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CORPORATE GOVERNANCE

MBAA 811

70%

Topic: KPMG

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1. Glossary

- BLSA - Business Leadership South Africa
- CEO - Chief Executive Officer
- COO - Chief Operations Officer Skills
- FCPA - Foreign Corrupt Practices Act
- IRBA - Independent Regulatory Board for Auditors
- KPMG - Klynveld Peat Marwick Goerdeler
- OECD - Organization for Economic Co-operation and Development
- PwC - Price Waterhouse Coopers
- SAIC - The South African Institute of Chartered Accountants – SAICA
- SARS - South African Revenue Services

2. Introduction

Board members come from many different walks of life. They may be teachers, lawyers, homemakers, bankers, secretaries, business owners or other individuals from an endless list of occupations. The most important thing to recognize is that each member brings a unique set of skills and experiences to his or her role as a board member. It would be unreasonable to expect all members to have the same level of knowledge in all agency management and governance functions; therefore, it is critical that a board make every effort to use the skills and knowledge of each of its members.

KPMG is a professional service company and one of the big four auditors, along with Deloitte, Ernst & Young (EY), and PricewaterhouseCoopers (PwC). Seated in Amstelveen, the Netherlands, KPMG employs 189,000 people and has three lines of services: financial audit, tax, and advisory. Its tax and advisory services are further divided into various service groups. The name "KPMG" stands for "Klynveld Peat Marwick Goerdeler." It was chosen when KMG (Klynveld Main Goerdeler) merged with Peat Marwick in 1987. https://en.wikipedia.org/wiki/KPMG

Services: KPMG is organized into the following three service lines (the 2016 revenue shares are listed in parentheses: Audit (40%), Advisory (38%), Tax (22%) https://en.wikipedia.org/wiki/KPMG

3. Ethical Issues

Audit firms are not just about legal issues. They are also about standards and audit ethics and professional conduct. It is true that the KPMG saga has shocked the SA business sector. But this is an interesting case of ethical destruction. After all, this is how a market economy should deal with its faulty and unethical firms. The case has also created a golden opportunity for SA corporations, and the business sector more broadly, to undertake a genuine and constructive recalibration of their ethical framework across all spheres. There is little doubt that all businesses could raise their ethical standards.

All businesses have basic ethical and legal responsibilities; however, successful businesses establish a strong belief in corporate citizenship, showing a commitment to ethical behavior by creating a balance between the needs of shareholders and the needs of the community and environment in the surrounding area.

3.1 The theories of corporate governance and ethics

In 2017, KPMG was embroiled in related scandals involving the Gupta family. KPMG, whose history in South Africa dated back to 1895, and which had been part of the international organization since its founding in 1979, faced calls for closure, and an uncertain future, as a consequence of the damage done to the South African economy as a result of its activities. KPMG had been working with a Gupta family company in the mining sector, Oakbay Resources and Energy, for 15 years prior to the revelations of corruption and collusion in 2016, at which point KPMG resigned. The full impact and financial profit that KPMG received is yet to be determined; however, at least one large company has terminated its services with KPMG due to its relationship with Oakbay.

In July 2017, after controversial documents were leaked by the amaBhungane Centre for Investigative Journalism, former chief executive of KPMG South Africa and the former partner that was responsible for audits related to the Gupta family, Moses Kgosana, withdrew from becoming the chairman of Alexander Forbes, a financial services firm. https://en.wikipedia.org/wiki/KPMG

4. The regulatory framework of corporate governance

Corporate Citizen refers to the legal status of a corporation in the jurisdiction in which it was incorporated as well as a company's role in, or responsibilities towards society. Corporate citizenship involves the social responsibility of businesses and the extent to which they meet legal, ethical and economic responsibilities, as established by shareholders. The goal is to produce higher standards of living and quality of life for the communities that surround them and still maintain profitability for stakeholders. The demand for socially responsible corporations continues to grow, encouraging investors, consumers and employees to use their individual power to negatively affect companies that do not share their values.
http://www.businessdictionary.com/definition/corporate-citizenship.html

5. The Role of the Board

The business of the Company is managed under the direction of the Board. Normally it is management's job to formalize, propose and implement strategic choices, and the Board's role to approve strategic direction and evaluate strategic results.

However, as a practical matter, the Board and management will be better able to carry out their respective responsibilities if there is an ongoing dialogue among the Chief Executive Officer, other members of top management and Board members.

To facilitate such discussions, the Board conducts an annual review of the Company's long-term strategic plans and principal issues. Periodically during the year, the Board receives strategy updates from members of senior management of the Company.
Directors are expected to spend the time and effort necessary to properly discharge their responsibilities. Accordingly, a Director is expected to regularly attend meetings of the Board and committees on which he or she sits, and to review prior to meetings material distributed in advance for such meetings. A Director who is unable to attend a Board or Committee meeting (which, it is understood will occur on occasion) is expected to notify the Secretary of the Company who will advise the Chairman of the Board and/or the Chairman of the relevant Committee. All Directors are expected to attend the Company's Annual Meeting of Shareholders. Corporate Governance Guidelines (As Amended May 23, 2017)

Selection of the Chairman of the Board: The Board does not require the separation of the offices of the Chairman of the Board and the Chief Executive Officer. The Board shall be free to choose its Chairman in any way that it deems best for the Company at any given point in time. Corporate Governance Guidelines (As Amended May 23, 2017)

Size of the Board: The board can recommend 8 - 12 Directors and it is the sense of the Board that this size is about right. This range permits diversity of experience without hindering effective discussion or diminishing individual accountability. Corporate Governance Guidelines (As Amended May 23, 2017)

Independence of the Board: The Board is comprised of a substantial majority of Directors who qualify as independent Directors. The Board will make a determination as to each Director's independence broadly considering all relevant facts and circumstances. However, the Board has adopted categorical standards to assist it in making the independence determination. Corporate Governance Guidelines Each Director is expected to participate in continuing educational programs in order to maintain the necessary level of expertise to perform his or her responsibilities as a Director. (As Amended May 23, 2017)

6. Good Corporate Citizenship

According to (Theo Botha, Sunday Times, Business News maker, pg8, 2018), In the UK there is a nine year rule. After nine years on the board you are gone, or classified as not independent. Directors become too familiar with each other and with the business, which is not in the interest of good corporate governance Corporate governance continues to be a topical subject with widespread debate on corporate failures, loss of confidence in capital markets, questionable business and accounting practices, independence issues and a lack of understanding of the role of non-executive directors.

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https://www.investopedia.com/terms/c/corporatecitizenship.asp#ixzz599Hs2n7o

Development of Corporate Citizenship

There are stages that companies go through during the process of developing corporate citizenship. Companies rise to the higher stages of corporate citizenship based on their capacity and credibility when supporting community activities, a strong understanding of community needs, and their dedication to incorporate citizenship within the culture and structure of their company. The five stages of corporate citizenship are elementary, engaged, innovative, integrated and transforming.

Elementary: In the elementary stage, known also as the compliant stage, a company's citizenship activities are basic and undefined because there is scant corporate awareness and little to no senior management involvement. Small businesses in particular tend to linger in this stage; they are able to comply with the standard health, safety and environmental laws, but they do not have the time nor the resources to fully develop a greater involvement in community activities.

Engaged: In this stage, companies will often develop policies that promote the involvement of employees and managers in activities that exceed rudimentary compliance to basic laws. Senior management is more active in developing policies for the entire corporation and assigning to all levels of management more sophisticated standards for corporate citizenship.

Innovative: Citizenship policies become more comprehensive in this stage. This occurs through increased meetings and consultations with shareholders and through participation in forums and other outlets that promote innovative corporate citizenship policies. Typically, this is the stage where corporate citizenship policies are funded and activated and become functional with assistance and support from upper-level management. Transparency comes into play in this stage as companies typically monitor how successfully they have become involved in the community, with results of this monitoring being made available through public reports.

Integrated: Citizenship activities are formalized and blend in fluidly with the company's regular operations. Performance in community activities is monitored. Citizenship activities are driven into the lines of a business. Consultations with shareholders continues, and some companies may even set up formal training in the area of community involvement for employees and management.

Transforming: Companies that have reached this stage understand that corporate citizenship plays a strategic part in fueling sales growth and expansion to new markets. Economic and social involvement, support and integration is a regular part of a company's daily operations in this stage.
https://www.investopedia.com/terms/c/corporatecitizenship.asp#ixzz599IFURlA

7. Committees and Guidelines

The Company can decide on a number of committees: Audit, Compensation, Corporate Governance and Finance. The purpose and responsibilities for each of these committees is outlined in committee charters adopted by the Board. The Board may, from time to time, form a new committee or disband a current committee depending on circumstances. In addition, the Board may determine to form ad hoc committees from time to time, and determine the composition and areas of competence of such committees.

Each of the Committees are composed entirely of independent Directors satisfying applicable legal, regulatory and stock exchange requirements necessary for an assignment to any such committee. The Corporate Governance Committee is responsible, after consultation with the Chairman of the Board, for making recommendations to the Board with respect to the assignment of Board members to various committees. After reviewing the Corporate Governance Committee's recommendations, the Board is responsible for appointing the Chairman and members to the committees on an annual basis.

The Corporate Governance Committee annually reviews the Committee assignments and considers the rotation of the Chairman and members with a view toward balancing the benefits derived from continuity against the benefits derived from the diversity of experience and viewpoints of the various Directors.

The Chairman of each committee, in consultation with the committee members, will determine the frequency and length of the committee meetings consistent with any requirements set forth in the committee’s charter. The Chairman of each committee, in consultation with the appropriate members of the committee and management, will develop the committee’s agenda. The schedule for each committee will be furnished to all Directors. Corporate Governance Guidelines (As Amended May 23, 2017)

8. Applications/ Lesson learned

As partners of KPMG, you cannot plead ignorance of the fact that your firm has conducted itself in an errant fashion and in breach of the Rules of Professional Conduct over a number of years – this was not a once-off mistake or an isolated error of judgment it has been happening frequently.

In particular, the collapse of KPMG should be a warning siren for the other audit firms to reassess their internal processes and their corporate governance mechanisms. This is vital for socio-economic development because in modern societies, underpinned by complex financial and economic structures, the audit firms play a unique and pivotal role in assuring that resources are used with probity and propriety. To this end, a number of measures need immediate consideration. For example, corporate SA should adopt the principle of “auditor rotation”, as importantly the audit companies themselves need to appoint non-executive directors with appropriate governance competencies; and external audit firms need to focus on audit work and avoid technical advisory work. Corporate finance advisory operations have no place within audit companies. The notion of "Chinese walls" within the audit firms simply does not work, as KPMG clearly demonstrates.

The huge penalty to KPMG in this case has marked as an important warning to the others who are trying to be committed in unethical actions. For people, like Hamersley who blew the whistle on KPMG, he deserves our applause and appreciation; his high ethical standards are what every accountant should aspire to

As often said, we should not waste a good crisis. The KPMG crisis should definitely not be wasted on the SA business and the country at large. The crisis is a stark reminder that our nation needs to re-examine the ethics of doing business, whether in the private or in the public sector. We have no time to prevaricate. Company directors, chairpersons of the boards, and members of the audit committees in particular need to act with vigilance and urgency. As Martin Luther King, Jr reminded us: "It is always the right time to do the right thing."

9. Conclusion

The collapse of KPMG might also provide a genuine opportunity to scale up a number of medium size audit firms, especially the "empowered firms". The demise of KPMG will also help reduce the oligopolistic concentration of the large audit firms and will help promote more healthy competition within the profession.

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10. Bibliography

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