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THE DISCLOSURE OF CORPORATE GOVERNANCE: A TICK-BOX EXERCISE OR NOT?

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─Abstract─

The King Committee published the first King Report on corporate governance in 1994. The King II and III Reports, implemented in 2002 and 2010 respectively, placed progressively more emphasis on proper disclosure of corporate governance practices. King IV, published in 2016, strives to encourage management to focus on governance and not regard it as mindless compliance. Different stakeholders raised concerns that the continued corporate scandals could be, on a large scale, attributed to shortcomings in corporate governance practices. One of the objectives of King IV is to promote corporate governance as an integral part of effective management.

The aim of this study is to assess whether the disclosure on governance, by selected Johannesburg Stock Exchange (JSE)-listed companies, is sufficient to confirm to users of financial statements that sound corporate governance is a priority in these companies. A documentary review of the latest governance reports of these companies was done to evaluate compliance with the King IV principles in general.

The results indicated that all of these companies disclosed that they are in general complying with the 17 principles of King IV; however, the ongoing global and local corporate failures may be an indication that sound corporate governance is not a priority, but is still dealt with as a "tick-box" exercise.

The recommendation from this study is that boards of directors should be held accountable for setting practices and strategies that are aligned with the King codes, to ensure effective management and control of business entities.

Keywords: Corporate governance disclosure, JSE-listed companies, King II, King III, King IV

JEL Classification: G34

1. INTRODUCTION

The ongoing large corporate failures serve as a primary argument for the successful implementation of sound corporate governance principles and practices, followed by the effective disclosure thereof in the annual reports of companies. The Institute of Directors in South Africa (IoDSA) tasked retired judge, Mervyn King to lead a team of experts to develop the King Reports of corporate governance for South Africa. This exercise spanned over a timeframe of more than 20 years, beginning with the introduction of King I in 1994, King II in 2002, King III in 2009 and the latest, King IV in 2016. These codes reiterated the fact that sound corporate governance practices are an indispensable part of effective management. Naudé et al. (2018) defined corporate governance as the "system whereby business organisations are directed and controlled." It is therefore important that basic governance principles such as accountability and business ethics inform board processes. King IV emphasises that transparency and accountability are equally important, which necessitates the disclosure of not only what has been done, but also the thinking behind it (IoDSA, 2018). It is therefore up to the shareholders and other stakeholders, including regulators, to hold boards accountable for the implementation of good governance.

Van Vuuren (2006 and 2016) revealed in previous studies that the failure of several large companies could possibly have been prevented if sound corporate governance practices were in place. Kirkpatrick (2009) recognised that the serious global financial crisis of 2008/2009 could largely be attributed to deficiencies in corporate governance practices. The Organisation for Economic Co-operation and Development (OECD, 2014) reported that high-profile corporate failures such as Enron, WorldCom and Saambou Bank were partially the result of inadequate corporate governance practices. Modiha (2018) opines that if good corporate governance principles were embedded within an organisation, these corporate scandals would not have occurred. He further states that these failures are an indication of serious deficiencies in most organisations' governance practices.

All these companies appeared to have complied with all listing and legal requirements, which may have resulted in a false sense of security regarding their compliance with good governance practices. These collapses, among others, resulted in a renewed interest in corporate governance globally. The OECD

(2014) suggests that, although effective corporate governance practices by itself may possibly not have prevented these collapses, it could have at least reduced the catastrophic impact of these failures. IoDSA (2018) states that the ongoing recent corporate scandals stimulated renewed focus on the role of directors and the significance of sound governance If corporate governance is treated as a "tick-box" exercise without it being underpinned by an ethical commitment of done all stakeholders, it merely becomes lip service as to the effectiveness thereof.

The aim of this study is thus, to determine if selected JSE-listed companies disclosed their compliance to the principles outlined by King IV (Table 1) in such a manner, that users of the annual reports are assured that sound corporate governance is a priority in the company. This is done to determine if corporate governance disclosure is merely a "tick-box" exercise in order to comply with JSE listing requirements.

1.1. The background and aim of the King Reports of corporate governance

The four King Reports on corporate governance, developed by IoDSA, have the objective to formalise the implementation and disclosure of effective corporate governance practices. The first code (King I) became effective in 1994 and aimed to institutionalise corporate governance (IoDSA, 2002). King II expanded on King I and became effective in 2002. Most of the principles included in King II were incorporated into the SA Companies Act of 2008 (IoDSA, 2009); where-after King III was developed and introduced in 2009. The latter embraced a "risk-centric approach" to corporate governance (SAICA, 2013) and King III continued to put South Africa in the lead on the development of pioneering governance principles internationally (IoDSA, 2009). King IV was introduced in 2016 and an "outcome-based" approach was followed. As the King Codes recognise that ethics is a choice, it always has been a voluntary code (IoDSA, 2018), which is in contrast with set laws. A voluntary code like King strives to set out the principles and best practices that organisations with a true desire to achieve good governance should follow (IoDSA, 2018). Despite the fact that compliance with the King Code is voluntary, it is a mandatory requirement for all JSE-listed companies to comply with and report on King IV (JSE, 2011, 2017).

The principle-based King III report on governance for South Africa required more detailed corporate governance disclosure; but it also allowed more flexibility for the board of directors to deviate from the recommendations of the King Report, providing that such deviations were explained in their annual report. The reason for this flexibility was to allow boards of directors to implement best practices for

the particular business, as opposed to a mindless adherence to each and every recommendation of the report (IoDSA:2009). This freedom to deviate from the recommendations in the report, however, resulted in the implementation of King III to become a "tick-box" exercise. A possible reason for this could be that King III has 75 principles, which made it very exhaustive for companies to implement and monitor, while King IV took a different structural approach by boiling down good governance into 17 simplified principles (Table 1). One of the objectives for the reduced principles was in fact to prevent another "tick-box" exercise, as King IV demands a mindful application of the code, as opposed to a compliance exercise (PWC, 2016). King IV requires entities to comply with the recommendations of the report and explain on what grounds it can state, with reasonable certainty, that the entity practices good governance.

These 17 principles are complimented with guidance on recommended disclosure practices under each of the principles, which serves as the starting point for disclosure. The detail of these disclosures should be steered by materiality, with the objective to equip stakeholders with the necessary information to make a well-educated assessment of the quality of an organisation's governance (IoDSA, 2016). It is important to note that, although King IV requires detail disclosures and explanations on the compliance to the 17 principles, it does not require disclosure on the implementation of each practice. King IV, therefore, offers flexibility and aids companies to achieve good corporate governance in ways that are appropriate to their specific conditions without undue constraint. Full compliance with the King Reports could assist governing bodies with the protection of the entity against unreasonable risk-taking, as well as preserving the survival, sustainability and wealth of the entity for all stakeholders. King IV also has an enhanced focus on stakeholder inclusion and disclosure. This emphasises the fact that the disclosure of corporate governance practices, is still very important for effective corporate governance, transparency and sustainability.

1.2. Corporate governance disclosure

The OECD (2017) explains that effective corporate governance plays a crucial role "in underpinning the integrity and efficiency of financial markets." Ineffective corporate governance diminishes a company's potential to be successful, while well-governed entities will attract good investments in the entity, which will in return ensure sustainability and growth. King III refers to corporate governance as a set of practices in an entity to ensure "fairness, accountability and transparency" for all its stakeholders (IoDSA, 2009). Effective corporate governance practices are critical to strengthen access to external capital

and continued advancement in an entity's performance, which will result in sustainable economic development and growth. King IV defines corporate governance as the exercising of ethical and effective leadership, to achieve an "ethical culture, good performance, effective control and legitimacy" for the entity, (IoDSA, 2016).

The International Finance Corporation (IFC, 2013) concluded that effective corporate governance structures assist entities in conducting better business, better access to funding, improving their risk-mitigation strategies and protecting the entity against mismanagement. Konstans et al. (2011) conclude that corporate governance is essential for the long-term prosperity of stakeholders. Abor and Adjasi (2007) refer to corporate governance as the processes that are in place to manage the organisation while optimising wealth and accountability, with a focus on long-term value creation for all stakeholders. Van Vuuren (2016) opined that corporate governance is thus an indication of management's quality and efficiency, with reference to accountability, leadership, risk management and reporting. Madigan (2018) states that good corporate governance should ensure effective use of resources and that accountability is properly assigned.

As stakeholders have to rely on the annual reports of companies to inform them of the effectiveness of corporate governance within the organisation, the proper disclosure of governance principles and practices is pivotal. Previous studies performed by Van Vuuren (2006 & 2016), indicated that there is a contradiction between the very nature of effective corporate governance reporting and the natural instinct of preparers of annual reports to always be positive, resulting in corporate governance reports in certain instances to be too generic and biased. The fact that the majority of the 17 King IV principles (Table 1) address characteristics such as "ethical culture, good performance, effective leadership and legitimacy" (IoDSA, 2016), may result in generic disclosures, as these principles are hard to quantify. Although there are a number of recommended practices under each of the 17 principles, King IV (2016) states that there is no need to disclose whether each practice has been implemented. This may increase the risk of generic and biased disclosures.

Manganye (2019) concludes that, "In an era of trade wars and Brexits, there is a lot to worry about and governance might be falling to the wayside as a result". The author further explains that South Africa is showing increasing signs of declining governance with reference to the recent exposure of seemingly huge shortfalls in governance at large organisations. Natesan and Du Plessis (2019) opined, "It's not what you do, but why, that counts in corporate governance".

They continue to emphasise the importance of good disclosure, in order to confirm to stakeholders that the organisation did what they said they would do and what the results were. Canter (2018) opines that the tick-box assessment of corporate governance practices fails to address the profound measures of sound governance of "governance policy" put into "governance practice". He further states that governance practices should be "principled, robust and sustainable". For this reason, disclosure has become an extremely important element of sound corporate governance in terms of the "apply and explain" approach of King IV.

2. METHODOLOGY

It is a listing requirement that companies with a primary listing on the JSE must adhere to King IV (JSE, 2017) and is therefore representative of this study's population. Judgement sampling was used to select the top 40 companies with a primary listing on the JSE from the top 100 listing as determined by SHARENET (2019). These companies represent a variety of industries in South Africa and are the largest based on market capitalisation (JSE, 2019). The use of market capitalisation as an indicator is justified, as it measures the aggregate value of a company (Investor-Words, 2019). The selected top 40 JSE-listed companies represent 84% of the total market capitalisation of the top 100 JSE-listed companies (excluding companies that do not have a primary listing on the JSE, as these companies are not required to comply with King IV).

As King IV only became effective from 1 April 2017, the most recent annual reports after 1 April 2017 was analysed to determine the level of disclosure on the compliance with the 17 principles of King IV in general. The reason for only evaluating the annual reports for adherence to the 17 principles of King IV and not the underlying practices as well, is because King IV specifically states that there is no need to disclose whether each practice has been implemented or not. A qualitative documentary review was conducted on these annual reports, which was the dominant approach. Swart (2018:12) illustrated that the selected reports are classified as secondary data and a qualitative documentary analysis can be performed, as the secondary data is available in the public domain.

In addition to this review of the annual reports of the selected top 40-JSE listed companies, a literature review was performed on corporate governance and the disclosure thereof. Thereafter a literature review was done on a few companies that suffered financial collapses to determine if corporate governance (or the lack there-of) could have contributed to their demise.

3. RESEARCH FINDINGS AND DISCUSSION

3.1. Findings on the disclosure of the compliance with King IV

The aim of this study was to determine if the selected JSE-listed companies disclosed their compliance to the principles outlined by King IV (Table 1) in such a manner, that it is clear to the users of the annual reports that sound corporate governance is a priority. Although the 17 principles are accompanied by recommended disclosure practices, King IV states that, "there is no need to disclose whether each practice has been implemented or not. For this reason, this study only focused on the disclosure of the compliance with the 17 principles (Table 1) of King IV and not on the disclosure of the recommended practices under each of the principles.

Table 1: 17 Principles of King IV (King IV, IoDSA 2016)

	Principle	% of selected companies that disclosed compliance with the principle
1.	The governing body should lead ethically and effectively.	100%
2.	The governing body should govern the ethics of the organisation in a way that supports the establishment of an ethical culture.	100%
3.	The governing body should ensure that the organisation is and is seen to be a responsible corporate citizen.	100%
4.	The governing body should appreciate that the organisation's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.	100%
5.	The governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation's performance, and its short-, medium- and long-term prospects.	100%
6.	The governing body should serve as the focal point and custodian of corporate governance in the organisation.	100%
7.	The governing body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.	100%

8.	The governing body should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with balance of power and the effective discharge of its duties.	100%
9.	The governing body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.	100%
10.	The governing body should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities.	100%
	Principle	**% of selected companies that disclosed compliance with the principle**
11.	The governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives.	100%
12.	The governing body should govern technology and information in a way that supports the organisation setting and achieving its strategic objectives.	100%
13.	The governing body should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the organisation being ethical and a good corporate citizen.	100%
14.	The governing body should ensure that the organisation remunerates fairly, responsibly and transparently to promote the achievement of strategic objectives and positive outcomes in the short=, medium= and long-term.	100%
15.	The governing body should ensure that assurance services and functions enable an effective control environment and that these support the integrity of information for internal decision-making and of the organisation’s external reports.	100%
16.	In the execution of its governance role and responsibilities, the governing body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.	100%
17.	The governing body of an institutional investor organisation should ensure that responsible investment is practised by the organisation to promote the good governance and the creation of value by the companies in which it invests. (Where applicable).	100%

Source: King IV (IoDSA: 2016)

Table 1 illustrates that all 40 JSE-selected companies disclosed in their latest annual reports that they comply with each of the 17 principles of King IV where applicable. The detail disclosures between the selected companies differ, however King IV is not prescriptive on how much detail should be given as a minimum. It could thus be concluded that JSE-listed companies are disclosing their adherence to the principles of sound corporate governance in accordance with King IV. This finding raises the concerning question that, if these JSE-listed companies disclose that they are adhering to sound corporate governance principles, why is the number of local as well as global corporate failures, which could partially be attributed to inadequate corporate governance practices, showing an increase? A possible explanation might be that compliance is still treated as a "tick-box" exercise. This study focused on JSE-listed companies, however the large corporate scandals all-over the world that could partially be attributed to poor corporate governance, might be an indication that this concern is a global phenomenon. This observation is strengthened by the following case studies:

3.2. South African corporate failures that could partially be attributed to weaknesses in corporate governance practices:

3.2.1. Steinhoff International Holdings N.V. (Steinhoff):

Naudé et al. (2018) indicated that Steinhoff appeared to have always complied with all listing requirements. Therefor it raises the question whether corporate governance might be seen as a "tick-box" exercise. Steinhoff had the following declaration in their annual report for the year ending on 30 September 2016 (the last annual report before their collapse), which strengthens this concern:

"The aim of this annual report is to provide stakeholders with an overview of the approach of the Steinhoff International Holdings N.V. group (the group) to corporate governance, at both group and divisional level, and to demonstrate that the group's businesses and assets across the globe are managed responsibly and in a sustainable manner..." (Steinhoff annual report, 2016).

Before the annual reports for the 2017 year-end could be published, the global business world was shocked by the devastating financial collapse of Steinhoff when the company lost nearly 85% of its market value since the end of 2017 (Rossouw and Styan, 2019). Before its demise, Steinhoff was among the top-10 companies on the JSE, with a market capitalisation of around R300 billion. Their share price fell below R1.50 per share in 2017 from a peak of R96.85 per share on 31 March 2016 (Business Tech, 2017). Full details of the Steinhoff downfall are still transpiring, but it quickly became eminent that corporate governance failure

was a huge contributor to the near-total collapse of this once powerful company. Some conclusions that can already been drawn from Steinhoff, are the risk of too much power in the hands of individuals and the restrictions of a two-tier board. The question to be answered if Steinhoff can ever return to its former pride.

3.2.2. Tongaat Hulett Ltd. (Tongaat)

In their integrated report of 30 September 2018, the board of Tongaat made the following declaration in terms of corporate governance:

"The company's approach to corporate governance continues to reflect that governance is regarded by the Board as being more than a mere compliance exercise that measures basic compliance with King IV™, but rather confirms that best practice principles are effectively applied and embedded by the company in its daily activities, resulting in short and long-term value creation for all stakeholder".

Shortly after this declaration in the 2018 Annual report of Tongaat, the business world was shaken when the JSE Stock Exchange News Service (SENS), published a cautionary announcement on 8 March 2019 made by the biggest sugar producer in South Africa, Tongaat Hulett Ltd. In this announcement, investors were warned to be cautious when dealing in the company's shares. On 10 June 2019, the Board of Tongaat requested the JSE to suspend their listing until further notice and made the following declaration:

"The Board has now reached a conclusion that the need to restate the March 2018 Financial Statements, and the consequential impact on the 30 September 2018 statement of financial position, renders reliance on the unaudited interim results for the six months ended 30 September 2018 ("September 2018 Interim Results") no longer appropriate..." (Tongaat Hulett - SENS, 2019). This is another example where the reality stands in contrast with what was disclosed and the final impact of the seemingly poor governance practices by this former business giant, is yet to be seen.

3.2.3. Tiger Brands Ltd (Tiger Brands)

In the 2017 integrated report of Tiger Brands, the following was declared: *"Our governance structures, policies and standard operating procedures were reviewed and aligned to King IV principles to support our new operating model and strategy. Sound corporate governance is an integral part of the group's success in achieving its strategic objective to create sustainable value*

Whilst the Annual report assured stakeholders that sound corporate governance was in place at the Tiger Brands group, the opposite became eminent. The South African community was shocked by the announcement from the former Minister of Health, Dr. Aaron Motsoaledi that the source of the outbreak of a deadly disease, *Listeriosis,* was traced back to a processed meat plant owned by Tiger Brands. (Department of Health, 2018). The World Health Organization (WHO) reported that this was the largest outbreak of Listeriosis, which resulted in more than 200 confirmed fatalities between January 2017 and June 2018. (Hunter-Adams *et al*., 2018).

3.3. Non-South African corporate failures that could partially be attributed to weaknesses in corporate governance practices

3.3.1. Honda Motor Company Ltd (Honda) and Takata Corporation (Takata)

Khoo (2019) stated the case of Honda, a leading Japanese automobile company, and Takata, which transgressed one of the four pillars of sound corporate governance, which is transparency, by not alerting stakeholders timeously of the defects in the Takata airbag inflators installed in some Honda vehicles. Although Honda was one of several car manufacturers that used Takata airbags, the company in particular is alleged to have known about the problem well before the others. Critical details such as airbag ruptures and deaths involving its vehicles were not disclosed timeously to regulators or the public. To date Honda recalled nearly 13 million vehicles to replace faulty airbags.

3.3.2. The Volkswagen Group (Volkswagen)

Another aspect of good governance is to protect the environment; therefore, the automobile industry was shocked when the diesel emission scandal of one of its world leaders, Volkswagen in Germany, was exposed in 2015. Matussek (2018) reported that the subsequent costs incurred by the company because of their undermining of the environmental norms on its diesel vehicles, is estimated to exceed $35 billion. Bachmann et al. (2019) found that the reputational spill over effect of this corporate governance scandal resulted in a reduction in the U.S. sales of the other German automobile manufacturers such as BMW, Mercedes-Benz and Smart by about 105 000 vehicles worth $5.2 billion.

4. CONCLUSION AND RECOMMENDATIONS

The study indicates that all 40 the selected JSE-listed companies that were evaluated, disclosed compliance with the 17 principles of King IV and they

endeavoured to explain what practices are in place to ensure compliance. What is of concern, is that despite the fact that all these companies are declaring that they are compliant with King IV, the business world is shaken on a regular basis by huge corporate failures that are partially due to corporate governance failures, as can be seen from the case studies of Steinhoff, Tongaat and Tiger Brands. The case studies on Honda and Volkswagen indicate that this is not only a South-African phenomenon, but also a global occurrence. This strengthens the possible conclusion, that despite the fact that organisations declare compliance with corporate governance principles, the disclosure thereof might be dealt with as a "tick-box" exercise to adhere to listing requirements, and is not seen as pivotal and integral to every critical aspect of value creation as envisaged by King IV.

This study confirms to the JSE that JSE-listed companies tend to disclose compliance with the principles of good corporate governance as stated in King IV. These findings also confirm to IoDSA that the fewer principles of the latest King Report enhanced the adherence to the disclosure requirements of King IV; however, none of this seems to prevent corporate failures that can partially be attributed to ineffective corporate governance practices. This study is limited by the fact that King IV only became effective for years ending after 1 April 2017 and relevant scientific publications are still limited. Further studies may investigate a possible relationship between specific governance disclosures, or the lack there-of, and corporate failures.
With the enhanced focus of King IV on disclosure, it is recommended that a uniform framework should be developed which give clear application guidelines on what practices should be in place, before an entity can claim full compliance with King IV. Until corporate governance is not considered to be a crucial part of the success of an entity, catastrophic business failures may remain a never-ending reality. Future research will be done on the compliance to and disclosure of specific governance practices that could enhance the effectiveness of corporate governance in entities.

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