	41	40	0
Your organisation uses a combined assurance framework to provide a coordinated approach to assurance activities	8	11	10	33	37	0
Within your organisation, internal audit has a sufficient degree of independence to enable it to execute its duties without undue influence or interference	2	3	3	21	72	0
Within your organisation, internal audit has adequate resources to enable it to execute its duties effectively	10	13	5	30	41	0

MULTIMEDIA

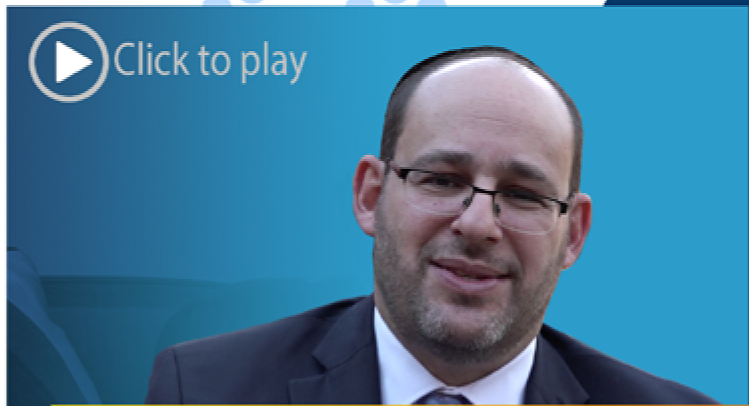
Thembekile Kimi Makwetu
Auditor-General of South Africa

Hester Hickey - *Executive Board Director Institute of Directors South Africa*

Solly Tshepiso Msimanga
Executive Mayor City of Tshwane

Parmi Natesan - *Governance Executive Institute of Directors South Africa*

Professor Wiseman Nkuhlu
Chancellor University of Pretoria



Rabbi Gideon Pogrund
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- Karin Barac
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