

**A Legal Analysis of the Application of Corporate Governance Principles in the  
Local government Sphere as a measure to Improve Service Delivery**

**By**

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## **Abstract**

The new democratic government of South Africa came into power in 1994 and it inherited a dysfunctional municipalities. In fact it inherited a country with high levels of poverty, growing levels of inequality and also social dysfunctionality. The local government sphere was established in South Africa with the main aim of addressing inequality, segregation, inequity, discrimination in the provision of municipal services and eradication poverty within communities. However, ever since the establishment of local government sphere in South Africa, the sphere of local government is fraught with many challenges which make it impossible for municipalities to render proper municipal services to the members of the public. This is evident from the protests which were observed in the country ever since the year 2008 were communities demanded better services from their municipalities. This mini-dissertation therefore discusses the application of the principles of corporate governance in delivering and improving municipal service in South Africa. It further discusses the legislative framework and the institution of government which are responsible for the effective implementation of corporate governance in the local government sphere. Pursuant to that it also explains the concept of Corporate Governance within the local government. Furthermore, it discusses the parameters of the challenges that are faced by the municipalities which are ranging from fraud, nepotism, corruption and poor financial management which result in poor service delivery.

## **Declaration by Supervisor**

I, **Adv. Lufuno Tokyo Nevondwe**, hereby declare that this mini-dissertation by **Adv. Tshehledi Isaac Mokgopo** for the degree of Master of Laws (LLM) in Development and Management Law be accepted for examination.

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**Adv. LT Nevondwe**

## **Declaration by Students**

I, **Adv. Tshehledi Isaac Mokgopo** do hereby declare that this mini-dissertation for the degree of Masters of Laws (LLM) in Development and Management Law in the University of Limpopo (Turfloop Campus) hereby submitted, has not been previously submitted by me for any other degree at this or any other university and that this is my own original work; and therefore all the materials contained herein has been duly acknowledged.

.....

**Adv. Tshehledi Isaac Mokgopo**

## **Dedication**

This study is dedicated to the following people: my lovely parents, Phineas Tshigivha Libago and Raesetja Rosina Mokgopo; to my blessed siblings, Samuel, Maebe, Martin, Themby, Rendy Mokgopo and my precious fiancé Pleasure Thobakgale and our precious stone, Moemeloa Godsend.

It is also dedicated to the following people who have departed to be with the Lord: my late aunt Masilo Jeridah Mokgopo whom I lost mysteriously, also my late uncle Nyonkoloza Phillip Mokgopo who loved me dearly like his own son and my late beloved grandmother Keribe Ramatsobane (Ngwana Mogale) Sarah Mokgopo who raised my elder brother and I to be the responsible men that we are today.

## Acknowledgements

To God the creator of heaven and earth, you have fulfilled the words which you have spoken to me in 2012: Call unto me, I will answer you, and show you great and mighty things which you do not know of. You have succeeded in answering yet another academic prayer. Indeed you are the God who answers prayers. I thank you for the wisdom and the strength that you have given me to complete this master's degree and this mini-dissertation.

My sincere gratitude goes to the man behind this brains; my supervisor, Adv. Lufuno Tokyo Nevondwe, for his expert advice, guidance, patience, support and motivation. To me you were not only my supervisor but became a father away from home. You were strategically sent from heaven to feed the world with knowledge and understanding. Through your guidance I made it. Thank you very much for using your academic horn to anoint me. Your scholarly ink is mightier than a warrior's sword.

I would also like to thank my beloved parents, my father Mr. Phineas Libago and my mother Ms. Rosina Mokgopo for the pillars they are continuing to be in my life. There was a time when life became so difficult that I decided to quit my academic journey to look for employment due to financial constraints but you never allowed me to do that. You made sure that you played your role as parents to ensure that I complete all my undergraduate and postgraduates degrees. For that reason I could not have chosen any better parents except you. I will always be indebted to you.

To my big brother Samuel Mokgopo and younger brother Martin and Rendy Mokgopo thank you for always being there and wishing me well in your prayers. To my beautiful little sisters Maebe and Themby Mokgopo, I know it was not easy to have an absent brother but all this was worth it. Thank you very much for all your prayers, for it was because of you that I persevered up to this far. To my fiancé Pleasure Thobakale you gave me hope while I had none left and for that reason I thank you, thank you for your unconditional love, support, patience and encouragement.

## **List of Abbreviations**

ANC	African National Congress.
COGTA	Corporative Governance and Traditional Affairs.
DLGTA	Department of Local Government and Traditional Affairs.
EPWP	Expanded Public Works Programme.
MC	Mayoral Committee.
NDP	National Development Plan.
NT	National Treasury.
PGDP	Provincial Growth and Development Plan.
SDBIP	Service Delivery and Budget Implementation Plan.
SMME	Small Medium and Micro Enterprises.
IDP	Integrated Development Plan.
LED	Local Economic Development.
LG	Local Government.
LGTA	Local Government Transformation Acts.
LGWSETA	Local Government Sector Education & Training Authority.
MFMA	Municipal Finance Management Act.
NGO	Non-Government Organization.
OECD	Organization for Economic Cooperation and Development.
RDP	Reconstruction and Development Programme.
DPLG	Department of Provincial and Local Government.
RSA	Republic of South Africa.
SAPS	South African Police Services.

SCOPA	Standing Committee on Public Accounts.
UK	United Kingdom.
UNDP	United Nation Development Programme.
USA	United States of America.
USAID	United States Agency for Intelligence Development.

## **List of International Instruments**

The American Sarbanes-Oxley Act, 2002.

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*Australian Securities and Investments Commission v Healey [2011] FCA 717.*

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Municipal Systems Act, 32 of 2000.

Municipal Finance Management Act, 56 of 2003.

Municipal Accounts Act, 21 of 1988.

Municipal Demarcation Act, 27 of 1996.

Promotion of Local Government Affairs Act, 91 of 1983.

Local Government Transition Act, 209 of 1993.

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Labour Relations Act 66, of 1995.

Local Government: Development Facilitation Act, 67 of 1995.

South African Citizenship Act, 88 of 1995.

National Archives of South Africa Act, 43 of 1996.

Local Government Transition Act, 97 of 1996.

Organized Local Government Act, 52 of 1997.

Basic Conditions of Employment Act, 75 of 1997.

Intergovernmental Fiscal Relations Act, 97 of 1997.

Financial and Fiscal Commission Act, 99 of 1997.

Transfer of Staff to Municipalities Act, 17 of 1998.

National Environmental Management Act, 107 of 1998 (NEMA).

Local Government: Municipal Structure Act, 117 of 1998.

Public Finance Management Act 1, of 1999.

Public Finance Management Amendment Act, 29 of 1999.

Promotion of Access to Information Act, 2 of 2000.

Promotion of Administrative Justice Act, 3 of 2000.

Promotion of Equality and Prevention of Unfair Discrimination Act, 4 of 2000.

Preferential Procurement Policy Framework Act, 5 of 2000.

National Land Transport Transition Act, 22 of 2000.

Protected Disclosure Act, 26 of 2000.

Local Government: Municipal Electoral Act, 27 of 2000.

Disaster Management Act, 57 of 2002.

Local Government: Municipal Electoral Regulations R848 of 22 August 2000.

Local Government: Municipal System Regulations GN R459 of 25 may 2001.

### **White and Green Papers**

White Paper on Public Service Training and Education, 1997.

White Paper on Transformation Public Service Delivery, 1997 (Batho Pele White Paper).

White Paper on Local Government, 1998.

White Paper on Traditional Leadership and Governance 2003.

## CHAPTER ONE: INTRODUCTION

### 1.1. History background to the study

Green highlights that Jan van Riebeck landed in South African in 1652 and the sphere of local government began thirty years later. Its subsequent history was confined almost wholly to the Cape of Good Hope until the middle of the nineteenth century.<sup>1</sup> Green further highlights that there was little settled population elsewhere before the urban centres of Pietermaritzburg, Durban, Winburg, Bloemfontein, Potchefstroom and Pretoria began to grow between 1840 and 1860; and it was not until the passing of the Natal Municipal Ordinance, 1854, that the initiative in the development of local government first tended to pass from the Cape.<sup>2</sup>

As a result, the municipal regulations were published for Stellenbosch and Colesberg on 5<sup>th</sup> and 19<sup>th</sup> June 1840 respectively, and for Caldeon and Paarl on 4<sup>th</sup> September and 9<sup>th</sup> October of the same year. Those for Stellenbosch provided for five elected commissioners, and four ward master, a town assizer, a chief fire-warden, and four assistants appointed in each ward to help the ward masters in case of fire. These regulations were even more comprehensive than that of Grahamstown and likewise exempted certain property from rating, including Government property.<sup>3</sup>

Green shows that the second great chapter in the history of local government in South Africa was written in Natal between 1854 and 1908. The initiative in municipal administration tended to pass from the Cape to a newly developed area whose people could stand on the shoulders of the pioneers. Therefore, in reforming the system established in the Cape in 1836, the St. George-Macleroy report of 1853 and subsequent legislation brought overseas ideas and experience to bear upon local

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<sup>1</sup> Green L P *History of Local Government in South Africa* (1957).

<sup>2</sup> Green L P (1957) 1.

<sup>3</sup> Green L P (1957)21.

problems, and injected contemporary institutions with a new dignity, power and enthusiasm.<sup>4</sup>

The success of this reform led not only to the early introduction of the office of mayor, councillor and town clerk in other provinces (beginning with Bloemfontein and Cape Town in 1859 and 1867 respectively) and to the general use of the committee system.<sup>5</sup> It also encouraged the rise of the full time, professional local government officer in South Africa and led to the development of high standards of municipal administration which, as in the case of Native administration, set the pattern for important Union legislation in later years.<sup>6</sup>

However, there was one other interesting result for a short while in 1898. The Pretoria temporary town board obtained the services of Durban's town engineer in undertaking to improve the streets of the South African Republics capital. Nevertheless, the Transvaal was soon to add its own chapter to the history of local government and it had begun to write the prologue over forty years before.<sup>7</sup>

According to Pieterse, the historical yardstick in South Africa during the 20<sup>th</sup> century was racial segregation violent and control of the influx of Black bodies into the city.<sup>8</sup> Zegeye and Maxted writes that black people were bared and denied access from living in so-called White reserved areas, and therefore those areas which were reserved for black people only were underdeveloped and characterised by poor service conditions as opposed to the areas reserved for white people.<sup>9</sup>

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<sup>4</sup>English Municipal Corporations Act of 1835. After the reform of parliamentary constituencies, the boroughs established by royal charter during the previous seven centuries were reformed by the Municipal Corporations Act 1835. The Act required members of town councils (municipal corporations) in England and Wales to be elected by ratepayers and councils to publish their financial accounts. Before the passing of the Act, the municipal boroughs varied depending upon their charters. In some boroughs, corporations had become self-perpetuating oligarchies, with membership of the corporation being for life, and vacancies filled by co-option.

<sup>5</sup><http://www.iol.co.za/capeargus/mayor-s-link-to-the-past-1.1069421?showComments=true#.VnJQ3NlrLIU>. The first mayor of Cape Town was Gillis Johannes De Korte, 1867-1870 and from 187-1874.

<sup>6</sup> Local government available at <http://www.gov.za/about-government/government-system/local-government> accessed 21 May 2015.

<sup>7</sup> See furthermore the above footnote.

<sup>8</sup>Pieterse E 'From Divided to Integrated City? Critical overview of the emerging metropolitan governance system in Cape Town. (2002)13 *Urban Forum* 3-35.

<sup>9</sup> Zegeye A & Maxted J 'Our Dream Deferred: The poor in South Africa' (2009) 108 *Afr Aff (Lond)* (432).

This is because in black cities and towns, little attention was paid to everyday spatialities such as neighbourhoods, home environment and trans-local social networks in the social construction of living space. In comparison with the white communities: in white cities, these aspects received exaggerated attention, with libraries, parks, schools and public facilities abounding often creating model environments not even found in more developed countries.<sup>10</sup>

This saw local government being structured to facilitate and regulate the agenda of racial segregation and exclusion in South Africa. Consequently, each 'racial group' was afforded its own type of local government and the different types coincided spatially with the formal segregation of races in terms of the Native Areas Act<sup>11</sup> and later, the Group Areas Act.<sup>12</sup> Practically, this meant that in terms of the Population Registration Act<sup>13</sup> four designated racial groups: Whites, Coloured, Indians and Africans, had their own version of local government, although with very different capacities and powers.<sup>14</sup>

However, Naude deemed the Group Areas Act as one of the most notorious centrepieces of apartheid legislation, which legislated the residential segregation and compulsory removal of Africans to 'Own Group Areas'. This is because it restricted the permanent presence of Africans in urban areas through a notorious 'pass system' until 1982.<sup>15</sup>

Cameron posits that white group areas were administered and governed by White Local Authorities (WLAs) that were fully-fledged municipal institutions with a political council and, administration to carry out the functions of the council and taxation powers. While on the other hand Local Affairs Committees and Management Boards technically governed Coloured and Indian areas. However, it is worth noting that both these institutions relied on the administration of WLAs and/or provincial administration to

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<sup>10</sup>Zegeye A & Maxted J 'Our Dream Deferred: The poor in South Africa' 2003 *South African History online and UNISA Press*.

<sup>11</sup>Native Act 21 of 1923.

<sup>12</sup>Group Areas Act 41 of 1952.

<sup>13</sup>Population Registration Act 30 of 1950.

<sup>14</sup>Nyalunga D 'The Reviatlisation of local government in South Africa' (2006)1(1) *International NGO Journal* 1-6 Available online at <http://www.academicjournals.org/INGOJ> © 2006 Academic Journals.

<sup>15</sup> Naude W A 'South Africa's local government transformation: An economic development perspective' 2001 *University of Leipzig Press* 1-17.

provide and administer services on its behalf. Occasionally, these Management Committees were established through elections characterised by very low levels of voter participation and were generally regarded as illegitimate.<sup>16</sup>

According to Shubane, these bodies were generally regarded as puppet structures controlled by the National Party (NP) and comprised of politicians with a penchant for corruption. This is because African communities were regarded as falling under the jurisdiction of Black Local Authority (BLA). However, these were beleaguered structures due to militant opposition from the black community and a well-established reputation for inefficiency, graft and collaboration with white interests.<sup>17</sup>

Naude writes that the apartheid government thus made South African cities to develop along unequal social, spatial and economic lines, with white rapping most of the benefits and being more privileged over the other race groups. In fact, the primary role of local government under the apartheid was to create and perpetuate local separation and inequality.<sup>18</sup> This was reflected in separated municipal institutions (as discussed above) with different political and financial power bases.<sup>19</sup> This therefore shows that in the past, municipalities were geared and equipped for the implementation of urban and rural apartheid agendas in South Africa.

It is therefore worth noting that before the transition to democracy in April 1994, local government in South Africa was based on apartheid racial division. Pursuant to that the 'apartheid city', as it has become known, had a number of key characteristics: firstly, environment, health and other administrative structures which were duplicated for each race group and between local communities, provincial and national levels of government.<sup>20</sup>

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<sup>16</sup> Nyalunga D (2006) 1.

<sup>17</sup> Shubane k 'Black Local Authorities: A contraption of control, in M. Swilling et al (eds). *Apartheid city in transition*. (1991) Cape Town: Oxford University Press.

<sup>18</sup> Naude W A 'South Africa's local government transformation: An economic development perspective' (2001) University of Leipzig Press 1-17

<sup>19</sup> Nyalunga D (2006)6 Available online at [http:// www.academicjournals.org/INGOJ](http://www.academicjournals.org/INGOJ) © 2006 Academic Journals.

<sup>20</sup>Medical Research Council of South Africa (2015). THE MANDATE OF THE SOUTH AFRICAN MEDICAL RESEARCH COUNCIL (MRC) IS LEGISLATED IN TERMS OF ACT 58 OF 1991: 'The objects of the MRC are, through research, development and technology transfer, to promote the improvement of the health and the quality of life of the

This resulted in fragmentation in terms of legislation, policy and programmes which led to inefficient and wasteful operations. In the Cape Metropolitan Area, for example, there were prior to 1996 some 18-20 different local government administrative structures with little metro level co-ordination. Secondly, local government was unaccountable, with Black South Africans having no elected representatives.<sup>21</sup>

Smith and Vawda are of the view that during the apartheid era service delivery in South Africa was characterised by great inequalities in access between well-resourced white suburbs and poor rural communities.<sup>22</sup> This is because apartheid policies of segregation fragmented the city/suburbs and rural communities in determining how and where the public sector delivered goods and services should be provided.<sup>23</sup>

Racial differences, the influx control of Blacks in urban areas, segregation and disenfranchisement of certain racial groups characterised the history of local government during the apartheid era. Therefore, during that period, local government in South Africa became the mechanism through which cultural and racial groups were divided and kept separate. This is the main reason why a racial change in local government was required on the demise of apartheid.

Therefore, during the negotiations stages, South Africa's constitutional makers decided in 1992/93 to divide the local government democratisation process into three phases.<sup>24</sup> The pre-interim phase: 1993-1995, the interim phase: 1995-1999 and the final phase after that: known as the Democratic Local Government phase.<sup>25</sup> This saw the adopting of the Local Government Transition Act 209 of 1993 which provided for the establishment of a Local Government Demarcation Board in each of the nine provinces

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population of the Republic, and to perform such other functions as may be assigned to the MRC by or under this Act.'

<sup>21</sup>Mahlangeni B M 'Reflections on the impact of the natives' land Act, 1913, on Local Government South Africa' 2013 *Research Unit, Parliament of the Republic of South Africa*

<sup>22</sup> Medical Research Council-MRC of South Africa, (1998). "Medical Research Council- MRC of South Africa. Linking health and environment in Cape Town, South Africa: The review from local government" July (1998).

<sup>23</sup>Smith L & Vawda A 'Citizens vs. Customer: Different Approaches to public participation in service delivery in Cape Town' (2003) 14 *Urban Forum*. Issue 1, 26- 52.

<sup>24</sup> Cameron R 'Central-Local Financial Relations in South Africa' 2002, available at <https://open.uct.ac.za/handle/11427/22281> (accessed 28 November 2016) 119.

<sup>25</sup> Ovens W & Associates '15 of Developmental and Democratic Local Government: Celebrating achievements whilst acknowledging challenges' 2015 *SALGA* 12, available at [www.SALGA.org.za](http://www.SALGA.org.za) (accessed 28 November 2016).

in South Africa;<sup>26</sup> with a pre-interim local government stage to demarcate boundaries for the first local government elections in South Africa in 1995.<sup>27</sup>

The major political objective of these provincial Boards was to eliminate apartheid boundaries into unified municipalities. This is because during the apartheid era, local government in South Africa became the mechanism through which cultural and racial groups were divided and kept separate. In performing its duties, the provincial Boards managed to break down apartheid boundaries.<sup>28</sup>

Mokgopo highlights that South Africa became a democratic country in 1994 after fighting many decades of apartheid.<sup>29</sup> Therefore, the dawn of democracy in South Africa advocated for the adoption of the new Constitution of the Republic of South Africa in 1996 which provided for three spheres of government which are the national, provincial and local government.

However, Ramutsindela argues that the South African local government structures have generally been designed to reproduce the urban system in accordance with the policy objectives of the new government as can be seen from the legislative prescriptions contained in the various constitutions that the South African government had before the adoption on the recent Constitution.<sup>30</sup>

The 1996 Constitution provided for the established of an independent body called the Municipal Demarcation Board. The Board is entrusted with the task of demarcating the boundaries of municipalities for the territory of the Republic in accordance with the conditions set out in terms of section 155 of the Constitution of the Republic of South Africa 1996. As a result the Local Government: Municipal Demarcation Act, 1998 (Act No. 27 of 1998) was adopted to give effect to section 155 of the Constitution which

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<sup>26</sup> S 11(1) Local Government Transition Act.

<sup>27</sup> Cameron R 'Local Government reorganisation' available [www.hsrcpress.ac.za](http://www.hsrcpress.ac.za) (accessed 05 November 2016).

<sup>28</sup> Meligrana J *Redrawing Local Government Boundaries: An International Study of Politics, Procedures and Decisions* (2004) 221.

<sup>29</sup> Mokgopo T I, 2016 'The burning South Africa in the 20 years of democracy: Service delivery protests and the demarcation problems with specific reference to the case of Malamulele and Vuwani' *SAAPAM* 65.

<sup>30</sup> Ramutsindela M 'Resilient geographies: land, boundaries and the consolidation of the former Bantustans in post-1994 South Africa' (2007)173 *The Geographical Journal* 43-55.

established the Municipal Demarcation Board.<sup>31</sup> Section 3 of the Act provides that the Board is a juristic person, independent; impartial and must perform its function without fear, favour or prejudice.<sup>32</sup>

In the year 2000 the structure of municipalities in South Africa were reformed and re-established as the Municipal Demarcation Board demarcated 284 municipalities and the first full democratic local government elections took place on the 5 December 2000 establishing the constitutionally designed system of local government, as a result this did not sit well with other members of the society as not all citizens were happy with boundary determination by the Board. Pursuant to that in 2009 the Board reduced the number to 278.

It is worth noting that this research is twofold. Therefore, having dealt with the historical background of the sphere of local government in South Africa, it will be better to unpack the term “corporate governance”. With regard to the history of corporate governance a decade ago the term ‘corporate governance’ was barely heard. However, today, like climate change, corporate governance is a staple of everyday business language and capital markets are better for it. Corporate governance is a dynamic force that keeps evolving.<sup>33</sup>

Mkhabele states that the history of corporate governance is traced back to 1961, when South Africa was banished from participating in the global economy because of its apartheid policies.<sup>34</sup> Prior to 1990, the South African economy was almost entirely isolated due to sanctions enforced during the Apartheid era, because most large corporations were family owned conglomerates, operating within a culture of cronyism and general lack of accountability.<sup>35</sup>

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<sup>31</sup> Local Government: Municipal Demarcation Act 27 of 1998.

<sup>32</sup> Section 3 Municipal Demarcation Act.

<sup>33</sup> ASX Corporate Governance Council Corporate Governance Principles and Recommendations with 2010 Amendments, 2nd Edition. See also further ASX Corporate Governance Council of (2007) 2.

<sup>34</sup> Corporate governance embodies processes and systems by which corporate enterprises are directed, controlled and held to account.

<sup>35</sup> Mkhabele C J M M *A legal analysis of the application of corporate governance principles in Musina local municipality*. Unpublished mini-dissertation completed in the fulfillment of a Master’s degree at the University of Limpopo-Turfloop Campus, (2014).

Corporate governance in South Africa was therefore institutionalised by the publication of the King Report on Corporate Governance (“King Report 1994”) in November 1994.<sup>36</sup> The purpose of the King Report 1994 was, and remains, to promote the highest standards of corporate governance in South Africa.<sup>37</sup>

According to Cliffe Dekker, in 1994 the King Report on Corporate Governance (King I) was published by the King Committee on Corporate Governance, headed by former High Court judge, Mervyn King S.C. King I<sup>38</sup>, incorporating a Code of Corporate Practices and Conduct. It was the first of its kind in the country and was aimed at promoting the highest standards of corporate governance in South Africa.

Over and above the financial and regulatory aspects of corporate governance, King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although ground-breaking at the time, the evolving global economic environment together with recent legislative developments, have necessitated that King I be updated.<sup>39</sup>

The first report was issued by the King Committee in 1994 (King Report I), 2002 (King Report II) and 2009 (King Report III). To this end, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II).<sup>40</sup>

Cliff Dekker also holds that King II acknowledges that there is a move away from the single bottom line (that is, profit for shareholders) to a triple bottom line, which embraces the economic, environmental and social aspects of a company’s activities. In the words of the King Committee: successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach.<sup>41</sup>

The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. This means

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<sup>36</sup> King Report I ‘on Corporate Governance’ (1994).

<sup>37</sup> King Report I (1994) 7.

<sup>38</sup> King Report (1994) 2.

<sup>39</sup> Ibid.

<sup>40</sup> King II Report on Corporate Governance for South Africa (2002).

<sup>41</sup> King II Report (2002) 6.

that the Board must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company".<sup>42</sup>

Nevondwe writes that the King III Report and the Code apply to all entities incorporated in and resident in South Africa, regardless of the manner and form of incorporation or establishment and whether that establishment is in the public, private or non-profit sectors. Whereas the King II Report only applied to certain categories of business enterprises, namely listed companies, financial institutions and sector enterprises, while companies falling out of these categories were merely required to consider the application of the King II Report insofar as it was applicable.<sup>43</sup>

Nevondwe further point out that USA codified its corporate governance provisions in the Sarbanes-Oxley Act of 2002 and legal sanctions are applied for non-compliance with this Act. While corporate governance practices in South Africa may be voluntary, note that they are highly recommended and have considerable persuasive force.<sup>44</sup>

Compliance with the King III Report and the code is mandatory for the companies listed on the JSE, financial institutions and sector enterprises, but for all other entities there is no statutory obligation to comply with the King III Report and the Code.<sup>45</sup>

The king IV Report also mandates the governing body to lead ethically and effectively.<sup>46</sup> For the sake of this study, in referring to the sphere of local government, municipal council is expected to display ethical leadership and perform its functions effectively to ensure that services are provided for to members of community.

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<sup>42</sup>Cliffe Dekker Artorneys 'King Report on Corporate Governance for South Africa, What it means to you' (2002)2-20.

<sup>43</sup>Nevondwe L 'The Thinker, Cooperative governance Frame work, lesson to be learnt' V o l u m e 4 4 / 2 0 1 2. See also the first International Conference on Development, Finance, Transformation & Economic Growth in Developing Countries for the 21st Century (2013) 27-29.

<sup>44</sup> Nevondwe N (2014) 265.

<sup>45</sup> See further the above footnote.

<sup>46</sup> king IV report 2016 *The Institute of Director in Southern Africa NPC* 40.

By ethical leadership this means that municipal council must act in good faith and in the best interests of the municipality and avoid conflict of interests at all cost. The King IV Report provides that in cases where conflict cannot be avoided, it should be disclosed to the governing body (Municipal council meeting) in full at the earliest opportunity, and the proactively managed as determined by the council and subject to legal provisions.<sup>47</sup>

In terms of responsibilities the king iv report highlight that members of the governing body (municipal council and staff members) should assume collective responsibility for strong and setting the direction of the municipality; approving policy and planning, overseeing and monitoring of implementation and execution by municipal management; and ensuring accountability for municipal or organizational performance.<sup>48</sup>

In ensuring that the principles of good corporate governance prevail, municipal council should be willing to answer for the execution of its responsibilities, even when these were delegated.<sup>49</sup>

Cassim *et al* highlights that corporate governance is concerned with the structure and processes associated with management, decision-making and control in organisations. Furthermore he attests that one of the most commonly cited definitions of 'corporate governance' emanates from the Cadbury Report, which defines corporate governance as the system by which companies are directed and controlled.<sup>50</sup>

## **1.2. Statement of the research problem**

The sphere of local government is always being considered as government that is closest to people or communities. However, it is very clear that non-compliance and lack of proper implementation of local government policies and legislation always contributed to large-scale failure of governance in South Africa. The failure of governance in South Africa can be traced back at the local government level which always led to poor service delivery by many municipalities to most communities in South

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<sup>47</sup> King IV Report 2016 (43) para 1.

<sup>48</sup> King IV Report 2016 (43) para 3.

<sup>49</sup> King IV Report 2016 (43).

<sup>50</sup>Hendrikse J & Hendrikse L *Business Governance Handbook, Principles and Practice* (2004) 121. See also Cassim FHI, Cassim MF, Cassim R, Jooste R & Yeats *Contemporary Company Law* (2013).

Africa. This research finds that most failures by municipalities in South Africa to provide adequate services to members of the public is due to lack of competent and qualified people in the local government level (municipalities). It further finds that other local government failures emanate from lack of proper implementation of the principles of corporate governance as provided for by the King III Report on Corporate Governance. This study also finds that most municipal council and staff members lack sufficient working knowledge in as far as the running of municipality is concerned. Therefore the findings of this study are that there is a serious lack of adherence of the principles of the King IV code on corporate governance in the local government level.

### **1.3. Literature review**

Nevondwe and Ramatji highlights that Corporate Governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors.<sup>51</sup>

The most famous definition of corporate governance was provided in 1992 by Sir Adrian Cadbury in the Report on Financial Aspects of Corporate Governance in the United Kingdom.<sup>52</sup> Corporate governance is the system by which companies are directed and controlled.<sup>53</sup> From this definition of corporate governance provided above it is very clear that corporate governance is described as management of institutions not only limited to companies but also to municipalities as a whole.<sup>54</sup>

Nevondwe also asserts that on the issue of leadership, the King III Report requires the board of directors to provide effective leadership based on an ethical foundation. This is

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<sup>51</sup> Nevondwe L & Ramatji K 'The governance of risk management in state-owned companies: hurdles and prospects' (2014) 49 *SAPAAM* 274-284.

<sup>52</sup> Report for the committee on the financial aspects of corporate governance (1992) available at <http://www.ecgi.org/codes/documents/cadbury> (Accessed 06 December 2015).

<sup>53</sup> Report for the committee on the financial aspects of corporate governance (1992) 14.

<sup>54</sup> King M 'TOOLKIT 2 Developing Corporate Governance Codes of Best Practice, Global Corporate Governance Forum' (2010) available at <http://www.ifc.org/wps/wcm/connect/9fbe290048a7e4ac9e67df6060ad5911/Toolkit2-read.pdf?MOD=AJPERES> (Accessed 06 December 2015).

because ethics or integrity is the foundation of and very reason for corporate governance. An ethical corporate culture constitutes more than social philanthropy or charitable donations.<sup>55</sup>

According to Mervyn E King, corporate governance mainly involves the establishment of structures and processes, with appropriate checks and balances that enable directors to discharge their legal responsibilities.<sup>56</sup> As such, in assessing the standard of appropriate conduct, the court will take into account all relevant circumstances, including what is regarded as the normal or usual practice in the particular situation. Therefore, the criteria of good governance, governance codes and guidelines will be relevant in the determination of what is regarded as an appropriate standard of conduct.<sup>57</sup>

It is worth noting that the more established certain governance practices become; the more likely a court would regard conduct that conforms to these practices as meeting the required standard of care. Corporate governance practices, codes and guidelines lift the bar of what are regarded as appropriate standards of conduct. Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable at law, this also include those entrusted with mandate to ensure the effective running of the local government structure in South Africa.<sup>58</sup>

King II Report provides that corporate governance is essentially about leadership: leadership for efficiency in order for companies to compete effectively in the global economy, and thereby create jobs; leadership for probity because investors require confidence and assurance that the management of a company will behave honestly and with integrity in regard to their shareowners and others; leadership with responsibility as companies are increasingly called upon to address legitimate social concerns relating to

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<sup>55</sup> “The underlying philosophy of the King III Report revolves around leadership, sustainability and corporate citizenship. On the issue of leadership, the King III Report requires the board of directors to provide effective leadership based on an ethical foundation. Ethics or integrity is the foundation of and very reason for corporate governance. As such the main reasoning behind the ethics of corporate governance, which requires the board of directors to ensure that the company is run ethically, is that, as this is achieved, the company earns the respect and approval of those affected by and affecting its operations”.

<sup>56</sup> King M (2010)1.

<sup>57</sup> Ibid.

<sup>58</sup> Khoza R & Adam M *The Power of Governance: Enhancing the Performance of State-Owned Enterprises* (2007) pp 49-71.

their activities; and leadership that is both transparent and accountable because otherwise business leaders cannot be trusted and this will lead to the decline of companies and the ultimate demise of a country's economy.<sup>59</sup>

According to Nevondwe, the South African corporate governance strategy aims to promote an effective framework for governance in the country, giving confidence to investors, business, and other stakeholders to underpin the relationship between an organisation and those who hold future financial claims against that organisation.<sup>60</sup>

Since 1994, South Africa has undertaken corporate governance reforms that include a number of codes, review of the Companies Act and new regulations.<sup>61</sup> Nevondwe further provides that good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly. There are no opportunities in this environment for cloaks and daggers. The Constitution of the Republic of South Africa also recognises the importance of good governance.<sup>62</sup> This is evident from section 195 of the South African Constitution which deals with basic values and principles governing public administration.<sup>63</sup>

The sphere of local government is characterized by poor financial controls by unqualified individuals thus opening an avenue for fraudulent activities. This is despite the existence of MFMA. The object of MFMA is to ensure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing norms and standards and other requirements for ensuring transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities and municipal entities; the management of their revenues, expenditures, assets and liabilities and the handling of their financial dealings; budgetary and financial planning processes and the coordination of those processes of organs of state in other

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<sup>59</sup> King II Report (2002) 19.

<sup>60</sup> King Report on Corporate Governance for South Africa, 1994 'What it means to you' 2002 " The board must retain full and effective control over the company and be responsible for monitoring management in respect of implementation of board plans and strategies. The board, with the guidance of the company secretary, has the duty of ensuring that the company complies with all the relevant laws, regulations and codes of business practice".

<sup>61</sup>Nevondwe L & Ramatji K (2014) 10.

<sup>62</sup>Nevondwe L, Odeku KO and Tshoose CI 'Promoting the Application of Corporate Governance in the South African Public Sector' (2014) 40 *Kamla-Raj SocSci* 261-275.

<sup>63</sup> The Constitution of the Republic of South Africa, 1996.

spheres of government; borrowing; the handling of financial problems in municipalities; supply chain management; and other financial matters.<sup>64</sup>

Roberts attests that you cannot have strong financial institutions without sound corporate governance. You cannot have a stable financial system without strong financial institutions.<sup>65</sup>

Mkhabele and Nevondwe *et al* further state that the MFMA aims to improve accountability by placing responsibility for decisions in the hands of each accounting officer and by ensuring that there is a framework of support from National Treasury, for example, in the form of 'best practice' guidelines, to assist managers in delivering services to communities as efficiently and effectively as possible. This therefore begs the question of whether MFMA is applied adequately in the municipalities. Are those entrusted with responsibility held accountable when they neglect to comply with the provisions of MFMA? "Therefore as such lack of controls, mismanagement and lack of governance principles are the key reasons for the state of despair in municipalities".<sup>66</sup>

#### **1.4. Aims and objectives of the study**

This study is aimed at enforcing the principle of corporate governance in the local government and point out the problems which could be or have been avoided if corporate governance was or is implemented. It also aims to assist and benefit the government through the National Treasury, Municipalities, Civil Society, Organisations and members of the public. This study will also assist young emerging academics who are intending to research on the similar topic to bring light into their programme and make sure that they succeed in their studies and research. Lastly it will also help students who are studying Company law, Business Entities, Business Law, Local

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<sup>64</sup> Local Government: Municipal Finance management Act 56 of 2003. Its main purpose is "to secure sound and sustainable management of the financial affairs of municipalities and other institutions in the local sphere of government; to establish treasury norms and standards for the local sphere of government; and to provide for matters connected therewith".

<sup>65</sup> Mehran H & Mollineaux L 'Corporate Governance for Banking Institutions' 2012 *Federal Reserve Bank of New York Staff Reports*, no. 539. Pp 1-45.

<sup>66</sup>Mkhabele C J M M A *legal analysis of the application of corporate governance principles in Musina Local municipality* (unpublished mini dissertation completed at the University of Limpopo, 2014).

Government, Public Administration and corporate Law by making their courses clearer as this research has been broken down into simple terms which could be understood by everyone studying in the above fields.

### **1.5. Research Methodology**

The research methodology used in this mini-dissertation is qualitative as opposed to quantitative. This research is library based and reliance on the text books, reports, legislations, regulations and articles. As well as government manuals, Internet sources, and policy documents.

### **1.6. Scope and Limitations of the study**

This mini dissertation consists of six chapters. Chapter one deals with an introduction which lays down the main foundation of the study. Chapter two discusses the legislative and regulatory framework. Chapter three seek to analyse the concept of governance in the local government. Chapter four states the applications and interpretation of corporate governance in local government sphere. Chapter five discusses the case law. Finally chapter six deals with the conclusion and recommendations of the whole study.

## CHAPTER TWO: LEGISLATIVE AND REGULATORY FRAMEWORK

### 2.1. Introduction

Corporate governance is defined as the system whereby entities are managed and controlled. The concept of corporate governance was born only at the beginning of the 1990s with the publication of the first corporate governance codes and corporate entities which were regulated by various forms of legislation throughout the nineteenth century. Examples of such legislation are the company, environmental and labour legislation. Various other forms of legislation and regulation therefore also form part of the system whereby entities are directed and controlled and could be seen as part of corporate governance in the broader sense of the word.<sup>67</sup>

There are several factors which led to the development and publication of codes of corporate governance internationally and nationally. As such, it is therefore provided that the most important factor, according to various publications, is the separation between ownership and the control of entities that took place in the late 1980. This saw the development of a situation within a number of companies where the owner of the company was no longer involved in the day to day running and management of the company. As a result, this saw the management of companies being handed over to professional managers to ensure the effective running of the company. It is therefore very important for the owners of the company to lay down proper principles according to which companies could be managed.<sup>68</sup>

### 2.2. History of Corporate Governance

In 1994 the King Report on Corporate Governance (King I) was published by the King Committee on Corporate Governance, headed by former High Court judge, Mervyn King S.C. King I, incorporating a Code of Corporate Practices and Conduct, was the first of its kind in the country and was aimed at promoting the highest standards of corporate

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<sup>67</sup> Marx B *et al* (2013) 97.

<sup>68</sup> Marx B *et al* (2013) 98.

governance in South Africa.<sup>69</sup> Over and above the financial and regulatory aspects of corporate governance, King I advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although ground-breaking at the time, the evolving global economic environment together with recent legislative developments, have necessitated that King I be updated to meet the needs of current generation. To this end, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II).<sup>70</sup>

King II acknowledges that there is a move away from the single bottom line (that is, profit for shareholders) to a triple bottom line, which embrace the economic, environmental and social aspects of a company's activities. In the words of the King Committee:<sup>71</sup>

“Successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company.”<sup>72</sup>

## **2.2 The applications of the king reports**

One of the most important purposes of the King Reports was and remains, to promote the highest standards of corporate governance in South Africa. Unlike its counterparts in other countries at the time,<sup>73</sup> the 1994 King Report went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to

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<sup>69</sup> Clieffe Dekker Attorneys, King Report on Corporate Governance for South Africa (2002).

<sup>70</sup> Clieffe Dekker Attorneys (2002)2 Para 2.

<sup>71</sup> Clieffe Dekker Attorneys (2002)2 Para 3.

<sup>72</sup> Clieffe Dekker Attorneys (2002) 2 Para 4.

<sup>73</sup> The King Report on Corporate Governance, 1994.

good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice.<sup>74</sup>

In adopting a participative corporate governance system of enterprise with integrity, the King Committee in 1994 successfully formalised the need for companies to recognise that they no longer act independently from the societies and the environment in which they operate.<sup>75</sup>

As a result, there have been several legislative developments to support the concept of corporate governance ever since the publication of the King Report 1994 which include the introduction of the Insider Trading Act providing for more rigorous supervision and monitoring of insider trading.<sup>76</sup> Others includes the Public Finance Management Act which was adopted to bring into force more stringent provisions for reporting and accountability by adopting an approach to financial management in government that focuses on outputs and responsibilities rather than the rule driven approach under previous legislation.<sup>77</sup> This saw also a comprehensive update of the provisions and regulations governing the Banks Act<sup>78</sup> in enforcing substantially higher levels of corporate governance compliance and risk reporting in banking institutions.<sup>79</sup>

With regard to the applications of the Reports, King I Report promoted the highest standards of corporate governance. It advocated for an integrated and inclusive approach to corporate governance which exhorted companies to widen their focus beyond financial matters and to consider the company's triple bottom line that is its economic, environmental and social impacts.<sup>80</sup> The King II and other such codes require directors to enquire and then, if satisfied, confirm in the annual report the adequacy of internal controls in a company.<sup>81</sup>

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<sup>74</sup>King committee of corporate Governance, King Report on Corporate Governance for South Africa, (2002).

<sup>75</sup> *Ibid.*

<sup>76</sup> Insider Trading Act 135 of 1998.

<sup>77</sup> Public Finance Management Act 1 of 1999.

<sup>78</sup> Banks Act 94 of 1990.

<sup>79</sup> King II Report (2002) 9 para 11.

<sup>80</sup> Mkhabele CJMM (2014)

<sup>81</sup> 'King Report on Governance for South Africa 2009: King Code of Governance Principles' (2006) 26.

It is worth noting that the King III Report and the Code apply to all entities incorporated in and resident in South Africa, regardless of the manner and form of incorporation or establishment and whether that establishment is in the public, private or non-profit sectors. In contrast, the King II Report only applied to certain categories of business enterprises, namely listed companies, financial institutions and sector enterprises, while companies falling out of these categories were merely required to consider the application of the King II Report insofar as it was applicable.<sup>82</sup>

### **2.3. The development of codes of corporate governance**

The King committee on Corporate Governance was formed in 1993 under the auspices of the institute of Directors in Southern Africa.<sup>83</sup> This led to the publication of the first King Report on Corporate Governance in November 1994. The second King Report on Corporate Governance was published in March 2002 by the King Committee after a review of corporate governance standards and practices in South Africa. International developments since 2002, as well as the promulgation of the new Companies Act, necessitated a review of the second report by the King Commission.<sup>84</sup> The third report in as far as corporate governance in South Africa is concerned was published in September 2009. Internationally, the Treadway Commission in the United States and the Cadbury Committee in the United Kingdom were the first to investigate and make recommendations relating to the financial aspects of corporate governance.<sup>85</sup>

The Cadbury Committee was set up in the United Kingdom in May 1991 because of the lack of confidence that was perceived in financial reporting and in the ability of the

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<sup>82</sup>Nevondwe L 'Corporate governance principles: lessons to be learnt' (2012) 44 *The Thinker Political Journal* 16.

<sup>83</sup> The Institute of Directors in Southern Africa NPC (IoDSA) is a professional body recognised by the South African Qualifications Authority (SAQA) and a non-profit company (NPC) that exists to promote corporate governance, and to maintain and enhance the credibility of directorship as a profession.

<sup>84</sup> Companies Act 71 of 2008.

<sup>85</sup> The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of five private sector organizations, established in the United States, dedicated to providing thought leadership to executive management and governance entities on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud, and financial reporting. COSO has established a common internal control model against which companies and organizations may assess their control systems. COSO is supported by five supporting organizations, including the Institute of Management Accountants (IMA), American Accounting Association (AAA); the American Institute of Certified Public Accountants (AICPA), the Institute of Internal Auditors (IIA), and Financial Executives International (FEI).

auditors to provide the assurances required by the users of the financial statements. The Committee considered, primarily, financial reporting and accountability, good practice concerning the responsibilities of executive and non-executive directors, the case for audit committees, the principal responsibilities of auditors and the links between shareholders, boards auditors. There have since been a number of reviews of corporate governance in the United Kingdom. The first Combined Code was issued in 1998, followed by the revised Combined Code in July 2003.<sup>86</sup>

In the United States, the Sarbanes-Oxley Act was passed in 2002 after several corporate scandals, of which Enron and WorldCom are the two examples, dented confidence in corporate governance in the United States.<sup>87</sup> It is therefore provided that the USA codified its corporate governance provisions in the Sarbanes-Oxley Act of 2002 and legal sanctions are applied for non-compliance with this Act.<sup>88</sup>

In South Africa, compliance with the King III Report and the code is mandatory for the companies listed on the JSE, financial institutions and sector enterprises, but for all other entities there is no statutory obligation to comply with the King III Report and the Code. While corporate governance practices in South Africa may be voluntary, note that they are highly recommended and have considerable persuasive force. Commonwealth countries and the European Union states have also not legislated their corporate governance practices and have adopted a similar approach to that adopted in South Africa.<sup>89</sup>

The Organisation for Economic Cooperation and Development (OECD) issued the OESCD Principles of Corporate Governance in 1999.<sup>90</sup> This document is widely recognised as an international reference point on corporate governance issues. A

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<sup>86</sup> The Cadbury Report, titled Financial Aspects of Corporate Governance, is a report issued by "The Committee on the Financial Aspects of Corporate Governance" chaired by Adrian Cadbury that sets out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures. Its revised and final version was issued in December of the same year. The report's recommendations have been used to varying degrees to establish other codes such as those of the European Union, the United States, and the World Bank etc.

<sup>87</sup> The Sarbanes-Oxley act of 2002.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> OECD Principles of Corporate Governance of 2004.

revised report was also issued by the OECD in 2004.<sup>91</sup> Clearly there are diverse arrangements for owners' participation in decision making in different countries although, in most areas, there is a noticeable trend towards conformity with OECD principles.<sup>92</sup>

The OECD code recommends that all shareholders (minority or majority; foreign or domestic) of each type of share be treated equally. An important aspect of 'equal treatment' is the concept of 'one share-one vote' which is practiced in many, though not all, OECD countries.<sup>93</sup>

According to this Anglo-American practice, all shares should have equal voting rights in order to provide owners with proportionate power to influence the decisions of the company. In many countries (including OECD countries), other practices such as non-voting shares, shares with greater voting power, etc. are common.<sup>94</sup>

In some countries there is a cap on the voting rights of large shareholders, effectively giving their shares less voting rights than that of minority shareholders. In these circumstances, minority shareholders exercise undue influence over the decision-making process. Pursuant to that the OECD principles do not choose one practice in preference to another, though in some countries different types of voting shares are either discouraged or being abandoned altogether (e.g., Denmark and Greece).<sup>95</sup>

Finally, OECD Principle III recognises the rights of other 'stakeholders' in a company and encourages cooperation between companies and their stakeholders. The main stakeholders of companies are identified as employees, customers, creditors, suppliers and governments. Of these groups, employees have been selected for special

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<sup>91</sup> First released in May 1999 and revised in 2004, the OECD Principles are one of the 12 key standards for international financial stability of the Financial Stability Board and form the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank Group. The OECD Principles are currently under review.

<sup>92</sup> Hashi I 'The Legal Framework for Effective Corporate Governance: Comparative Analysis of Provisions in Selected Transition Economies' 2003 *Centre for Social and Economic Research*. Studies & Analyses No. 268. Pp 1-13.

<sup>93</sup> OECD Principles of Corporate Governance (2004) 19 Principle III.

<sup>94</sup> Hashi I (2003) 10.

<sup>95</sup> OECD Principles of Corporate Governance (2004) 33.

treatment and offered various rights such as consultation and representation at supervisory board level.<sup>96</sup>

## **2.4. Institutions and structures which are responsible in enforcing corporate governance in public sectors in South Africa**

South Africa has a number of institutions and structures which are mandated to promote the principles of good governance both in the public and private sectors. These institutions play a vital role in making sure that there is an adherence of the principle of corporate governance by enforcing its implementation. It is therefore expected that these institutions should adopt mechanisms of promoting the principles of corporate governance for the purposes of controlling the activities of organisations that operate as parastatals or public entities and others that function as business units within the broad context of the government sector.

### **2.4.1 Public Protector**

The Public Protector was set up in terms of South Africa's Constitution to investigate complaints against government agencies and government officials.<sup>97</sup> The office of the Public Protector (PP) derives its mandate from the Constitution.<sup>98</sup>

The office of the Public Protector receives and investigates complaints from the public or civil society organisations against government agencies or officials, and has the power to recommend corrective action and to issue reports. The Public Protector is appointed by the President, on the recommendation of the National Assembly, in terms

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<sup>96</sup> The OECD is currently conducting a review of the Principles to ensure their continuing high quality, relevance and usefulness, taking into account recent developments in the corporate sector and capital markets. The review was scheduled for release in September 2015. G20/OECD Principles of Corporate Governance OECD Report to G20 Finance Ministers and Central Bank Governors 2015. Available at <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> (accessed on 10 August 2016).

<sup>97</sup> Read more: <http://www.southafrica.info/about/democracy/pubprotect.htm>

<sup>98</sup> Section 182 Constitution.

of the Constitution, for a non-renewable period of seven years.<sup>99</sup> The Public Protector has the power, as regulated by national legislation—

- a) to investigate any conduct in state affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper or to result in any impropriety or prejudice;<sup>100</sup>
- b) to report on that conduct; and<sup>101</sup>
- c) to take appropriate remedial action<sup>102</sup>

From the above mandates it can be concluded that it is the duty of the public to ensure that the principle of corporate governance is adhered to by reporting any irregularities in order to eliminate any irregularities in the local government. As a result, it is therefore encouraged that members of the public report any criminal activities that are taking place in their municipalities ranging from corruption and lack of service deliveries by their municipalities.

A complain to the Public Protector can be lodged by anyone who feels aggrieved. The Public Protector will then investigate the complaint. This shows that the office of the public protector is very paramount in South Africa because through it most corrupt activities and irregularities were investigated and those incriminated were held accountable. Think of the Public Protector as a referee who can look at all sides of a problem. If the Public Protector finds that your complaint is justified, he/she will do whatever possible to find a solution to the problem, which includes recommending changes to the system.

The good thing about the office of the Public Protector is that when conducting its investigations it does not choose sides and people, it investigates all people even the organs of state ranging from the national level up until the provincial and local government level. The Public Protector is tasked with investigating improper prejudice suffered by the complainant or another person, for example as a result of:

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<sup>99</sup> Available at [www.publicprotector.org](http://www.publicprotector.org) (Accessed on 06 June 2015).

<sup>100</sup> Section 182(1) (a) Constitution.

<sup>101</sup> Section 182(1) (b) Constitution.

<sup>102</sup> Section 182(1) (c) Constitution.

- a) Abuse of power.
- b) Unfair, capricious, discourteous or other improper conduct.
- c) Undue delay.
- d) The violation of a human right.
- e) Any other decision taken, or situation brought about, by the authorities.
- f) Maladministration.
- g) Dishonesty or improper dealings with respect to public money.
- h) Improper enrichment.
- i) Receipt of improper advantage.

By so saying members of the public are advised and encouraged to lodge any complaints that they have with regard to any misuse of the public finances by government departments, including the local government sphere (Municipalities).

#### **2.4.2 National Treasury**

The National Treasury is responsible for managing South Africa's national government finances. Supporting efficient and sustainable public financial management is fundamental to the promotion of economic development, good governance, social progress and a rising standard of living for all South Africans. The Constitution of the Republic (Chapter 13) mandates the National Treasury to ensure transparency, accountability and sound financial controls in the management of public finances.<sup>103</sup>

The National Treasury's legislative mandate is also described in the Public Finance Management Act.<sup>104</sup> The National Treasury is mandated to promote government's fiscal policy framework; to coordinate macroeconomic policy and intergovernmental financial relations; to manage the budget preparation process; to facilitate the Division of Revenue Act, which provides for an equitable distribution of nationally raised revenue

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<sup>103</sup> Section 216 Constitution.

<sup>104</sup> <http://www.treasury.gov.za/legislation/PFMA/act>.

between national, provincial and local government; and to monitor the implementation of provincial budgets.<sup>105</sup> As mandated by the executive and Parliament, the National Treasury will continue to support the optimal allocation and utilisation of financial resources in all spheres of government to reduce poverty and vulnerability among South Africa's most marginalised.<sup>106</sup>

It is worth noting that the National Treasury priorities include increasing investment in infrastructure and industrial capital; improving education and skills development to raise productivity; improving the regulation of markets and public entities; and fighting poverty and inequality through efficient public service delivery, expanded employment levels, income support and empowerment. This means that the National Treasury may also promote good governance encouraging accountability, transparency and risk management in the public sector. It is therefore further provided that the National Treasury may encourage the public sector through the drafting of risk and fraud plans for the department which may be implemented by both the departments and officials to promote good governance.<sup>107</sup>

### **2.4.3 Auditor General**

Functions of Auditor-General, the Auditor General is also mandated by the Constitution to perform its functions.<sup>108</sup> The Auditor-General must audit and report on the accounts, financial statements and financial management of—

- a) all national and provincial state departments and administrations;<sup>109</sup>
- b) all municipalities;<sup>110</sup> and
- c) any other institution or accounting entity required by national or provincial legislation to be audited by the Auditor-General.<sup>111</sup>

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<sup>105</sup> Public Finance Management Act 1 of 1999.

<sup>106</sup> <http://www.treasury.gov.za/nt/info.aspx>.

<sup>107</sup> Siswana B *leadership and governance in South African Public Service: An overview of the public finance management system* (unpublished thesis completed at the University of Pretoria, 2007) 195.

<sup>108</sup> Section 188 of the Constitution of the Republic of South Africa of 1996.

<sup>109</sup> Section 118(1) (a) of the Constitution of the Republic of South Africa of 1996.

<sup>110</sup> Section 188(1) (b) of the Constitution of the Republic of South Africa of 1996.

The role of the Auditor-General is an important one. Parliament relies on the Auditor-General to provide independent assurance that governmental activities are carried out, and accounted for, consistent with Parliament's intentions.

The role of the Auditor-General is therefore an important element of helping to maintain the integrity of any systems of government. The Auditor-General ensures that Parliament has access to independent audit information as part of the framework of accountability and scrutiny of the Executive Government.<sup>112</sup> The role of the Auditor-General can only be effective if the office is viewed as being independent and competent. Therefore, without these characteristics, the assurances of the Auditor-General may lack credibility.

Pursuant to that to be seen to be independent the Auditor-General must be both free from control or direction of the Executive Government and free from political bias. Consequently, an important feature of the statutory framework that supports the office of Auditor-General should be that it provides an appropriate level of freedom for the Auditor-General to act without direction or interference.<sup>113</sup>

In support of accountability and responsibility, the Auditor General must submit the annual report, financial statement and audit reports of financial statements within six months after the financial years to which they relate to oversight mechanism and to the National Assembly.<sup>114</sup>

#### **2.4.4 Public Service Commission**

The Public Service Commission (PSC) derives its mandate from sections 195 and 196 of the Constitution, 1996. The PSC is tasked and empowered to, amongst others, investigate, monitor, and evaluate the organisation and administration of the Public Service. This mandate also entails the evaluation of achievements, or lack thereof of Government programmes. The PSC also has an obligation to promote measures that

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<sup>111</sup> Section 188(1) (c) of the Constitution of the Republic of South Africa of 1996.

<sup>112</sup> Australasian Council of Auditor General, Roles of Auditor General available at <http://www.acag.org.au> (Accessed 15 May 2015).

<sup>113</sup> Ibid.

<sup>114</sup> Siswana B (2007) 193-194.

would ensure effective and efficient performance within the Public Service and to promote values and principles of public administration as set out in the Constitution, throughout the Public Service.<sup>115</sup>

## **2.5. International law framework**

Corporate governance has been a global phenomenon. The financial scandals and collapses which have hit every country without exception have ensured that interest continues to grow unabated. Countries around the globe are either developing corporate governance codes or guidelines, or revamping those that they already have in existence.<sup>116</sup> Global governance principles such as the OECD principles, originally issued in 1999, have been amended to take into account developments in the corporate governance arena and the revised OECD principles introduced in 2004.<sup>117</sup>

Corporate governance is still very much an emergent political issue in both Russia and Poland.<sup>118</sup> During the last decade, policy makers, regulators and market participants around the world have increasingly come to emphasise the need to develop good corporate governance practices. The reason for this is an increasing amount of empirical evidence showing that good corporate governance facilitates corporate access to capital markets, improves investor's confidence and contributes to corporate competitiveness. From this perspective, considerable effort at the national and international level has been invested to promote and assist efforts to improve corporate governance.<sup>119</sup>

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<sup>115</sup> Section 196 Constitution.

<sup>116</sup> Elgar E *International Corporate Governance A case study approach* (2006) 47.

<sup>117</sup> Readers of the business pages may know, at least, that those initials stand for the Organisation for Economic Cooperation and Development. They may even have some idea that the OECD has something to do with the world economy.

<sup>118</sup> Ibid.

<sup>119</sup> White Paper on Corporate Governance in Russia available at <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/2789982>. Pp1-88.

The focus is on corporate governance in various European countries. Within Europe there exists both the unitary board system of governance and the dual board system.<sup>120</sup> The UK for example, has a unitary board whereby executive and non-executive directors serve on one board; on the other hand, many European countries have a dual board system where there is a supervisory board and a management board.<sup>121</sup> The supervisory board may have employee members (and indeed in countries such as Germany, employee membership of the supervisory board is mandated by the co-determination rules.<sup>122</sup>

South Africa also realized that there was a need to review corporate governance standards in the vein of the Cadbury recommendations.<sup>123</sup> The Institute of Directors in Southern Africa (IoDSA) formally introduced the King Code of Governance Principles and the King Report on Governance (King III). The Code and the Report which were unveiled at the Sandton Convention Centre in Sandton, Johannesburg, in September 2009. King III came into effect on 1 March 2010 – until then King II applied.<sup>124</sup>

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<sup>120</sup> A Dual Board or Two Tier system is a corporate structure system that consists of two separate Boards of directors that work together in order to govern a business. The structure is composed of two boards, the "Management Board", and the "Supervisory Board" each of these serves a particular purpose. The Dual Board system is prescribed by law in countries such as Germany. Here the "German Corporate Governance Code" prescribes that businesses which are quoted in the stock market such as Lufthansa, and Adidas must apply the Dual Board system.

<sup>121</sup> The United Kingdom has a unitary board system characterised by a single board of directors. In the European Union, corporate governance codes recommend a unitary-board system in 8 countries and a dual-board system in 10 countries, though there may be some exceptions. In the remaining 9 countries a hybrid system applies and companies can choose between a one or two-tier approach.

<sup>122</sup> "Codetermination in Germany is a concept with a solid history that involves the right of workers to participate in management of the companies they work for. Known as Mitbestimmung, the modern law on codetermination is found principally in the Mitbestimmungsgesetz of 1976. The law allows workers to elect representatives (usually trade union representatives) for almost half of the supervisory board of directors. The legislation is separate from the main German company law Act for public companies, the Aktiengesetz. It applies to public and private companies, so long as there are over 2000 employees. For companies with 500-2000 employees, one third of the supervisory board must be elected. There is also legislation in Germany, known as the Betriebsverfassungsgesetz, whereby workers are entitled to form Works Councils at local shop floor level".

<sup>123</sup> Sebola K R *the Principles of Corporate Governance with specific reference to the case of South African Broadcasting Corporation (LTD) V Mpofu 2009 4 ALL SA 169. (GSJ)*, (unpublished mini-dissertation completed at the University of Limpopo, 2012).

<sup>124</sup> The King Report on Corporate Governance, report of a committee on corporate governance headed by Mervyn E King SC, 1994, Institute of Directors. Johannesburg.

The new Code and Report also falls in line with the Companies Act no 71 of 2008, which became effective on 1 May 2011.<sup>125</sup> Like its 56 commonwealth peers, King III has been written in accordance to the-comply or explain principle based approach of governance, but specifically apply or explain regime. This regime is currently unique in the Netherlands and now in South Africa. Whilst this approach remains a hotly debated issue globally, the King III Committee continues to believe it should be a non-legislative code on principles and practices

The JSE has implemented many of the recommendations made by the King committee, which now form part of the listing requirements.<sup>126</sup> Since it was the duty of the King Committee to review corporate governance on an on-going basis, it issued on 26 March 2002, the second report of corporate governance in South Africa.<sup>127</sup>

### **2.5.1. Corporate Governance in the UK**

The wave of financial scandals and collapses around the world has highlighted the need for better corporate governance. In the UK, it was after the failures of Coloroll and Polly Peck that the Committee on the Financial Aspects of Corporate Governance was established in May 1991.<sup>128</sup> The committee published its report in 1992, and it became widely known as the Cadbury Report, after its Chair, Sir Adrian Cadbury. The Report is widely recognized as having set the foundations for a 'best practice' system of corporate governance, both in the UK and subsequently in many countries across the world which incorporated some or all of its recommendations into their own corporate governance codes.<sup>129</sup>

The corporate scandals in the USA and the Sarbanes-Oxley Act prompted a review of regulation across the European Union and particularly in the UK.<sup>130</sup> In Britain there was a traditional bias in favour of self-regulation for Codes of Practice rather than new laws,

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<sup>125</sup> Companies Act no 71 of 2008.

<sup>126</sup> Ibid above on para 1, see also Schedule 22 to the JSE Listing Requirements.

<sup>127</sup> Ibid.

<sup>128</sup> Mallin C A *International Corporate Governance: A Case Study Approach* (2006) 44.

<sup>129</sup> Ibid.

<sup>130</sup> Ibid.

and reliance on professions to set standards and discipline their members. Ever since the bankruptcy of Enron, British accountants had been quietly congratulating themselves that 'it couldn't happen here'.<sup>131</sup> But, particularly after the Sarbanes-Oxley Act, the regulation of British auditors and accountants seemed inadequate. In the last five years US SEC has required 1200 companies to correct their audit accounts. By comparison, Britain's Financial Report Review Panel with only one full time accountant, acted as a kind of ombudsman. The Panel only investigated if there was a complaint. In 12 years the Panel had made only 67 inquiries and had requested 15 re-statement and in most cases the companies had been let off with a caution.

However, behind the scenes the British government was planning to establish an independent regulator along the lines of the US Accounting Oversight Board and early in 2004 they announced the establishment of the Financial Reporting Council, which will incorporate the Financial Reporting Review Panel and is also responsible for regulating the accounting profession and the inspection of audits. After the publication of the Cadbury Report in 1992, Britain became a pioneer in Corporate Governance and the Cadbury Code became a model for the self-regulating of quoted company boards in other countries. The past decade saw dozen inquiries advocating for the following:

- a) An expanded role for non-executive directors;
- b) Tighter control of executive remuneration;
- c) Fuller disclosure and transparent financial reporting;
- d) The active engagement of institutional shareholders; and
- e) Independent regulation of accountants and auditors.

These recommendations were brought together in a New Combined Code which took effect in July 2003 and was intended to make boards more independent and more

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<sup>131</sup> At the end of 2001, it was revealed that it's reported financial condition was sustained substantially by an institutionalized, systematic, and creatively planned accounting fraud, known since as the Enron scandal. Enron has since become a well-known example of willful corporate fraud and corruption. The scandal also brought into question the accounting practices and activities of many corporations in the United States and was a factor in the creation of the Sarbanes–Oxley Act of 2002. The scandal also affected the greater business world by causing the dissolution of the Arthur Andersen accounting firm.

effective in controlling chief executives and their management teams. At the same time the Netherlands and other continental countries were reviewing their company laws and developing their own corporate governance codes. Particularly relevant to Shell was the Tabaksblat Committee Code, which was also published in 2003. So Phillip Watts' watch from July 2001 to March 2004 coincided with a period of intense activity which led to the reform of laws, regulations and codes of practice aimed at imposing tighter controls on executive teams, their accountants and auditors.

### **2.5.2. The Sarbanes-Oxley Act, 2002**

After Enron,<sup>132</sup> WorldCom,<sup>133</sup> Xerox and a spate of other accounting scandals, the US Congress and business leaders urged the President to take action to reassure investors, to restore confidence in the integrity of US corporations and financial markets and to discourage fraudulent corporate behavior. On the 30 July 2002 President Bush signed the Sarbanes-Oxley Act, which established a new, much tougher regime of regulations to control the actions of Boards of Directors, corporate executives, accountants and auditors. The Act include the following arrangements: Tougher penalties for corporate fraud.

The legislation creates penalties for corporate fraud of up to 20 years for destroying or altering documents sought in federal investigations. Also chief executives who certify false financial reports will face prison terms of 10-20 years and fines of US\$1 million to US\$5 million: An independent accounting oversight board.

The new law creates a new (independent) five-member private sector board to oversee the accounting industry with subpoena authority and disciplinary powers: Restrictions on auditors' consulting.

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<sup>132</sup> Enron Corporation (former New York Stock Exchange ticker symbol ENE) was an American energy, commodities, and Services Company based in Houston, Texas. Before its bankruptcy on December 2, 2001, Enron employed approximately 20,000 staff and was one of the world's major electricity, natural gas, communications, and pulp and paper companies, with claimed revenues of nearly \$111 billion during 2000.

<sup>133</sup>WorldCom was the United States' second largest long distance telephone company (after AT&T). WorldCom grew largely by acquiring other telecommunications companies, most notably MCI Communications. It also owned the Tier 1 ISP UUNET, a major part of the internet backbone. It was headquartered in Clinton, Mississippi, before being relocated to Virginia.

The law would restrict consulting and other non-auditing services that accounting firms could provide to clients: Curbs on financial analysis.

The SEC is empowered to impose new rules on financial analysts to prevent conflicts of interest: Facilitation of investors' lawsuits.

The Act also extends the period of time in which defrauded investors might bring lawsuits against companies: Form 6k filing. The requirements on Form 6k filing came into force on 29 August 2002-a more detailed and onerous reporting system: Empowering the audit committee

The audit committee of the board, consisting of independent directors, should have the authority to propose external auditors to the shareholders: Loans to top executives

The Act placed a ban on subsidized personal loans to top executives and required prompt disclosure of share dealings to repay company loans: Vouching for financial statements

Separately, 700 companies with annual revenues of more than US\$1.2 billion must meet an SEC deadline to confirm that their chief executives and chief financial officers will vouch for the veracity of their companies; accounts: Dual listings

Shortly afterwards the SEC made it clear that European and Asian companies with US listings would be covered by the Sarbanes-Oxley Act, but the application of certain provisions would be negotiable. In the summer of 2002 the impact of the Sarbanes-Oxley Act was reinforced by the new listing requirements issued by the New York Stock Exchange and NASDAQ which require firms:

- a) To get shareholder approval for all stock-option plans;
- b) To have a majority of independent directors on their boards;
- c) To only independent directors on the audit committee and the committees that select chief executives and deal with executive compensation.

## **2.8. Conclusion**

This chapter concludes that for municipalities to be effective and to be able to perform their functions there is a high demand for independent institutions to oversee and monitor the performance and the functions of the sphere of local government on a day to day basis. This means that from the South African approach there is a need for the independent institution like the office of the Public Protector to continue doing the great work that it is currently doing by investigating corruptions activities and maladministration. It is through the Public Protector's office that the voiceless members of the public will be able to voice out the challenges they are faced with on a day to day basis in their municipalities.

Due to municipality failure to provide adequate services to communities, most members of the community took their frustrations to the street to demonstrate against the failure and poor services rendered by their municipalities.

It is worth noting that sometimes it might be difficult to spot out irregularities in the local government. Therefore is a serious need for the office of the Auditor General working together with the National Treasury to submit audit reports for each and every financial year so that members of the public can be able to inspect whether municipalities failures to render an effective services to its people is as a results of less revenues which were allocated to them from the national level or is as a result of corruptions activities that are taking place in their offices. It is therefore very clear that through the above institutions the principles of corporate governance in the public sector should be promoted. The chapter that follows this discusses the concept of governance in the local government.

## **CHAPTER THREE: THE CONCEPT OF GOVERNANCE IN LOCAL GOVERNMENT**

### **3.1. Introduction**

The development of the South African nation lies at the heart of the local government. Through its policies, such as the integrated development plans (IDP), service deliveries vision which needs to be provided for to members of the public will be reached and fulfilled, but such will not be reached as long as municipalities in South Africa continue to operate without a proper governance structures. There is a void space which needs to be filled in the local government. This is because in most case the day to day running of municipalities are in the hands of many politicians who are not well equipped with necessary skills. That is why many municipalities are constantly criticized due to its bad governance. To ensure that services are being provided to communities in South Africa the concept of governance should be understood at the local government level because municipalities are often regarded as government closest to people.

### **3.2. History of Governance**

Governance brings about development because where there is proper governance there is an effective development. It is therefore worth noting that the aspect of Governance is broad and therefore it is more than government itself. As such it would be difficult to for one pinpoint an exact time at which governance in local government first surfaced as a concept.

However, even though it might be difficult to trace the exact time of the concept of governance in local government, the etymological roots of governance can be traced back to the Greek *Kybernan*, which means to pilot or to steer.<sup>134</sup> The etymological developments of governance, governance as a scientific concept was surprisingly not coined in the political sciences but in the field of economics, in the 1970s, when it was

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<sup>134</sup> Kotze L J *Global Environmental Governance: Law and Regulation for the 21<sup>st</sup> century* (2012) 54.

See further Mette K A (2004), *Governance*, Cambridge: Polity Press, 3; Schneider, Volker (2004), 'Organisational Governance: Governace in Organisationen' in Arthur Benz (ed), *Governance-Regieren in KoplexenReglesystemen: EineEinfiihrung*, Wiesbande, Germany: VS Verlag Fur Sozialwissenschaften, 179.

used to collectively describe the institutional rules and management arrangements in companies and other business enterprises.<sup>135</sup>

It was also at this time that there was a marked revival of the concept and its scientific utility. This is because governance in the economic context refers to company or corporate management and corporate administrative structures and processes, as well as the vertical and horizontal design of interactions in a company and the various actors in the company that have as their primary aim the reduction of transaction costs.<sup>136</sup>

The concept of corporate governance then gradually found its way into the public-centered political governance realm or government in its traditional sense via international institutional economics, which is concerned with markets, federative and hierarchical organisations, contracts and commitments between private and public actors. As well as the manner in which cooperation occurs between these actors.

It was specifically through the work of the World Bank in Sub-Saharan Africa during the 1980s that the concept of good and bad governance “as meaning acceptable and unacceptable governance respectively” was coined. As such, these events cumulatively marked the first endorsement and support for the concept in a political context at the international level, this saw the concept of governance increasingly featured in the globalization debate in 1990s.<sup>137</sup>

It is therefore usually argued that governance is as old as humanity itself and, more importantly, that governance grew from the globalization maelstrom in an era which increasingly acknowledges the need to develop descriptive umbrella terms more closely suggesting complex contemporary societal concerns.<sup>138</sup> It is also pointed out that

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<sup>135</sup> Kotze L J (2012) 55.

<sup>136</sup> Kotze L J (2012) 55-56.

See also notably, it is also the concept of corporate governance with its decidedly institutional character that has subsequently led to the institutionalisation of the governance concept in the public/ political context. Mayntz, Renata (2006), ‘Governance Theory alsfortentwickelteSteuerunsthorie?’ in Gunnar FolkeSchuppert (ed), Governance-Forschung, Baden-Baden: Nomos Verlag, 15. For detailed theoretical treatment of corporate governance in the governance context see Jurgens, Ulrich (2008).

<sup>137</sup> Claude S M ‘The Proper Use of Governance in International relations’ (1998) 50 (155) *International Social Science Journal* 81-9 at 82.

<sup>138</sup> Kotze L J (2012) 7.

governance is a notoriously post-modern, vague, and globalized concept, and has even been described as fuzzy<sup>139</sup> and slippery, yet innocent".<sup>140</sup>

In the opening years of the 21<sup>st</sup> century, the question of 'governance' has moved to the center of our political, economic, social; personal and religious lives. The most immediate and obvious reason for this is that the dominant institutions of contemporary societies-international law regimes, state government, the global financial system and the corporate organization of economic life, educational and cultural institutions of all kinds have lost their capacity to govern the spheres of human activity for which they are deemed responsible in such a way as to maintain the common good.<sup>141</sup>

Therefore the word governance invokes a certain sense of familiarity in that it is often encountered in a daily life. For example in the media, corporate boardrooms, the world of politics and power, in dealings with governments, state departments and government officials; in almost all instances where regulation occurs and where authority, in whatever form and whether emanating from state or non-state sources, is present and exercised.<sup>142</sup>

As such, governance has become a popular focus of scholarly analysis in many disciplines, especially the social and economic sciences (for example, in public administration, business administration, and political science).<sup>143</sup> Governance is used in many scientific disciplines and contexts including, for example, political science, comparative politics, economics, international relations, public administration, public policy, and increasingly law. It is therefore a concept with as many definitions as there are commentators that write on it, with most of these working within specific disciplines and hailing from various perspectives and backgrounds.<sup>144</sup>

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<sup>139</sup> Finkelstein L S *what is Global Governance? Global Governance* (1995) 367.

<sup>140</sup> Harlow, Carol, *Deconstructing Government?* In Tom Ginsburg and Robert A. Kagan (eds), *Institutions and Public Law: Comparative Approaches*, New York (2005): Peter Lang Publishing, 143.

<sup>141</sup> Ronald E Introduction in Engel R J, Westra L & Bosselmann K (eds), *Democracy, Ecological Integrity and International Law*, Cambridge:(2012) 2 Cambridge Scholars Publishing. See also Kotze L J (2012) 51.

<sup>142</sup> Kuokkanen T, Honkonen T, Lewis M *International Environmental Law-making and Diplomacy: Insights and Overviews* (2016) 15.

<sup>143</sup> Ibid.

<sup>144</sup> Kotze L J (2012)58.

The term 'Governance', refers to the interaction between civil society<sup>145</sup> and government in determining governmental action<sup>146</sup>.

Governance is a term which is applied in many different domains and the inevitable result is a chameleon-type concept which changes itself and is changed according to specific external considerations and needs, for example, list at least five versions of governance, or five different areas in which it is used, including: governance in economic development and in the context of international development agencies such as the World Bank; governance in terms of international relations and international regimes; corporate governance or governance in private corporations; governance as new public management; and negotiated social governance, which is representative of networks, partnerships and various deliberative forms.<sup>147</sup>

Furthermore in its earliest guise, governance was used mostly to express the procedural aspects of government,<sup>148</sup> to the extent that it functioned as a derivative of the verb 'to govern'.<sup>149</sup> Other aspects include governance as meaning: "the capacity to

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In addition to there being many descriptions of the concept, governance is also not culturally neutral. This is evidenced by the fact that there is a concept which is difficult and in some instances impossible to translate into many languages. For instance in French understanding of governance (*gouvernance*) is not the same as the Anglo-American understanding. There is no equivalent of the word in Afrikaans and the words *regulerend/regering* (regulating or government) are often used instead. This is also the case in Germany, where the words *Steuerung/Regulierung* (Steering, control or regulating) are used instead of governance. Because of these difficulties of translation and for the sake of consistency most languages seem to use the term governance. See also Friedrichs, Jorg (2004).

<sup>145</sup> "By civil society, it is referred to those organized segments of society outside the public sector, including the civil associations, community organizations, social movements, trade unions, religious organizations, among others".

<sup>146</sup> "Governmental action is broadly construed to include public sector investments, implementation of social and economic development programs, operations of governmental institutions, and operations of judicial systems; in sum, actions taken by public sector institutions".

<sup>147</sup>Hirts, Paul, *Democracy and Governance* in Jon Pierre (ed), *Debating Governance: Authority, Steering and Democracy*, Oxford University Press, 14-19. See further Louis J. Kotze, *Global Environmental Governance: Law and Regulation for the 21<sup>st</sup> century*: Edward Elgar Publishing Limited, USA (2012). On A Multi-disciplinary, Multi-textual and Plural Setting in Page 58.

<sup>148</sup> Renate M 'governance in modernen Staat' in Arthur Benz (ed), *Governance-Regieren in Komplexen Regelsystemen: Eine Einführung*, Wiesbaden, Germany: VS Verlag für Sozialwissenschaften (2004) 66.

<sup>149</sup> Volker S 'Organizational Governance; Governance in Organisationen' in Arthur Benz (ed), *Governance-Regieren in Komplexen Regelsystemen: Eine Einführung*, Wiesbaden, Germany: VS Verlag für Sozialwissenschaften, (2004) 176.

regulate; situations where authority is exercised, a mode of allocating values; and the emergence of rule-like systems and problem solving mechanisms.<sup>150</sup>

It is then evident that governance could mean many things and that it has many faces, its content will vary in relation to the details of its application and the purpose for which it is used and the context in which it is used. In addition, the meaning of the term will also depend on which actors one chooses to include in one's concept of governance or the problems it aims to solve (i.e., whether they are to be found in the domain of the environment, trade, or economics, for example); the general purpose of a specific governance effort; the level of governance, and so forth.<sup>151</sup>

### **3.3. Understanding the concept of government and governance**

The word government means an institution; an institution in turn is a set of internal roles and relationships, rights and obligations, responsibilities and functions.<sup>152</sup> An institution consists of people assigned specific positions, functions and role within an organized structure. A developmental-oriented government, therefore, is one that has designed its internal relationships in such a way that specific developmental goals are achieved.<sup>153</sup>

Governance therefore in contrast refers more broadly to the environment in which government functions and to government's relationships with outside stakeholders, whereas a system of governance refers to government's relationships with the electorate, the public, the consumers of services, and non-state actors.<sup>154</sup>

A development oriented system of governance therefore is an institutional environment in which government creates the types of relations with outside stakeholders that encourage those stakeholders to launch and sustain development initiatives.<sup>155</sup> During

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<sup>150</sup>Rosenau J N 'Governance, Order, and Change in World Politics' in James N. Rosenau and Ernst-Otto Czempiel (eds), *governance without Government: Order and Change in World Politics* (1992) Cambridge University press, 6-9

<sup>151</sup> Kotze L J (2012) 59.

<sup>152</sup> Atkinson D 'Local Government Local Governance and Sustainable development' 2002 *HSRC* 1-29.

<sup>153</sup> Atkinson D Local 'Government, Local Governance and Sustainable development: Getting the right parameters right' 2002 *HSRC*.

<sup>154</sup> Atkinson D (2002) 2.

<sup>155</sup> Atkinson D (2002) 2 para 2.

the past eight years enormous progress has been made in designing development oriented government structures and governance systems in South Africa. The most significant innovation has been the formal adoption of developmental local government as the cornerstone of development policies and programmes.<sup>156</sup>

In terms of the White Paper on Local Government (1998), the Municipal Structures Act<sup>157</sup> and the Municipal Systems Act,<sup>158</sup> municipal government has come to the fore as arguably the most important level of government in the overriding purpose of promoting development.

The importance of local government is based on several key factors. Firstly, local government is intrinsically multi sectoral. It is the only sphere of government that has the mandate to bring together a variety of sectoral issues within one developmental programme, policy or project. Secondly, local government is closest to the people.<sup>159</sup>

This often used phrase has several aspects. For one thing, municipal offices are often simply geographically closer to residents than other levels of government and, especially for poor people; such offices are often easier to reach. For another thing, local councillors have a much smaller constituency to report to, than public representatives at provincial or national level, and can therefore concentrate on issues and local matters that are highly community specific. More specifically, the ward system of representation unlike the proportional representation system at provincial and national level means that councillors must attend to the needs and interest of specific neighbourhoods and as such since councils are elected institutions, it therefore means that a councillor who consistently fails to deliver can be removed at the end of his or her term of office or even during it.<sup>160</sup>

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<sup>156</sup> Atkinson D (2002) 2-3 para 3.

<sup>157</sup> Local Government: Municipal Structure Act 117 of 1998.

<sup>158</sup> Local Government: Municipal System Act 32 of 2000.

<sup>159</sup> Atkinso D Local Government, Local Governance and Sustainable Development: Getting the parameters right (2002)3.

<sup>160</sup> Atkinson D (2002) 2-3 para 3.

The third important dimension of local government is the spatial one. Increasingly, development theorists and planners have come to realise that development is profoundly labour intensive.<sup>161</sup>

Real development requires ongoing involvement with beneficiaries and communities, whether in the form of leadership development, institutional capacity building, public participation in planning or project implementation and frequently, conflict management. It simply makes more sense for such developmental activities to be based at a level of government that is staffed by people who are physically accessible to residents, and who preferably live within the local community.<sup>162</sup>

It is clear that local government should play a key role within the developmental renaissance that Africa and South Africa have embarked upon. In this regard, South Africa is at the cutting edge of development debates. Therefore, the claim that municipalities are the primary developmental agency within the governmental system has radical and far reaching implications for governmental structuring and practices.<sup>163</sup>

The real challenge now, is to work through the implications of these claims and debate. The questions that one needs to ask are what would developmental municipalities look like? How would they function? What would their relationship be with other institutions within the system of government? And what should their relationships of governance be with other developmental players.

Atkinson further writes that

Municipalities are currently at a critical juncture in their development. Since mid-2001, municipalities have been required to write integrated development plans (IDPs). These IDPs are intended to be multi sectoral programmes, including a wide variety of development, ranging from hard services such as water, sanitation, electricity, housing and roads, to soft or human development issues such as land reform, poverty alleviation, tourism and local economic development (LED). Many municipalities completed their IDPs during early 2002. Now the crucial question is and will always remain as follows: do

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<sup>161</sup> Atkinson D (2002) 3.

<sup>162</sup> Atkinson D (2002) 3.

<sup>163</sup> Atkinson D (2002) 4.

they have the capacity to implement their IDPs? Or will these IDPs become dust covered tomes that grace municipalities' bookshelves? The argument of government and governance will always proceed from questions of internal municipal management, to inter-municipal relations and finally, to inter-governmental relations.<sup>164</sup>

### **3.4. Characteristics of good governance**

The four characteristics of good governance can be described as follows:

#### **3.4.1. Transparency**

By transparency we mean that decisions taken and their enforcement are done in a manner that follows rules and regulations. This also means that information is freely available and directly accessible to those who will be affected by such decisions and their enforcement. Pursuant to that it means that enough information is provided and that is provided in easily understandable forms and media.<sup>165</sup>

Transparency is the ease with which an outsider is able to make meaningful analysis of a company's (Local governments) action and its economic fundamentals. Management must make the necessary information available candidly, accurately and timeously. It should be possible to obtain a clear and true picture of what is happening inside a company from the information supplied by the company.<sup>166</sup>

Nonetheless, there has been a significant improvement in transparency in reporting. An example which illustrates the improved transparency is that the reporting of aggregate year-on-year irregular expenditure has increased. It could easily be concluded that performance has regressed. In the past limited emphasis was placed on the disclosure of these types of expenditure and only through the implementation of the various reforms have higher levels of transparency and accountability been achieved.<sup>167</sup>

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<sup>164</sup> Atkinson D (2002) 5.

<sup>165</sup> 'What is Good Governance?' *United Nations Economic and Social Commission for Asia and the Pacific* 1-3. Available at <http://www.unescap.org/sites/default/files/good-governance.pdf> (accessed 31 September 2015).

<sup>166</sup> Ibid.

<sup>167</sup> Joint Media Statement by the Ministers of Finance and Cooperative Governance and Traditional Affairs (CoGTA) on the Consolidated General Report on Local Government Audit Outcome for (2012/13).

Transparency means that the municipal council should be transparent in the manner in which they exercise their governance role and responsibilities; and should embody ethical characteristics in order to offer effective leadership that result in achieving strategic objectives and positive outcomes over time. There should also be arrangements by which the council is being held to account for ethical and effective leadership. Such arrangements should include, but not limited to, codes of conduct and performance evaluations of the councils and its members.<sup>168</sup>

### **3.4.2. Accountability**

Accountability is a key requirement of good governance. Not only for governmental institutions but also for private sector and civil society organizations, must be accountable to the public and their institutional stakeholders. It is worth noting that who is accountable to whom varies depending on whether decisions or actions taken are internal or external to an organization or an institution is accountable to those who will be affected by its decisions or actions. However, accountability cannot be enforced without transparency and the rule of law.<sup>169</sup>

Accountability is at the heart of good governance and has to do with holding governments responsible for their actions.<sup>170</sup> Individuals or groups in a company or local government (Municipalities) who make decisions and take actions on specific issues need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability, thus facilitating both transparency and responsibility. This provides investors with the means to query and assess the actions of the board and its committees.<sup>171</sup>

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<sup>168</sup> King IV (2016) 44.

<sup>169</sup> 'What is Good Governance?' available at <http://www.unescap.org/sites/default/files/good-governance>. (Accessed on 10 October 2015). United Nations Economic and Social Commission for Asia and the Pacific 3.

<sup>170</sup> DEVELOPMENT IN: PRACTICE Governance-The World Bank's Experience, The Development in Practice series publishes reviews of the World Bank's activities in different regions and sectors. It lays particular emphasis on the progress that is being made and on the policies and practices that hold the most promise of success in the effort to reduce poverty in the developing world, May (1994).

<sup>171</sup>See Ibid on the above footnote 113.

The board should endeavour to ensure that the business enterprise is financially viable and properly managed, so as to protect and enhance the interests of the corporation and its shareholders over time. The board should seek to understand the expectations of shareholders and endeavour to fulfil those expectations when deciding upon the best interests of the corporation. The board should always ensure that all shareholders are treated fairly and provided with appropriate information on an equal basis, irrespective of the significance or otherwise of their interest in the corporation. The board should act in the context that its shareholders, certainly in the case of publicly quoted corporations, are constantly changing. Consequently, decisions should consider the interests of future shareholders as well.<sup>172</sup>

This means that the municipal council should be willing to answer for the execution of their responsibilities, even when were delegated.<sup>173</sup>

### **3.4.3. Responsibility**

Responsibility pertains to management behaviour that follows internal mechanisms to allow for corrective action and the sanctioning of mismanagement. When necessary, responsible management would put in place what it takes to set the sphere of local government on the right path.<sup>174</sup> This means that the municipal council should assume collective responsibility for steering and setting the direction of the municipality; approving policies and planning; overseeing and monitoring of implementation and execution by management and ensuring accountability for municipal performance.<sup>175</sup>

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<sup>172</sup> Wolfensohn J D CACG Guidelines, Principles for Corporate Governance in Commonwealth (1999) 1-100 available at [http://www.nfcgindia.org/pdf/cacg\\_guidlines.pdf](http://www.nfcgindia.org/pdf/cacg_guidlines.pdf) “The proper governance of companies will become as crucial to the world economy as the proper governing of countries”.

<sup>173</sup> King IV Report 2016(43).

<sup>174</sup> Ibid

<sup>175</sup> King IV Report 2016(43).

#### **3.4.4. Fairness**

By fairness it means that municipal staff members and the council should adopt a stakeholder-inclusive approach in the execution of their governance role and responsibilities; and should also direct the organization in such a way that it does not adversely affect the natural environment, society or future generations.<sup>176</sup> The systems that exist within the company or municipalities must be balanced in taking into account all those who have an interest in the municipality or company and its future. This means that the rights of various groups have to be acknowledged and respected. The interest of minority and members of the community must receive equal consideration to that of the dominant.<sup>177</sup>

#### **3.5. Challenges of improving governance**

Governance remains an alien concept in many developing countries. Many view the concept as an imposition of international agencies and western, industrialized countries. Nevertheless, the attention being given to governance should be welcomed. Despite the lack of consensus, the concept encourages the focus of development and government practice to expand beyond government itself. By broadening the context of governmental action, it tends to emphasize responsiveness of government to citizens and to improving government through stronger mechanisms of accountability. Nevertheless, caution must be exercised in the application of governance to particular country and cultural contexts. As a result of these considerations, governance can best be used as a diagnostic rather than a set of normative propositions.<sup>178</sup>

Improving the effectiveness of government action, especially in terms of the improvement of living conditions in a country, remains the core concern. The responsibilities of local government vary substantially across countries and within a single country performance must be evaluated against the responsibilities and

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<sup>176</sup> King IV Report 2016(44).

<sup>177</sup> Ibid.

<sup>178</sup> George M Local government and the empowerment of women. In: WILSON, Robert H., CRAMER, Reid (Eds.). *International workshop on local governance: second annual proceedings*. Austin, TX: LBJ School of Public Affairs (1996)247-256.

competencies that local governments hold. As others have suggested, governance should be conceptualized as the relationship between civil society and the public sector as it affects governmental action. This definition and understanding of governance can make an important contribution to the diagnosis of government action in a particular country especially in South African and others areas.<sup>179</sup>

In this framework, inadequate performance of local government can result from a number of sources. The problem may be in the public sector itself, which may have inadequate local capacity or will to act or be severely constrained by its intergovernmental context. Another potential source of difficulty is civil society, which may not be able to articulate interests and demands in an effective manner. Or inadequate performance may result from the relationship between the public sector and civil society.<sup>180</sup> Citizens may not be able to participate fully and freely in the election of their leaders or there not may be a public space in which the interests of society are debated, aggregated and heard by public officials. Perhaps channels of communication between the two sectors are available but the public has inadequate knowledge of governmental action or understanding of the issues involved.<sup>181</sup>

The analysis of poor performance in this framework leads to multiple strategies for enhancing performance. And substantial variation among countries regarding the most appropriate strategies should be expected. For example, a change in political culture so that citizens develop expectations concerning government performance or better electoral systems may be needed. Better information, so called transparency, concerning governmental procedures, planning, and actions may be required. The

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<sup>179</sup> Larry G 'Summation of the issues and criteria in identifying good local government' In: WILSON, Robert H., CRAMER, Reid (Eds.). *International workshop on good local government: first annual proceedings*. Austin, TX: LBJ School of Public Affairs (1995) 151-53.

<sup>180</sup> 'Municipal borrowing and financial emergencies policy framework' available at [http://www.gov.za/sites/www.gov.za/files/mun\\_fin.pdf](http://www.gov.za/sites/www.gov.za/files/mun_fin.pdf) (accessed 27 October 2015).

<sup>181</sup> 'Understanding local governance: an international perspective' available at <http://www.scielo.br/pdf/rae/v40n2/v40n2a06.pdf> (accessed 15 November 2015).

creation of mechanisms that allow for the direct participation of civil society in determining governmental action may enhance performance.<sup>182</sup>

Can experiences in one locale be successfully replicated in others? Although community participation can produce positive results on issues in a particular place, how can local action overcome the obstacle of being local? Can localities unite or associate in ways that lead to the adoption of enabling mechanisms at national government level? Can cross-fertilization of effective practice across local governments influence governance practices at the national level? Promoting participation across local governments and insuring that local participation can be aggregated to affect higher levels of government are mechanisms for overcoming the limitations of local action. One would hope that success in community and citizen participation in specific locales could eventually be broadly incorporated into a country's practice and even affect its political culture. Finally, what opportunities and constraints do national governments place on local governance? Improved local governance may be achieved through initiatives of higher levels of government. However, diffusion of innovative practice across local governments or local governments acting in coalition may also improve the prospects of local government performance.

The burden and responsibility this conception of governance places on civil society should not be underestimated. Effective government action is a responsibility civil society shares with government itself. A variety of governmental prerogatives and responsibilities, including the protection of basic human rights and the creation of contexts for citizen participation, exists in all societies but society must organize itself. The development of social capital is, in the end, a responsibility and function of civil society. If the unorganized and disenfranchised are also poor, the challenge is even greater.

In some extreme cases, with widespread poverty, a complete lack of government institutions makes local governance moot. The argument that governance must be improved in order to improve governmental performance has much merit, but it must be

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<sup>182</sup> Wilson R H 'Understanding local governance: an international perspective' (2000) 40 *RAE-Revista de Administração de Empresas*, available at <http://www.fgv.br/rae/artigos/revista-rae-vol-40-num-2-ano-2000-nid-46199/> (accessed on 15 November 2015).

applied with caution. In some situations, effective leadership, public and private, may be necessary before broad participation in public life can be achieved. If citizens have historically held no expectations of governmental action, without even some simple examples of government accomplishment, public expectations of improvement will not materialize. Even when the channels of participation are open and accessible, the information and analysis needed for coherent policy formation are substantial. In order for citizens to acquire such independent analysis, they will need considerable resources. This conception of governance identifies civil society as an essential factor for producing good government, but it also implies that only well organized and politically active societies have the ability to hold governments accountable.

### **3.6. Conclusion**

In conclusion the word 'governance' means to govern. Therefore it is very important that public institutions such as municipalities should have an independent oversight board rather than the provincial government which will be able to ensure that all local government staff members and municipal facilities are governed in such a way that municipal services are being provided for to all members of the public.

It is worth noting that the reason why most municipalities are faced with too much corruptions and maladministration is because in most instances the aspect of governance is left out. As a result, it should be borne that the principles of corporate governance and governance on its own as a concept are two different things but they are intertwined, they work together. This means that the concept of governance cannot be claimed outside or without the principles of corporate governance and the other way around. This study therefore finds that a good and effective municipality is a municipality which has the concept of governance and knowing how to govern and regulate its affairs. Having discussed the concept of governance in the local government the chapter following this one seek to interpret the application of the principles of corporate governance in the local government level.

## CHAPTER FOUR: INTERPRETATION AND APPLICATION OF CORPORATE GOVERNANCE PRINCIPLES

### 4.1. Introduction

Corporate governance can be defined as the system whereby entities are managed and controlled.<sup>183</sup> The object of corporate governance rules is to improve the quality of leadership which boards are giving to their businesses. Corporate governance guidelines seek to assist directors to understand what good governance requires of them.<sup>184</sup>

Company law is essentially concerned with first making available the corporate form to facilitate and regulate the process of raising capital (corporate finance or capitalisation of a company); and, secondly, imposing controls on persons whose power is derived from the finance that the users of the corporate form have put at their disposal (i.e. corporate governance).<sup>185</sup>

Corporate governance is generally understood to mean the way in which companies are directed and controlled.<sup>186</sup> Thus, the emphasis is on those organs which play a vital role in corporative decision-making. It is widely accepted that corporate governance does not affect or apply exclusively to listed companies, as some writers insist. In order to simplify matters, a distinction needs to be drawn between corporate governance applicable to all companies and corporate governance applicable to 'affected companies' as defined by the King Committee on Corporate Governance.<sup>187</sup>

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<sup>183</sup> Marx B et al (2011) 97. See also Sebola K R *Principles of Corporate Governance with specific reference to the case of South African Broadcasting Corporation (LTD) V Mpopu 20009 4 ALL SA 169. (GSL) (2012) 7.*

<sup>184</sup> Bowman Gilfillan Attorneys, Quick Guide to Corporate Governance and King III. See further Ellis Ferran on *Company Law and Corporate Finance* (1993).

<sup>185</sup> Nevondwe L 'Corporate Governance Principles, Lessons to be learned, The Thinker, Cooperative governance Frame work, lesson to be learnt (2012) 4 4.

<sup>186</sup> In the past the term Corporate Governance was not use, instead the term used was 'Company management', this concept is therefore fairly new. See 'the Report of the Committee on the Aspect of Corporate Governance', December 1992.

<sup>187</sup> The affected companies are defined by the King II as 'all companies with the securities which are listed on the JSE securities Exchange, financial and South African Banks and also insurance entities as explained in various legislation regulating South African Financial sector'. "Companies are directed and controlled such that they can

## 4.2. Definition of Corporate Governance

It is without any doubt that the concept of corporate governance is broad and can be defined in different ways depending on a scholarly research and countries. The way countries define what is corporate governance differs from one country to another. In defining corporate governance one should first look on its framework. Therefore by defining the principle of corporate governance, corporate governance framework depends on the legal, regulatory, institutional and ethical environment of the community. Whereas the 20th century might be viewed as the age of management, the early 21st century is predicted to be more focused on governance. Both terms address control of corporations but governance has always required an examination of underlying purpose and legitimacy.<sup>188</sup>

The term corporate Governance or Governance has appeared similarly to other terms such as privatization and globalization. They are newly used terms in the economies, institutions and economic units of the developing countries.<sup>189</sup> It is therefore always difficult to define the concept of corporate governance in a universally acceptable way because definitions vary from country to country. Moreover, countries differ from each other in terms of culture, legal systems and historical developments; therefore as such this explains why there is a wide range of definitions of the concept of corporate governance.<sup>190</sup>

However, even though this concept is very broad, corporate governance allows firms to prepare for their future expansion and sustainable growth and therefore the core values of transparency and accountability will be embedded in their business culture, this

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fulfil their goals and objectives in a manner that adds to the value of the companies and is also beneficial to all stakeholders in the long term”.

<sup>188</sup> McRitchie J ‘what is Corporate Governance (8/1999)’ available at [http://www.corpgov.net/library/corporate-governance-defined/Corporate\\_Governance](http://www.corpgov.net/library/corporate-governance-defined/Corporate_Governance) CorpGov.net: improving accountability through democratic corporate governance since 1995 (Accessed on 06 July 2015).

<sup>189</sup> Kenawy E M & AbdElgany M F K ‘Corporate governance and its potential implementation in Egypt in light of international experiences’ (2009) 1 (5) *Journal of public administration and policy research* pp. 084-100 Available online <http://www.academicjournals.org/jpapr> ©2009 Academic Journals.

<sup>190</sup> Mulili B M ‘Corporate Governance Practices in Developing Countries: The Case for Kenya’ (2011)2 *International Journal of Business Administration* 1-14.

culture of transparency and accountability will also indicate professional management and good governance for successful and well organised companies.<sup>191</sup>

#### **4.3. Complexity analysis of the definitions of Corporate Governance**

As stated above the definitions of corporate governance are varied according to the different adopted viewpoints related to the research scope, therefore governance can be defined as the corporations' rational governance through a group of laws, rules and bases that guarantee transparency and law enforcement.<sup>192</sup>

By defining governance it will be much easier to explain what is meant by corporate governance, which in a broad light the concept of corporate governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors.

Corporate governance is about how investors get the managers to give them back their money.<sup>193</sup>

Corporate governance is about the whole set of legal, cultural, and institutional arrangements that determine what public corporations can do, who controls them, how that control is exercised, and how the risks and return from the activities they undertake are allocated.<sup>194</sup>

Corporate governance refers to how a corporation is governed. Who has the authority to make decisions for a corporation within what guidelines? This is the corporation's governance. In the United States, the governance of corporations is largely determined by state laws of incorporation. State laws typically say that each corporation must be

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<sup>191</sup> Dube I, Dube D & Mishra P 'Macrothink Institute' (2011) 1 *Journal of Public Administration and Governance*.

<sup>192</sup> Kenawy M E & Abd Elgany M F K 'Corporate governance and its potential implementation in Egypt in light of international experiences' (2009) 1(5) *Journal of public administration and policy research* 084-100.

<sup>193</sup> Andrei S & Vishny R W 'A Survey of Corporate Governance' (1997) 52 (2) *Journal of Finance*, pp 737-783.

<sup>194</sup> Blair M 'Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century' (1995) 39 *Challenge* pp. 62-64.

“managed by or under the direction of its boards of directors.” More specifically, corporate boards of directors are responsible for certain decisions on behalf of the corporation. At a minimum, as stated in most state statutes of incorporation, director approval is usually required for amending corporation bylaws, issuing shares, or declaring dividends. Also, the board alone can recommend that shareholders vote to amend articles of incorporation, dissolve the corporation, or sell the corporation. No other person or entity except the board can take these actions. That is why discussions of “corporate governance” often focus on boards.<sup>195</sup>

Corporate governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised. Good corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.<sup>196</sup>

It was therefore also provided for by the Delaware Supreme Court which has stated that the most fundamental principles of corporate governance are a function of the allocation of power within a corporation between its stockholders and its board of directors.<sup>197</sup>

Generally, corporate governance refers to the host of legal and non-legal principles and practices affecting control of publicly held business corporations. Most broadly, corporate governance affects not only who controls publicly traded corporations and for what purpose but also the allocation of risks and returns from the firm’s activities among the various participants in the firm, including stockholders and managers as well as creditors, employees, customers, and even communities. However, American corporate governance doctrine primarily describes the control rights and related responsibilities of three principal groups: the firm’s shareholders, who provide capital and must approve major firm transactions, the firm’s board of directors, who are elected by shareholders to

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<sup>195</sup> Ibid.

<sup>196</sup> ASX Principles of Good Corporate Governance and Best Practices Recommendations, (2003).

<sup>197</sup> Brown J R & Casey L L ‘Corporate Governance: Cases and Materials’ (2012) *Legal Research Paper Series Working Paper No. 11-34*, pp 1-25.

oversee the management of the corporation, and the firm's senior executives who are responsible for the day, today operations of the corporation.<sup>198</sup>

On the other hand it is provided that corporate governance is the process carried out by the board of directors, and its related committees, on behalf of and for the benefit of the company's stakeholders, to provide direction, authority, and oversight to management.<sup>199</sup> Corporate governance is generally understood to mean the way in which companies are directed and controlled.<sup>200</sup> One should be careful not to limit corporate governance to only how the companies are directed and controlled but should rather expand it to all the private and public institutions in which this concept applies or should apply.

#### **4.4. The application of the principles of corporate governance**

The King III Report and the Code apply to all entities incorporated in and resident in South Africa, regardless of the manner and form of incorporation or establishment and whether that establishment is in the public, private or non-profit sectors.<sup>201</sup> In contrast, the King II Report only applied to certain categories of business enterprises, namely listed companies, financial institutions and sector enterprises, while companies falling out of these categories were merely required to consider the application of the King II Report insofar as it was applicable.

The USA codified its corporate governance provisions in the Sarbanes-Oxley Act of 2002 and legal sanctions are applied for non-compliance with this Act.<sup>202</sup> In South Africa, compliance with the King III Report and the code is mandatory for the companies listed on the JSE, financial institutions and sector enterprises, but for all other entities there is no statutory obligation to comply with the King III Report and the Code. While

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<sup>198</sup> McRitchie J, Corporate Governance CorpGov.net: improving accountability through democratic corporate governance since 1995 available at <http://www.corpgov.net/wp-content/uploads/2016/03/SEC-QCOMproxy>. (Accessed on 04 August 2016)

<sup>199</sup> Sobel P J *Auditor's Risk Management Guide: Integrating Auditing and ERM* (2007) 2005 edition.

<sup>200</sup> Nevondwe L, Odeku K O & Raligilia K 'Ethics in the State-Owned Companies in the Public Sector: A Thin Line between Corporate Governance and Ethical Leadership' (2014) 5 *Mediterranean Journal of Social Sciences* MCSER Pp1-8.

<sup>201</sup> King III Report (2009).

<sup>202</sup> The Sarbanes-Oxley Act of 2002 applies only to all companies which have securities trade publicly in USA.

corporate governance practices in South Africa may be voluntary, note that they are highly recommended and have considerable persuasive force. Commonwealth countries and the European Union states have also not legislated their corporate governance practices and have adopted a similar approach to that adopted in South Africa. Having discussed the application of the principles of corporate governance this study further discusses the principles of corporate governance.

#### **4.5. Principles of corporate governance**

The King III Report provides guidance on the following aspects related to corporate governance:

- a) Ethical leadership and corporate citizenship;
- b) Boards and directors;
- c) Audit committees;
- d) The governance of risk;
- e) The use of information technology;
- f) Compliance with the laws, codes, rules and standards;
- g) Internal audit;
- h) Governing stakeholder relationships; and
- i) Integrated reporting and disclosure

##### **4.5.1. Ethical leadership and corporate citizenship**

The underlying philosophy of the King III Report revolves around leadership, sustainability and corporate citizenship. On the issue of leadership, the King III Report requires the board of directors to provide effective leadership based on an ethical foundation.<sup>203</sup> Ethics or integrity is the foundation of and very reason for corporate

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<sup>203</sup> Nevondwe L, Odeku K O & Tshoose C I (2014) 6.

governance. An ethical corporate culture constitutes more than social philanthropy or charitable donations.<sup>204</sup> The reasoning behind the ethics of corporate governance, which requires the board of directors to ensure that the company is run ethically, is that, as this is achieved, the company earns the respect and approval of those affected by and affecting its operations.<sup>205</sup> The company should conduct its business in an ethical manner.<sup>206</sup> The board should set the values on the company and ensure the formulation thereof in a code of conduct. It is therefore also held that the board should ensure that the company's ethics are managed effectively.

The board should ensure the following: that an ethical corporate culture is built and sustained in the company.<sup>207</sup> It determines ethical standards which are clearly understood by the company and that the company ensures adherence in all aspects of its business, adherence to the ethical standards is measured. The risk management process incorporates ethical risks and opportunities; the ethical performance of external business partners is aligned around the ethical standards of the company.<sup>208</sup> The company introduces a code of conduct and that ethics-related policies are implemented and that the operations of the company are based on compliance with the code of ethics. The company also assesses, monitors, reports, and discloses its ethical performance.<sup>209</sup>

#### **4.5.2. Boards and directors**

The King III Report differentiates between executive and non-executive directors. An executive director is involved with the day-to-day management of the company. He or she is in the full-time salaried employment of the company and is generally under a contract of service with the company. A non-executive director, on the other hand, is a part-time director. He or she is not involved in the management of the company, but plays an important role in providing objective judgment, independent of management,

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<sup>204</sup> King III Report (2009) 20 para 9.

<sup>205</sup> King III Report (2009) 21 para 12.

<sup>206</sup> Opcit .

<sup>207</sup> Nevondwe L (2012) 17.

<sup>208</sup> Sebola K R (2012) 9.

<sup>209</sup> Ibid.

on issues facing the company. Generally, non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors.<sup>210</sup>

In *Fisheries Development Corporation of SA Ltd v Jorgenses and Fisheries Development Corporation of SA Ltd v AWJ Investment*,<sup>211</sup> the court stated that non-executive directors are not bound to give continuous attention to the affairs of the company. Their duties are of an intermittent nature, to be performed at periodical board meetings and at any other meetings that may require their attention. Non-executive directors are expected to attend board and relevant board committee meetings and to acquire and maintain a broad knowledge of the economic environment, industry and business of the company. The role of non-executive directors and the independence that they are believed to bring to the board of directors has been a consistent theme of corporate governance theories, policies and programmes.<sup>212</sup>

An independent non-executive director is a director who is required to be independent in character and judgment. There should be no relationships or circumstances that are likely to affect, or could appear to affect, their independence. In this context, 'independence' means the absence of undue influence and bias that could be affected by the intensity of the relationship between the director and the company, rather than any particular fact such as length of service or age. Not only should the director be independent in fact, but he or she should also appear to be independent in the perception of a reasonably informed outsider. The King III Report defines an independent non-executive director as a non-executive director who:

- a) is not a representative of a shareholder who has the ability to control or significantly influence management or the board;
- b) does not have direct or indirect interest in the company which is less than 5 percent of the group's total number of shares in issue;

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<sup>210</sup> King III Report (2009) 22 Principle 2.

<sup>211</sup> *Fisheries Development Corporation of SA Ltd v Jorgenses and Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd* 1980 (4) SA 165.

<sup>212</sup> Blackman et al *Contemporary on the companies Act Vol 2* (2002).

- c) does not have direct or indirect interest in the company that exceeds 5 percent of the group's total number of shares in issue, but is material to his or her personal wealth;
- d) has not been employed by the company or the group of which it currently forms part in any executive capacity, or appointed as the designated auditor or partner in the group's external audit firm, or as senior legal advisor in the preceding three financial years;
- e) is not a member of the immediate family of an individual who is, or has, during the preceding three financial years, been employed by the company or the group in an executive capacity;
- f) is not a professional adviser of the company or the group, other than as a director;
- g) is free from any business or other relationship (contractual or statutory) that could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer or supplier to the company; or
- h) does not receive remuneration contingent upon the performance of the company.

The board of directors is the most important governance structure, as it is ultimately responsible for the performance and affairs of the company. Several investigations after recent corporate collapses pointed towards a lack of effective accountability within companies. The board of directors can therefore be seen as the focal point of any corporate governance system, and the code as part of its recommendations lists the duties and responsibilities of the board of directors from a corporate governance point of view.<sup>213</sup>

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<sup>213</sup> Nevondwe L (2012) 17.

### 4.5.3. Audit committees

The King III Report requires the board of directors to ensure that the company has an effective and independent audit committee.<sup>214</sup> An independent audit committee plays a central role in corporate governance and is vital to ensure the integrity of integrated reporting and financial controls and to identify and manage financial risks.<sup>215</sup>

The report requires listed and state-owned companies to establish an audit committee.<sup>216</sup> The shareholders must elect the members of the audit committee at each annual general meeting. Private companies, nonprofit companies and personal liability companies may voluntarily appoint an audit committee and define its composition, purpose and duties in the Memorandum of Incorporation. The audit committee should meet as often as is necessary to perform its functions, but it is recommended that it meets twice a year. It should also meet with the internal and external auditors at least once in a year without the management being present.

The audit committee should comprise at least three members who should be suitably skilled and experienced independent nonexecutive directors. Section 94(4) of the Act prescribes further requirements to qualify as a member of the audit committee. A member of the audit committee must be director of the company who satisfies any minimum qualification requirements set out by the Minister of Trade and Industry as being necessary to ensure that the committee comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions.<sup>217</sup>

The audit committee is currently viewed as one of the most important governance structure within the modern company. The Companies Act also regulates the appointment, role and composition for all public companies and state-owned entities.

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<sup>214</sup>Mkhabele C J M M A *legal analysis of the application of corporate governance principles in Musina Local municipality* (unpublished mini dissertation completed at the University of Limpopo 2014).

<sup>215</sup> King III Report (2009) 59 Para 1.

<sup>216</sup> Marx B et al (2011) 42-43. A state-owned company, public company or any other company that has voluntarily determined to have an audit committee, must elect an audit committee comprising of at least three members. "Usually the minister may prescribe minimum requirements for members of audit committee as necessary to ensure that such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its function" ..

<sup>217</sup> "The regulations require that at least 1/3 of the members should have a qualification or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource. Therefore this questionable as no financial experience and expertise requirement was set'".

The King Code furthermore stipulates that the board should ensure that the company has an effective and independent audit committee.<sup>218</sup>

#### **4.5.4. The governance of risk**

The King III Report requires that the board of directors be responsible for the governance of risk and determine the levels of risk tolerance that the company is able to bear in the pursuit of its objectives.<sup>219</sup> Risk is defined as the taking of risk for reward. The board of directors should determine the levels of risk tolerance at least once a year. It should review these limits during periods of increased uncertainty or any adverse changes in the business environment.

It is recommended that the board's responsibility for risk governance be expressed in the board charter. In addition, the board's responsibility for risk governance should manifest in a documented risk management policy and plan, which should be widely distributed throughout the company and reviewed by the board at least once a year. The board should also comment in its integrated report on the effectiveness of the system and process of risk management.<sup>220</sup>

#### **4.5.5. The governance of information technology (IT)**

The governance of IT is dealt with for the first time in the King III Report. As acknowledged by the King III Report, IT has become an integral part of doing business and is fundamental to support, sustain and grow the business. The King III Report states that IT governance is not an isolated discipline, but an integral part of overall corporate governance. Information technology governance can be considered as a framework that supports the effective and efficient management of IT resources to facilitate the achievement of a company's strategic objectives. The IT governance framework should include the relevant structures, processes and mechanisms to enable

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<sup>218</sup> Marx B et al (2013) 111 para 1.

<sup>219</sup> King III Report (2009) Principle 4.1.

<sup>220</sup> Therefore as such "the process of risk management can be described as the identification, evaluation and measurement, management and monitoring of all major risks with which the company/municipalities are faced with".

IT to deliver value to the business and to mitigate IT risks. It should focus on the governance of the information as well as the governance of technology.<sup>221</sup>

The King III Report requires the board of directors to be responsible for IT governance. The board may appoint an IT steering committee or similar forum to assist with its governance of IT. It is recommended that the Chief Executive Officer (CEO) appoints a Chief Information Officer (CIO) to be responsible for the management of IT. There is an increased risk to organisations that embrace IT and its directors should ensure that the reasonable steps have been taken to govern IT.<sup>222</sup>

The board should monitor and evaluate significant IT investment and expenditure. The board should specifically focus on value for money, return on investment and the protection of intellectual property and also the assurance on IT internal controls should also include outsourced services.<sup>223</sup> IT should form an integral part of the company's risk management: Management should regularly demonstrate to the board that sufficient disaster recovery procedures are in place and that the board should also ensure that the company complies with all IT-related laws and regulations.<sup>224</sup>

It is therefore held that a risk committee and audit committee should assist the board in carrying out its IT responsibilities. The risk committee should ensure that IT risks are adequately addressed and assurance should be obtained regarding controls in place. It is further recommended that IT should be considered by the audit committee in relation to financial reporting and going concern, it should also be considered how the use of IT could improve audit coverage and efficiency.<sup>225</sup>

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<sup>221</sup> "The board should ensure that information assets are managed effectively by ensuring that an information security management system is developed and implemented, the information security strategy should be approved by the board and its implementation should be delegated to management and furthermore the board should ensure that personal information is treated as an important assets of the Company (Municipality)".

<sup>222</sup> "It is the duty of the CEO to appoint the Chief Information Officer (CIO) to be responsible for the management of IT and as such the CIO should have regular access and interaction with the board or the designated committee and executive management on strategic IT issues: by so saying the CIO should also be a suitably qualified and experienced person"

<sup>223</sup> Marx B et al (2013) 116.

<sup>224</sup> Marx Bet al (2013) 117.

<sup>225</sup> Marx B (2013) 117 Para 3.

#### **4.5.6. Compliance with laws, rules, codes and standards**

The King III Report requires the board of directors to ensure that the company complies with all applicable and relevant laws and that it considers adherence to non-binding rules, codes and standards. A compliance culture should be encouraged through leadership, establishing the appropriate structures, education and training, communication and the measurement of key performance indicators relevant to compliance. The board has a duty to take necessary steps to ensure the identification of laws, rules, codes and standards that apply to the company. Details must be disclosed by the board in its integral report on how it has discharged its responsibility to establish an effective compliance framework and process.<sup>226</sup>

The King III Report goes as far as to require the board and each individual director to have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business. Directors should sufficiently familiarise themselves with the general content of applicable laws, rules, codes and standards to be able to adequately discharge their fiduciary duties and their duty of care, skill and diligence in the best interest of the company.<sup>227</sup>

#### **4.5.7. Internal audit**

The Institute of Internal Auditors defines internal auditing as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations<sup>228</sup>. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.” From this definition we can conclude that the internal audit department of a company can play an integral role as part of an effective corporate governance system<sup>229</sup>

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<sup>226</sup> The King III Report (2009) Principle 6.1.2.

<sup>227</sup> Marx B et al (2013) 117 “induction programmes and an ongoing programmes for directors should incorporate and overview of changes to law and legislation”.

<sup>228</sup> The Institute of Internal Auditors.

<sup>229</sup> The King III Report (2009) 34 Principle 4.

The King III Report requires the board of directors to ensure that there is an effective risk-based internal audit.<sup>230</sup> An internal audit should evaluate business processes, perform an objective assessment of the effectiveness of risk management and the internal control framework, systematically analyse and evaluate business processes and associated controls, and provide a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities.<sup>231</sup>

An internal audit plays an important role in providing assurance to the board regarding the effectiveness of the system of internal controls and risk management of the company.<sup>232</sup> Internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management: the internal audit should form and integrated part of the combined assurance model as the internal provider of assurance.<sup>233</sup> The internal audit should also focus on operational, compliance and sustainability issues, and not only on financial matters. It is also provide that the internal audit should provide a written assessment of the system on internal control and risk management to the board. Furthermore the internal audit should provide a written assessment of internal financial controls to the audit committee.<sup>234</sup>

#### **4.5.8. Governing stakeholder relationships**

The King III Report adheres to the 'triple context' or integrated approach, which acknowledges that companies should act with economic, social, and environmental responsibility.<sup>235</sup> Directors should consider economic, social and environmental factors

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<sup>230</sup>The King III Report (2009) Principle 7.1. See also Nevondwe L, Odeku K O & Tshoose C I (2014) 270.

<sup>231</sup> "the Chief Audit Executive (CAE) should report functionally to the chairman of the audit committee and also the CAE should be appointed, assessed and dismissed by the audit committee, therefore the internal audit should report at all audit committee meetings and should also ensure that the internal audit committee is well resourced with an appropriate budget allocated to it".

<sup>232</sup> King III Report (2009) 34 principle 4.

<sup>233</sup> Marx B et al (2013) 119.

<sup>234</sup> With regard to Internal Audit "the Codes makes several recommendations on the status, role and scope of the internal audit department and stresses the importance of an integrated approach to assurance"

<sup>235</sup> Marx B et al (2013) 121. "Communication with stakeholder should be complete, relevant, honest, accurate, in an understandable language, and should take place on a timely basis and; the board should also consider disclosing the number of requests for information lodged in terms of the Promotion of Access to information Act 2 of 2002 in the integrated report, and which were refused".

when they manage the company.<sup>236</sup> Thus the Report advocates the notion that the board of directors is responsible not merely for the company's financial bottom-line, but rather for the company's performance within the triple context in which it operates ('triple bottom-line'). Companies in South Africa are encouraged to adopt the inclusive approach to governance based on which companies are required to act in the best interest of all stakeholders. This section of the code provides guidance regarding the governance of stakeholder relationships.<sup>237</sup>

One implication of the right to vote being a right of property is that shareholders may choose not to exercise their right to vote at all but if shareholders are passive, it undermines good levels of compliance by management. To encourage shareholders activism, an environment should be created where shareholders are not mere speculators, but owners concerned with the well-being of the company in which they hold shares, constantly checking whether the directors are practicing good corporate governance.<sup>238</sup>

#### **4.5.9. Integrated reporting and disclosure**

Sustainability reporting has been the subject of the King II report.<sup>239</sup> Sustainability reporting can be defined as reporting on those financial and non-financial matters that influence the company's ability to survive and prosper and sustain its business future.<sup>240</sup> Where financial reporting tends to provide an historic account, sustainability reporting and disclosures provide a balanced and integrated record of the economic, social and environmental performance of the company.<sup>241</sup>

This is now generally referred to as "triple bottom line" reporting. The economic aspect of "triple bottom line" involves the financial aspects relevant to the business of the company, whilst the social aspect focuses on the values of the company, ethics, and

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<sup>236</sup> King III Report (2009) para 18 - 22.

<sup>237</sup> Marx B et al (2013) 120.

<sup>238</sup> See further Nevondwe L on the principles of corporate governance (2012).

<sup>239</sup> Section 4, King II Report. See also principles encapsulated in King III Report paragraph 1, 108.

<sup>240</sup> Section 4 Para 3 on page 91.

<sup>241</sup> Op cit.

reporting on the company's engagement with stakeholders. The environmental aspects includes reporting on the effect of the company's products or services on the environment.<sup>242</sup>

The King III Report on Corporate Governance advocates the publication of an integrated report dealing with both financial and non-financial matters in integrated manner.<sup>243</sup> The board of directors should ensure the integrity of the company's integrated report. An integrated report means a holistic and integrated representation of the company's performance in terms of both its finances and its sustainability. The integrated report should be prepared every year. Sustainability reporting and disclosure should be integrated with the company's financial reporting. The annual financial statements should be included in the integrated report, and the board should include a commentary on the company's financial results. This commentary should include information to enable a stakeholder to make an informed assessment of the company's economic value.<sup>244</sup>

The board should ensure that positive and negative impacts of the company's operations, together with plans to improve the positives and eradicate or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.

### **3.5. Conclusion**

The effective and efficient management of public organisations in South Africa is an issue of concern and the most visible signs of this are seen mostly in local government. Public sectors are expected to function effectively and efficiently because they serve the interest of the whole society and therefore, should the public sectors such as the local governments fail then the whole society will then fail. This means that the municipalities must and are expected to find ways of improving their activities and services by

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<sup>242</sup> Marx B et al (2013) 121 Para 1.

<sup>243</sup> King III Report (2009) Principle 5, para 2.

<sup>244</sup> Marx B et al (2013) 121 'In short the King III Report on Corporate Governance advocates the publication of an integrated report dealing with both financial and non-financial matters in an integrated manner'.

searching for adequate instruments which will help in making local government governable and effective.

It is therefore very clear from the above discussed principles of corporate governance that an effective municipality is the one with an effective board of directors as stated in the King III Report and the members of the local government who are able to perform their duties in an ethical manner, by ethical it means being able to determine what is right and wrong. The local government must also be transparent in its financial reporting at the end of each financial year which was audited by independent auditors who are not biased.

From the above definitions of the corporate governance it is also paramount for local government to function very well and provide good services to communities and members of the society in general. By so saying, corporate governance is a way to go as it deals more effectively on how institutions must be directed and controlled. Therefore the definition of corporate governance can also mean the way in which local government "municipalities" are directed and controlled. Corporate governance in local government will bring stability in such a way that the board of directors and its related members will be able to perform their duties independently, without internal and external influence and provide the needed direction in the municipality. As such, it is without any doubt that the corporate governance's implementation depends much on the cooperation between private and public sectors and the extent to which the legislative authority is strong to enforce this corporation by adopting the implementation of corporate governance in the local government.

## CHAPTER FIVE: CASE LAW ON CORPORATE GOVERNANCE

Case law is very important in this study because it will help and share some lights on how the courts interpret the application of the concept of corporate governances as well as its principles. There is therefore a serious lesson to learn for the decided cases in as far as corporate governance is concern.

Lessons to be learned from the *SABC v Mpfu*<sup>245</sup> Case, the appeal by the South African Broadcasting Corporation (SABC) against the judgment of Tsoka J was dismissed with costs. The full bench of the South Gauteng High Court found that the suspension of Dali Mpfu as Group Chief Executive Officer of the SABC at a meeting of 6 May 2008 was not in accordance with the Articles of Association or good corporate governance. The court found that the Board was not properly constituted as three of the directors of the Board were excluded from a Board meeting at a time a decision to suspend Mr. Mpfu was taken. The court also found there was insufficient notice for the three directors to attend the Board meeting, that their failure to object when they were sent from the meeting did not amount to acquiescence in that decision. The court also found that Mpfu did have the necessary locus standi to seek reinstatement since he was acting in his own personal capacity and not on behalf of the company. Jajbhay J found that Ubuntu-botho is deeply rooted in our society.

These values should assist in informing corporate decisions made by directors in state owned enterprises. Proper and constructive dialogue would enable better outcomes in the decision making process. This form of governance is underpinned by the philosophy of Ubuntu-botho. The time is right to incorporate the views of *umuntu ngumuntu ngabantu* in the King code of good governance.

The court therefore ruled that a crucial point is whether the Board in making the decision to suspend the respondent (Group Chief Executive Officer) was mindful of and indeed applied proper corporate governance principles in coming to their decision. The central issue of corporate governance is the accountability of senior management and the Board of a company because of the extensive powers vested in them.

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<sup>245</sup> SABC Ltd v Mpfu [2009] 4 ALL AS 169 (GSJ).

The King Report II on Corporate Governance for South Africa 2002 deals with public sector enterprises. The SABC is a public company and is a public sector enterprise as defined in terms of the Public Finance Management Act (PFMA). Companies and their Boards are required to measure up to the principles set out in the Code. King recommends that public enterprises should try and apply the appropriate principles set out in the Code. The Code sets out principles and does not determine detailed conduct. The conduct of public enterprises must be measured against the relevant principles of the Code and must adhere to best practices. The Code regulates directors and their conduct not only with a view to complying with the minimum statutory standard but also to seek to adhere to the best available practice that may be relevant to the company in its particular circumstances.

The Board and its directors are ultimately accountable and responsible for the performance and affairs of the company. King noted that given the synergy which takes place between individuals with different skills, experience and background, the unitary board structure with executive and non-executive directors interacting remains appropriate for a South African company. In terms of the King Code, Board meetings should include mechanisms that are efficient and timely. Board members should be briefed prior to meetings and Board members should take the responsibility of being objectively satisfied that they have been furnished with all the relevant information and facts before making a decision. Although non-executive directors may meet separately the attendance of executive directors at Board meetings is of value. The diversity of views is important. The Board has a collective responsibility to provide effective corporate governance and should exercise leadership, enterprise, integrity and judgment in directing the company.

The court further ruled that integrity is a key principle underpinning good corporate governance. Good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly. There are no opportunities in this environment for cloaks and daggers. Such important decisions are not made in haste or in anger. There must be ethical behaviour in the exercise of dealings with fellow board members. These must be conducted in a

sensitive manner, following due process. The Constitution of the Republic of South Africa recognises the importance of good governance. Section 195 deals with basic values and principles governing public administration. In terms of this section there must be a high standard of professional ethics. In fact this standard must be promoted and maintained. These principles apply to organs of state and public enterprises.<sup>246</sup>

This is not surprising, given our history and the advent of our new democratic era. Our Constitution compels government in all of its forms, both through government departments and organs of state (including state-owned enterprises) to adhere to principles of good governance. State-owned enterprises such as the SABC are included in the definition of “organ of state”. It is for this reason that the provisions of the Constitution as well as the legislation enacted in terms thereof are applicable to state-owned enterprises. Our Constitution has enshrined certain rights that also have a direct bearing on the corporate governance of state-owned enterprises. The Constitution imposes a number of general obligations on all organs of state to promote cooperative government. In particular, organs of state involved in intergovernmental disputes are required to make every effort to settle the dispute and exhaust all other remedies before approaching the courts. This does not prevent organs of state seeking relief from the courts and is therefore a workable model.

The Public Finance Management Act as amended was promulgated to give effect to Chapter 13 of the Constitution.<sup>247</sup> The aim of this Act is to modernise the system of financial management in the public sector. It represents a fundamental break from the past regime of opaqueness, hierarchical systems of management, poor information and weak accountability.

The Act will lay the basis for a more effective corporate governance framework for the public sector.” In state-owned enterprises, like other organisations, good corporate governance is ultimately about effective leadership. An organization depends on its board to provide it with direction, and the directors need to understand what that leadership role entails.

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<sup>246</sup> Ibid.

<sup>247</sup> The Public Finance Management Act 1 of 1999.

The codified standard for director conduct combines “care, skill and diligence” in one single test. The test to measure a director’s duty to exercise a degree of care, skill and diligence provides for an objective assessment to determine what a reasonable director would have done in the circumstances. However, the objective assessment contains subjective elements in that it takes into consideration the, skill and experience of that particular director. In applying the test, a distinction is made between different types of directors.

*In Fisheries Development Corporation of SA Ltd v Jorgenses and Fisheries Development Corporation of SA Ltd v AWJ Investment*,<sup>248</sup> it was held that “the extent of a director’s duty of care and skill depends to a considerable degree on the nature of the company’s business and on any particular obligations assumed by him or assigned to him.... In that regard there is a difference between the so-called full-time or executive director, who participates in the day to day management of the company’s affairs or of a portion thereof, and the non-executive director who has not taken on any special obligation. The latter is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodical board meetings, and at any other meetings that may require his attention.”

*In the case of Australian Securities and Investments Commission v Healey*<sup>249</sup> the court stated that the duty of care and skill was considered with respect to the duty of directors to approve the financial statements of the company. In this case that court found that all non-executive directors were in breach of their duty of care and skill. The failure to notice certain omissions may well be explicable – but here the directors clearly looked solely to management and external advisors. However, if they had acted as the final filter, taking care to read and understand the financial accounts, the errors may have been discovered.

As such in this case it was stated that

All directors must carefully read and understand financial statements before they form the opinions which are to be expressed such a reading and understanding would require

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<sup>248</sup>*Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W).

<sup>249</sup>*Australian Securities and Investments Commission v Healey* [2011] FCA 717.

the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director.<sup>250</sup>

These include the following: a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged; a director should keep informed about the activities of the corporation; whilst not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies; a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements; a director, whilst not an auditor, should still have a questioning mind.<sup>251</sup>

Furthermore it was held that a director is not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside the area of the director's expertise." The court stated that nothing that is decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.<sup>252</sup>

*In Majola Investments (Pty) Ltd v Uitsigt Properties (Pty) Ltd* Broome J, came to the following conclusion at para 241:

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<sup>250</sup> The decision of His Honour Middleton J in *Australian Securities and Investments Commission v Healey* [and others] [2011] FCA 717 (the Centro Case) (<http://www.austlii.edu.au/au/cases/cth/FCA/2011/717.html>) handed down by the Federal Court on 27 June 2011 held that the defendant directors had breached their director's duties in failing to discharge their duties of care and diligence.

<sup>251</sup> 'Centro Case – Director's Duties – the 'bar has been raised' available at <http://www.corneyandlind.com.au/resource-centre/commercial/directors-duties-financial-statements-centro-case/> (accessed 20 December 2016).

<sup>252</sup> *Australian Securities and Investments Commission v Healey*, page 17-20.

I therefore accept the principles that notice of a directors' meeting must be given to every director who is within reach and that the question whether a director is within reach depends upon the circumstances, including the nature of the business to be transacted. If the business to be transacted were contentious the degree of inaccessibility would have to be very great. If, on the other hand, the business were not contentious but required immediate attention, the degree of inaccessibility would be very much less, particularly where the absent director knew and approved of the formal business to be transacted.<sup>253</sup>

Therefore these principles were followed in *Burstein v Yale* this is the case in which two out of three directors had purportedly authorised a cession by the company without prior consultation with the third director who was readily accessible. Fair and reasonable notice to attend a directors' meeting depends on the circumstances and on the structure, practice and affairs of the company.<sup>254</sup> *In casu* only four of the 12 non-executive directors were present. The others were on teleconference. This is not a satisfactory situation where a matter of the suspension of the General CEO was being deliberated. The haste was unnecessary as there was already a meeting scheduled for 7 April 2008 when the chairperson's non acceptance of the suspension of Dr Zikalala was to be discussed.

In *De Villiers and another NNO v Boe Bank Ltd* Navsa JA stated that of course, principles of good governance of companies dictate that resolutions should be properly taken at general meetings or meetings of directors after due and proper deliberation. This does not mean, however, that in instances where this course is not strictly followed the directors cannot otherwise bind a company.<sup>255</sup>

In other words the particular circumstances are of importance when assessing the validity or otherwise of the resolution. The suspension of a high profile General CEO in a public sector enterprise which is particularly directed to observe principles of good corporate governance and best practice must ensure that it adheres to the principles

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<sup>253</sup>Majola Investments (Pty) Ltd v Uitsigt Properties (Pty) Ltd 1961 (4) SA 705 (T).

<sup>254</sup>Burstein v Yale 1958 (1) SA 768 (W).

<sup>255</sup>De Villiers and another NNO v Boe Bank Ltd 2004 (3) SA 1 SCA.

referred to above. There could not have “due and proper” deliberation” in the absence of the three Board members.

## **CHAPTER SIX: CONCLUSION AND RECOMMENDATIONS**

### **6.1. Conclusion and Recommendations**

In conclusion, it is evident that without the Principles of Corporate Governance there is no effective municipality. This is because when these principles are not applied, corruption activities and maladministration becomes day to day functions of municipal officials and this has a tendency of affecting the sphere of local government in general.

The purpose of the King I Report (1994) was to promote the highest standards of corporate governance in South Africa and it applied to all the spheres of government namely: the National, Provincial and local governments. This means that municipalities cannot be exempted when corporate governance is mentioned. This is because it's a must that in each and every financial year municipalities must provide their financial year return reports which were audited by independent auditors or the office of the Auditor General. Furthermore, the integrated report of very municipality should be prepared every year to allow citizen to have a say on the affairs of their municipality.

Sustainability reporting and disclosure as well as annual financial reports should be integrated within the municipality's financial reporting. As a result, the Municipal Councils and Board of Directors of municipal entities should include a commentary on the municipal financial results so that members of the community are given fair opportunities to comment of the financial status of their municipalities.

It is therefore provided that this commentary should include all the information to enable all stakeholders to make an informed assessment of the municipal economic value and its ability to provide services to members of the community in South Africa. The board (municipal council) should ensure that positive and negative impacts of the municipal's operations, together with plans to improve the positives and eradicate or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.

This means that for South African municipalities to perform their functions and to be able to carry out their duties effectively, government must do away with the hiring of politicians who do not have necessary skills or excellent educational background to

make sure that the principles of corporate governance are promoted and enforced. This is because due to an unqualified politicians who are running the day to day business of the municipality, most municipalities are put under administration and are forever surrounded by irregularities and strikes due to poor service deliveries. It was observed through this study that most politicians are incapable of performing their functions in as far as the effective running of the municipality is concern. In a nutshell, they are there to promote and safe guard the interest of their political parties.

Corporate governance is generally understood to mean the way in which companies are directed and controlled. By looking at the definition of corporate governance it is not only about the companies, the sphere of local government is also covered in the definition. Thus, the emphasis is on those organs which play a vital role in corporative decision-making. As such, it is widely accepted that corporate governance does not affect or apply exclusively to listed companies, as some writers insist. In order to simplify matters, a distinction needs to be drawn between corporate governance applicable to all companies and corporate governance applicable to 'affected companies' and other government institutions as defined by the King Committee on Corporate Governance.

The King III Report provides that an executive director is involved with the day-to-day management of the company and he or she is therefore in the full-time salaried employment of the company; and is generally under a contract of service with the company. A non-executive director, on the other hand, is a part-time director, who is not involved in the management of the company, but plays an important role in providing objective judgment, independent of management, on issues facing the company. Generally, non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors. Therefore, municipal entities needs an effective board of directors apart from the municipal council, as provided for in the King III Report.

Section 195 of the Constitution of the Republic of South Africa deals with the basic values and principles which are governing public administration.<sup>256</sup> It is therefore evident that the Constitution of the Republic of South Africa recognises the importance of good governance because it compels government in all its forms, both through government departments and organs of state (including state-owned enterprises) to adhere to principles of good governance.<sup>257</sup> Therefore, there is no doubt that corporate governance is a key element in improving municipal service deliveries and eradicating corruption from its roots. It will also assist in promoting economic efficiency and growth as well as enhancing investor confidence.

South Africa is known as a country which is rich with the legislations and policies but however, it lacks the ability to implement its policies in building an effective country. This is because the cry about eradicating corruption has been in existence ever since the first democratic elections. As state above, the Cabinet proposed in 1997 to have the agencies which will fight corruption but even today there is a little that is being done.

In the past few months the South African government observed lot of service delivery protest where people demonstrated against municipalities displaying their dissatisfactions against municipalities and government in general. Most of them demonstrated against many promises from the government without any action at all while members of the community continue to live in an unbearable situations which are not even suitable for human beings to stay in. however, the blame should be put to different municipalities in their respective capacities for their failures to provide services, because they have adequate budget allocated to them yet they continue to employ people with unnecessary skills.

From this we can conclude that the interview questions must be amended from what people knows about their potential employers to what value are they bringing to their respective employers? What differences are they bringing to the municipalities? It must be borne in mind that not all politicians are bad in our municipalities but municipalities must do away with all the politicians who are illiterate and who have been or are

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<sup>256</sup> Section 195 Constitution.

<sup>257</sup> *Ibid.*

continuing to being part of the municipal employees for many years just to push the agendas of their political parties.

The economy of South Africa is not in the hands of the national government and provincial government only but also in the hands of municipalities. Local government is the custodian of the image of the whole South African country, should local government run its affairs effectively then that will be a stepping stone for South Africa to compete in an international level.

The principle is, no effective and proper implementations of local government policies, no better South Africa were members of the society lives in peace and harmony. For local government to be effective the first step is to look where we come from as a country, where we are today and where we are going. This will ensure that the Principles of Corporate Governance are adhered to. This will also help in enforcing the concept of governance in local government to eradicate corruption and mismanagement of public funds.

### **3. Recommendations**

This study therefore recommend that all institutions which are responsible in ensuring that the local government sphere runs and manage its affairs effectively should speed up their investigations when they are investigating irregularities in local government. So that those who are found to have defrauded the municipalities be prosecuted and that they pay whatever amount of money they have stolen personally. Pursuant to that their assets should be forfeited to the state. This study further recommend that the municipalities should establish an independent board to oversee and ensure that the each municipal council follow the rules of law and that proper structures are implemented to ensure that services are provided to communities. This is to ensure that there is internal and external influence by political parties when municipal managers and the entire municipal administration are performing their functions. Pursuant to that the local government structure should follow the principles that are provided for in the King III Report which will range from having an:

- a) Ethical leadership;
- b) Boards and directors;
- c) Audit committees;
- d) The governance of risk;
- e) The use of information technology;
- f) Compliance with the laws, codes, rules and standards;
- g) Internal audit;
- h) Governing stakeholder relationships; and
- i) Integrated reporting and disclosure

Furthermore, this study recommend that whatever is being contained in the National Development Plan be implemented and that capable agencies be entrusted with the mandate of fulfilling vision 2030 as contained in the National Development Plan.

Also that municipality must employ people with visions, people with skills to uplift the standards of our municipalities. This is because there is a firm acceptance and realisation of the fact that lack of professionalism and professionalization in the local government has a major impact on the capacity of individual municipalities to deliver quality services to members of the community.

Therefore this study recommends that all municipalities should ensure that incompetent staff members get proper training and qualifications. Also that staff members should be given performance contracts which will be reviewed on an annual basis to monitor their ability in performing their functions and that those who are found not to be effective be released from their contracts or have their contracts of employment not renewed for the following financial annual year based on their performance. Such evaluation should be carried out by the external body which does not have any direct or indirect personal interest in the local government.

It is worth noting that professionalization of the local government sector in South African is a huge project that needs to be monitored on a day to day basis. This is to say that at

the end of every project, every receptionist, driver, debtors clerk, engineer and all the practitioners covering all the employees of the municipalities in all the 278 municipalities in South Africa, should be in a position to do things based on commonly held standards and norm in accordance with the broader ethos of a developmental and service delivery oriented local government sector.

Lastly this study recommends that the audit committee in the municipality should be strengthened to hold the municipality and the council accountable rather than giving mere recommendation at the end of each financial year.

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