



INSTITUTE OF DIRECTORS
SOUTHERN AFRICA

Boards - Governance Considerations Relating to Corruption

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“Corruption affects the lives of everyone in South Africa – it is our common enemy”¹

¹ From the "Guide to the Prevention and Combating of Corrupt Activities Act, Act 12 of 2004" by the South African National Anti-Corruption Forum.

Introduction

For boards and senior management who take the principles of ethical leadership and legal compliance seriously, the prevention and combatting of corruption poses significant challenges. This is especially so in the light of South Africa's deterioration in the World Governance Indicator rating for South Africa from 86th out of 183 in 1996 to 114th out of the 209 countries measured in 2013. Transparency International's 2013 Global Corruption Barometer shows South Africa's frequency of bribery as 80th out of 95 countries. Withstanding corruption is more difficult for business people when they operate in a corrupt environment. But it is even more essential that they do so.

Despite the potential loss of business which could result from a refusal to participate in corruption, the cost of participating therein could ultimately be higher. The German company Siemens, for example, paid approximately \$1,6 billion in fines to American and European authorities in 2008 as a result of having paid bribes amounting to \$1,4 billion. In addition, senior management of the organisation was criminally prosecuted.

The first principle in Chapter 1 of the King Report on Governance for South Africa, 2009 (King III) provides that:

"The board should provide effective leadership based on an ethical foundation"

One of the cornerstones of honest and ethical leadership is compliance. In this context, Principle 6.1 of King III requires as follows:

"The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards"

Purpose of this paper

The purpose of this paper is to highlight the obligations of directors (and those charged with corporate governance) with regard to the combatting of corruption in a society which is perceived as increasingly corrupt and to propose mechanisms to assist in fulfilling these obligations.

What is corruption?

In essence, giving anything of value to entice someone to fulfil that person's duties in a particular manner, or to accept or solicit anything of value to fulfil duties in a particular manner, constitutes corruption. This includes facilitation payments, "gifts" and "tips" that are intended to "encourage" a particular outcome (more information on the definition of corruption is contained in Annexure "A"). The relevant South African legislation in this regard is the Prevention and Combatting of Corrupt Activities Act No 12 of 2004 (in the interest of brevity referred to as PRECCA).

Note that:

- PRECCA applies to both the public and private sectors, including transactions or relationships that involve only private parties; and
- PRECCA applies to activities of South African companies both within as well as outside of South Africa, and to foreign entities doing business in South Africa.

South African companies are also impacted by legislation in other jurisdictions, such as the USA's Foreign Corrupt Practices Act and the UK's Bribery Act. Both these pieces of legislation have a near-universal application, allowing for the prosecution of individuals or companies with links to the USA or UK, regardless of where the corruption was perpetrated. This paper is primarily focused on South African anti-corruption legislation. Companies with international links are thus cautioned that international anti-corruption legislation is complex and the definition of corruption and application may differ from that in South Africa. Boards should take measures to ensure that the application of such legislation is understood and pro-actively dealt with.

Consequences of corruption

The consequences of corruption can be severe, impacting negatively on the individuals involved and the sustainability of the affected business. Some examples of potential consequences are presented below:

- **Reputational damage:** The reputational impact of an act of corruption may be extremely damaging. This is true in respect of any individuals involved, as well as any company associated with such individual. Board members are particularly vulnerable to being tainted by their association with a company that is perceived to have acted unethically or dishonestly.

- **Commercial consequences:**
 - **Cancellation of contract:** In common law, a participant in a contract who finds that it was induced by corruption, may cancel the contract and claim damages for breach of contract.
 - **Register of Tender Defaulters:** Particulars of persons (natural and/or juristic) convicted of offences relating to contracts or tenders are recorded in the Register of Tender Defaulters kept by National Treasury, which record is retained for a period of up to 10 years. The government is entitled to cancel contracts with persons on the register and will not enter into future contracts with such persons or the enterprises with which they are associated.
- **Criminal sanction:** Corruption is an offence and PRECCA provides that a court may impose a fine or imprisonment. The court has discretion on the penalty, but is entitled to impose up to life imprisonment.
- **Civil claims:** Parties who suffer loss or damage as a result of corruption have a civil claim against the relevant offender(s). If a contract is cancelled on the grounds of corruption, damages claimed may be substantial. The behaviour that led to the conviction in terms of PRECCA could also lead to personal liability² for the director involved.
- **Other potential consequences:** Other potential consequences of corruption include automatic disqualification from being a director for a period of at least 5 years³ and disciplinary steps pursued by a professional body to which the perpetrator belongs.

Duty to report corruption

Of critical importance to directors is understanding the duty⁴ imposed by PRECCA, on persons in a position of authority, to report contraventions of PRECCA (and related crimes) involving an amount of R100 000 or more. The report must be made to a police official in the Directorate for Priority Crime Investigation.

It is not acceptable for companies to refrain from prosecuting offenders, even if embarrassment will result. Directors are cautioned that, even if not in any way involved in corruption committed by an employee of the company, that director will nevertheless be committing an offence if the contravention of PRECCA (or other crimes listed therein) is not duly reported.

How should the board address corruption?

1. Tone at the top

Much of the anti-corruption legislation relates to behaviour that would instinctively be recognised as “wrong”. As a result, the risk that individuals in an organisation would commit corruption (or in fact commit any other crime of which dishonesty is an element) is mitigated by the general principles of ethical and values-driven governance, led by the board. The board, executives and management should lead by example. An entrenched value-system and attendant culture therefore forms the foundation of preventing corruption in an organisation.

2. Board committees

The board as a whole should be satisfied that anti-corruption steps taken by management, whether reported directly or through the relevant committees, are robust. The size and composition of the board will determine the mechanisms through which the board will interact most effectively with relevant management functions.

Various board committees may have a role to play in engaging with management on the risk of corruption, for example:

- The social and ethics committee, which is obliged by regulation to monitor the company’s standing against, amongst others, Principle 10 of the United Nations Global Compact. Principle 10 provides that businesses should work against corruption in all its forms, including extortion and bribery. In addition to the 10 principles of the United Nations Global Compact, this committee is also specifically obliged to consider the recommendations by the Organisation for Economic Co-operation and Development (OECD) regarding corruption. More information on these recommendations is available at www.oecd.org/corruption/.
- The audit and risk committees, that focus on risks and controls for the prevention and detection of events such as bribes, inappropriate commissions, etc.
- The remuneration committee, when ensuring that remuneration packages and incentive criteria are balanced and actively discourage dishonest behaviour.

² For example for breach of fiduciary duties or in terms of section 77 of the Companies Act, 2008

³ See section 69 of the Companies Act, 2008 and Regulation 39 of the Regulations for the Companies Act

⁴ Section 34 of PRECCA

- The nomination committee, by conducting a due diligence in respect of proposed senior and board appointments. Examples of this may include ensuring that information on criminal records of and ongoing investigations against potential candidates are checked and considered.

3. What should the board monitor?

In its monitoring of management's prevention and response to corruption, the board can consider whether the practices discussed below are followed:

- A code of conduct is formulated: The code of conduct should set out policies that are specific to the relevant company. It should at least record the company's values and emphasise the potential consequences to those who participate in corruption. It would be beneficial to communicate clear guidelines on actions that are inappropriate, the giving or receiving of gifts, entertainment and disclosure (for example by way of a gifts register).
- Anti-corruption training is provided: The purpose of the training is to create awareness of and vigilance against corruption. It is proposed that training be repeated at regular intervals, to provide for new employees that join the company and also to maintain the level of knowledge of existing employees.
- Appropriate internal controls: Management should have due regard to the risk of corruption, particularly in vulnerable areas of the business such as procurement, marketing and activities that require licences from authorities. The overall risk management in the company should reflect that risk assessment appropriately considers corruption risk and that controls are implemented and monitored in this regard.
- Service providers are vetted and contractually bound to refrain from corruption: A company should be particularly vigilant where third parties source business for the company or engage with government on the company's behalf.
- Due diligence processes for new business ventures and foreign jurisdictions: In addition to a financial due diligence the board should insist that the background and reputation of third parties that the company proposes to deal with are duly investigated. The corruption risk focus should be heightened where multinationals operate in countries where the corruption index is known to be high.
- Appropriate response to corruption detected: The manner in which management deals with corruption, if discovered, impacts the culture of the organisation. This aspect is further considered in paragraphs 5 and 6 below.

4. Internal and external audit

Assurance providers, including internal and external audit, fulfil an important role in discouraging and detecting corruption in the company. Both internal and external audit should be in a position to provide comfort to the board that management has in fact implemented appropriate policies, procedures and controls to manage corruption risk.

5. Whistleblowing facility

Providing employees with an opportunity to report suspicions of corruption is fundamental to the board's detection thereof⁵. Anonymity and protection of whistleblowers, and appropriate action in respect of incidents reported, are important to ensure that a whistleblowing facility is effective. It is recommended that the board (or an appropriate committee, such as the risk committee) insists on regular reports from management on matters reported and actions taken pursuant to such reports.

6. Zero-tolerance

As indicated above, the culture and values of an organisation should be reinforced by a code of conduct, providing unambiguous guidance to everyone in the company.

It should be emphasised that disciplinary steps, including dismissal, will be pursued against perpetrators of corruption. All persons within an organisation should also be informed that management is required by law to report corruption (including a suspicion of corruption) to the police, which means that those guilty of such practices will face criminal prosecution. The board must insist that incidences of corruption are dealt with decisively and consistently.

Conclusion

It is clear from the above analysis that contravention of PRECCA and/or international anti-corruption legislation can have serious criminal, civil and reputational consequences for the individuals and companies involved. As such, boards are encouraged to be clear about the values of the company and diligent in its oversight of management's actions in this regard.

⁶ According to the 2014 Report to the Nations on Occupational Fraud and Abuse by the Association of Certified Fraud Examiners "Tips are by far the most common way that occupational fraud schemes are detected". The report indicated that more than 40% of the initial detection of occupational fraud (which includes corruption) is done through tip-offs.

Annexure A

SALIENT FEATURES OF SOUTH AFRICAN ANTI-CORRUPTION LEGISLATION

The general offence of corruption

The Prevention and Combatting of Corrupt Activities Act No 12 of 2004 (in the interest of brevity referred to as PRECCA) provides⁶ for a "general" offence of corruption. It is illegal to:

- accept (or offer or agree to accept) any gratification from any other person, whether for the individual's own benefit or the benefit of a third party; or
- give (or offer or agree to give to) any other person any gratification, whether for the benefit of that other person or a third party,

in order to act (personally or by influencing another) in a manner -

- that is illegal, dishonest, unauthorised, incomplete, or biased; or
- that amounts to misuse of information acquired in the course of the exercise of any powers, duties or functions arising out of a constitutional, statutory, contractual or any other legal obligation;

that amounts to-

- the abuse of a position of authority;
- a breach of trust; or
- the violation of a legal duty or a set of rules, designed to achieve an unjustified result; or
- any other unauthorised or improper inducement to do or not to do anything.

Specific offences

In addition to the "general" offence of corruption, PRECCA also provides for a number of "specific" offences, including, for example:

- Receiving or offering unauthorised gratification to perform any duty that is within the scope of an individual's employment;
- Corrupt activities relating to contracts (whether with the private or public sector) including to improperly influence the promotion, execution or procurement of any contract;
- Corrupt activities relating to the procuring and withdrawal of tenders including inducement to award a tender to a specific person, or at a specific price or to be allowed to withdraw a tender already submitted.

Wide reach of legislation

It is worth noting that:

- Even where an attempt at corruption does not have the intended result, the participating parties would still be guilty of an offence;
- Even where the gratification is not given or received directly by the parties involved, but by or for a third party, the participating parties are nevertheless guilty of an offence.

⁶ The provisions of the legislation have been paraphrased. Please refer to PRECCA for the full definition.

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