



## **SUMMARY OF FINANCIAL REPORTING MONITORING AND CORPORATE GOVERNANCE REVIEW FINDINGS**

**FOR THE YEAR ENDED 31 DECEMBER 2018**

# RECOMMENDED BEST PRACTICE CORPORATE GOVERNANCE MODEL FOR BOTSWANA

## 1. INTRODUCTION

- 1.1 The Botswana Accountancy Oversight Authority (BAOA) was established by the Financial Reporting Act, 2010 as the independent oversight body of the accounting and auditing profession; to regulate the reporting of financial matters of Public Interest Entities (PIEs) and the corporate sector.
- 1.2 Section 5(g) of the Financial Reporting Act, 2010 sets out one of the principal objectives of the Authority as “to promote high standards of corporate governance and compliance with professional ethics. However, the Act does not provide any further guidance as to what “corporate governance” entails, and how the BAOA should proceed in fulfilling its mandate in that regard.

## 2. PROCESS FOLLOWED IN ARRIVING AT RECOMMENDED BEST PRACTICE CORPORATE GOVERNANCE MODEL FOR BOTSWANA

- 2.1 In 2016 BAOA carried out a research to determine the most appropriate corporate governance model for Botswana by examining, among others, various sources of corporate governance practices currently in use in Botswana; each underpinned by one of the following Corporate Governance Principles:
  - a) “apply or explain’ basis, as explained in King III;
  - b) “Comply or explain” basis, such as in the UK Corporate Governance Code; and
  - c) “Comply or else” basis, such as in the Sarbanes Oxley Act, 2002.
- 2.2 Having carried out the research, BAOA arrived at the conclusion that King III would be the most suitable and appropriate Code for Botswana, for the following reasons:
  - a) the flexibility and all-encompassing nature of its application arising from the “apply or explain” principle, which enables the board of an entity to apply a recommendation of King III differently or apply another practice and still achieve the objective of the overarching

corporate governance principles of *fairness, accountability, responsibility and transparency*;

- b) many entities listed on the Botswana Stock Exchange have adopted the King III Code of Corporate Governance;
- c) PEEPA Guidelines to improve shareholder oversight (corporate governance) over parastatals are practically all accommodated in the King III;
- d) practically all the principles in the Botswana Code of Corporate Governance, also based on the “apply or explain” basis, are embodied in King III;
- e) foreign subsidiaries of local companies are required to apply the Code to the extent prescribed by the holding company and subject to entity-specific foreign legislation;
- f) King III clearly differentiates corporate governance principles that **must, should, or may**, be complied with.
- g) A benchmarking exercise of King III against two other principles-based corporate governance systems; the Botswana Code and the UK Code revealed that King III is much more encompassing.

2.3 A Corporate Governance Procedures Manual based on King III was therefore compiled, and was approved by the BAOA Board for the internal use of BAOA, and is intended to provide guidance regarding:

- a) the corporate governance standards and codes that PIEs regulated by the Authority are expected to use; and
- b) review programs which the Authority is expected to use to ensure conformance to the recommended corporate governance standards and codes by PIEs; **or one that achieves similarly high standards of corporate governance that include practically all the recommended best practice corporate governance elements and principles, and as required by applicable laws, rules and codes.**

- c) Adoption and application, of the Code of PIEs, of the above-mentioned recommended corporate governance code as may be appropriate; **or one that achieves similarly high standards of corporate governance that include practically all the recommended best practice corporate governance elements and principles, and as required by applicable laws, rules and codes.**

### **3. INITIAL FINDINGS FROM CORPORATE GOVERNANCE REVIEWS CARRIED OUT BY THE AUTHORITY**

The reviews that have been carried out so far covered 10 (ten) entities including a bank, listed companies, non-bank financial institutions, such as insurance companies, and State-owned Enterprises (Parastatals).

In terms of findings made by the Authority during the reviews, listed companies and banks appear to be better managed than their public sector counterparts.

Listed companies have strong boards constituted along the lines of King III, with the necessary balance of skills and expertise and also the balance in terms of executive and non-executive directorships. They also have strong board committees, including nominations, remuneration, risk committees in addition to the conventional committees like finance, audit, and human resources. Generally, the staff and board members are well remunerated.

Parastatals generally appear to be lagging behind with poorly constituted boards dominated by ex-officio members appointed by the shareholder, which is government. Any semblance of balance in skills and expertise is by coincidence and not through a deliberate action by the appointing officers. Naturally, therefore, board committees are weak and, more often than not, do not include committees like remuneration, nominations and risk. The responsibility of risk is normally assumed by the finance and audit committee. Comparatively speaking, the remuneration of staff and board members is also lagging behind and does not meet the guidelines of King III.

The summary of results below shows that the overall average number of findings per company were thirteen (13) findings per company for all the companies reviewed during the year. If we split the average findings per category, parastatals recorded the highest average per company with an

average of 18 findings per company, while listed companies recorded an average of 9 findings per company. The only bank reviewed recorded the lowest average findings of 6.

One surprising revelation was that virtually all the entities reviewed did not have well constituted and compliant internal audit departments as they did not undertake a quality assurance and improvement program review (QAIP) which gives them the right to claim compliance with internal audit practice standards. Very few companies in Botswana have undertaken a QAIP. Infact we are reliably informed that only Debswana and Bank of Botswana are amongst the few that have undertaken a QUAIP review in Botswana. This is a serious issue that we have drawn to the attention of the Institute of Internal Auditors (Botswana) for them to address with their members as a matter of urgency as this also brings into question their legitimacy and that of their members.

#### 4. REVIEW FINDINGS

4.1 The review findings on corporate governance were as summarised below:

<b>Corporate Governance</b>			
	<b>Number of entities</b>	<b>Findings</b>	<b>Percentage of Total</b>
<b>Banks</b>	<b>1</b>	<b>6</b>	<b>5%</b>
<b>Listed Companies</b>	<b>4</b>	<b>34</b>	<b>26%</b>
<b>Parastatals</b>	<b>5</b>	<b>88</b>	<b>69%</b>
<b>TOTAL</b>	<b>10</b>	<b>128</b>	<b>100</b>

***NB: For comparative purposes, please note the number of entities reviewed***

**Summary of findings grouped into appropriate themes**

<b>Theme</b>	<b>Findings</b>	<b>Regulated by BOB</b>	<b>Regulated by BSE</b>	<b>Regulated by SOE</b>	<b>Total number of findings</b>
Compliance Code disclosure	No statement of compliance with a corporate governance code such as King III or similar code	<b>1</b>	<b>2</b>	<b>4</b>	<b>7</b>
Board Composition and succession	<ul style="list-style-type: none"> <li>• Membership of the Board not according to best practice, example: no executive directors and inadequate mix of independent non-executive director and non-executive</li> <li>• No succession plan for the Board Chairperson or other key roles in the entity</li> </ul>	-	<b>2</b>	<b>10</b>	<b>12</b>
Board Annual Report disclosures	<p>Inadequate/non-disclosure in the Annual Report of Board members information:</p> <ul style="list-style-type: none"> <li>• Qualifications and experience</li> <li>• Induction, training and development</li> <li>• Board &amp; its Committee meeting attendance register</li> <li>• Independence assessment of the Non-Executive Directors</li> </ul>	<b>2</b>	<b>6</b>	<b>20</b>	<b>28</b>
Board appointment & removal process	<ul style="list-style-type: none"> <li>• Inadequate policies for appointment and removal of Directors</li> <li>• Absence of Board Nomination Committee</li> </ul>	-	<b>3</b>	<b>16</b>	<b>19</b>
Board secretary	<ul style="list-style-type: none"> <li>• Absence of official Board secretary</li> <li>• Executive director acting as Board secretary</li> </ul>	-	-	<b>2</b>	<b>2</b>
Board Evaluation	Evaluation of the Board, its committees and individual directors not performed.	-	<b>3</b>	<b>5</b>	<b>8</b>
Directors' remuneration approval and disclosures	<ul style="list-style-type: none"> <li>• No shareholder approval of Directors remuneration policy;</li> <li>• Inadequate Annual Report disclosures of remuneration of directors</li> </ul>	<b>1</b>	<b>5</b>	<b>5</b>	<b>11</b>

Theme	Findings	Regulated by BOB	Regulated by BSE	Regulated by SOE	Total number of findings
Effectiveness of Internal audit	<ul style="list-style-type: none"> <li>No effective risk based internal audit review</li> <li>Internal audit function not subjected to a Quality Assurance and Improvement Programme (QAIP) review</li> <li>Internal audit function not reporting functionally to the Board Audit Committee</li> </ul>	2	8	15	25
Timely reporting	The Annual Report not prepared timely	-	-	2	2
Shareholder compact	There was no shareholder compact	-	-	1	1
Effectiveness of the Audit Committee and risk assessment	<ul style="list-style-type: none"> <li>Not all members of the Audit Committee were independent Non-Executive Directors</li> <li>Audit Committee Chairperson not independent</li> </ul>	-	5	8	13
<b>Total findings</b>		<b>6</b>	<b>34</b>	<b>88</b>	<b>128</b>

**Key:**

BOB: Bank of Botswana

BSE: Botswana Stock Exchange

SOE: State Owned Entities / Parastatals

4.2 Coupled with the corporate governance reviews, we also carried out financial reporting monitoring of PIEs, which looked at, amongst other things, financial performance, compliance with International Financial Reporting Standards, liquidity and gearing. The results in terms of findings mirrored those described above under corporate governance where there was a strong positive correlation between good corporate governance and good performance and compliance with international standards.

Most parastatals were technically insolvent as their continued existence (i.e. going concern status) depended upon continued support and bailout by the government.

The review findings on financial reporting monitoring were as summarised below:

<b>Financial Reporting Monitoring</b>			
	Number of entities	Number of Findings	Percentage of Total
Banks (Listed)	1	9	12%
Listed Companies	4	29	37%
Parastatals	5	40	51%
<b>TOTAL</b>	<b>10</b>	<b>78</b>	<b>100%</b>

**NB: For comparative purposes, please note the number of entities reviewed**

### Summary of findings

Theme	FINDING AS PER INTERNATIONAL FINANCIAL REPORTING STANDARDS(IFRS) 2018	Regulated by BOB # of findings	Regulated by BSE # of findings	Parastatal # of findings	Total number of findings ten (10) PIEs
Primary financial statements	IAS 1: Presentation of financial statements <ul style="list-style-type: none"> <li>material differences between primary financial statement balances and notes;</li> <li>non-disclosure of required financial statement line items.</li> </ul>	3	7	7	<b>17</b>
Non-current assets presentation and disclosure	Inadequate disclosure of: <ul style="list-style-type: none"> <li>IAS 2: inventory write downs, inventory expensed during the year;</li> <li>IAS 16: cost model carrying amounts for PPE assets held at valuation; and</li> <li>IAS 40: direct operating expenses, rental received and valuer information for investment property.</li> </ul>	-	1	6	<b>7</b>
Consolidation /Group reporting	<ul style="list-style-type: none"> <li>IFRS 3: insufficient business combination disclosures.</li> <li>IFRS 11: Incorrect accounting for "joint ventures and joint operations"</li> </ul>	2	1	1	<b>4</b>
Income taxes	IAS 12-Non-disclosure of: <ul style="list-style-type: none"> <li>tax portion relating to other comprehensive income;</li> <li>tax rate reconciliation.</li> </ul>	1	1	2	<b>4</b>
Accounting policies	IAS 8-Accounting policies: <ul style="list-style-type: none"> <li>nature and extent of government grant not disclosed;</li> <li>non-disclosure of accounting policies on a material balances;</li> </ul>	-	3	4	<b>7</b>

Theme	FINDING AS PER INTERNATIONAL FINANCIAL REPORTING STANDARDS(IFRS) 2018	Regulated by BOB # of findings	Regulated by BSE # of findings	Parastatal # of findings	Total number of findings ten (10) PIEs
	<ul style="list-style-type: none"> <li>disclosure of "boiler plate/irrelevant accounting policies.</li> </ul>				
Leases	IAS 17: Inadequate disclosures of: <ul style="list-style-type: none"> <li>minimum lease payments;</li> <li>significant leasing arrangements.</li> </ul>	-	-	7	7
Income statement presentation and disclosure	Non- disclosure of: <ul style="list-style-type: none"> <li>IAS 19: Defined contribution expense;</li> <li>IFRS 15: Contract assets, contract liabilities and performance contracts obligations;</li> <li>IAS 7: Interest paid/received in the statement of cashflows.</li> </ul>	-	3	5	8
Related party disclosures	<ul style="list-style-type: none"> <li>IAS 24: Incorrect/inadequate disclosures of related party balances and transactions.</li> </ul>	-	2	1	3
General deficiencies in disclosures	<ul style="list-style-type: none"> <li>IAS 33: Weighted average number of shares in calculating EPS not disclosed.</li> <li>IAS 37: Description of the nature of a provision not disclosed</li> <li>IFRS 8: Inadequate disclosures on factors used to identify reportable segments</li> </ul>	1	3	-	4
Valuation	Inadequate disclosures of: <ul style="list-style-type: none"> <li>IFRS 13: Level 2 and Level 3 information;</li> <li>IFRS 7: collateral; gains and losses on financial instruments; market related risks and financial instruments carried at fair value.</li> </ul>	1	4	7	12
Subsequent events	IAS 10: Dividends approved after balance sheet date incorrectly accrued for	1	4	-	5
<b>Total</b>		9	29	40	<b>78</b>

The overall average number of findings per company was 8 findings for all the companies reviewed. Compared to the average, parastatals had an average of 8 findings per company, listed companies averaged 7 findings per company and the only bank reviewed had 9 findings. This shows that compliance with IFRS for financial reporting is fairly uniform across the companies. This is because most of the companies are audited by the big-4 firms where standards are fairly high for PIEs. Hopefully, with BAOA's input, the findings will gradually reduce.

Periodic reviews of the Corporate Governance Review Manual by BAOA will be made so that any changes arising from periodic international revisions of

the code, such as those arising from the implementation of King IV, for example, are captured.

## **5. THE CURRENT POSITION WITH THE BOTSWANA CODE OF CORPORATE GOVERNANCE**

The Botswana Code of Corporate Government was prepared by a consultancy headed by Professor Mervin King through facilitation by the Directors Institute of Botswana. Our enquiries as to the process in progress in incorporating the new developments of King IV revealed the sad news that the Directors Institute of Botswana was not active as the members had not met in a long while. The Institute could therefore be regarded as 'dormant'.

Consequently, the Botswana Stock Exchange Limited removed the Botswana Code from its listing requirements as a recommended Code of Corporate Governance for the Botswana. This is a huge step backwards in view of the inroads that had been made for Botswana to have its own Code of Corporate Governance. In addition, the Code had been prepared through the support of an international donor, the African Development Bank (ADB).

The Directors Institute of Botswana is encouraged to resuscitate the Institute so that Botswana could have its own Code that it could work on domesticating as the current Botswana Code of Corporate Governance is a mirror image of King III and does not have legal enforceability in Botswana.

## **6. CONCLUSION**

In comparing the performances of these different categories of PIEs, it is important to take cognisance of their mandates and objectives as certain entities like parastatals may concentrate on socio-economic developmental initiatives where the emphasis is on administration and delivering a product or service for the society rather than an emphasis on commercial viability and creating shareholder value. The emphasis on social delivery has in the past given birth to a culture of operational inefficiencies and poor financial performance.

That notwithstanding a tailored adoption of good corporate governance practices can be beneficial across sectors or entities whether they are

private entities, public entities non-governmental organisations or investment entities. One apparent weakness that came to the fore during our reviews was that for certain entities, representation in the board was not based on the need to constitute a board with the right skills, knowledge and experience but on stakeholder representation without considering the legitimate interests and expectations of the broader stakeholders.

The decision by the Government of Botswana to monitor corporate governance practices in Botswana through the Authority is highly commendable and will revolutionise corporate governance in this country. The results of the first batch of reviews conducted by the Authority have sent shock waves to the PIEs as many are found wanting in this regard. BAOA has also signed the long-awaited Memorandum of Understanding with PEEPA in order to coordinate activities by the two entities in pursuance of their mandates.

PIEs are encouraged to start preparations for the migration from King III to King IV (apply and explain) which is more principles based.

---