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CS PART III SECTION 5

GOVERNANCE AND ETHICS

FRIDAY: 27 November 2020. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

LAKESIDE FERRY LIMITED (LFL)

Lakeside Ferry Limited (LFL) is a public limited company that provides both vehicle and passenger ferry services on a border lake connecting two landlocked Countries in Central Africa. The company was established in Maloa, a landlocked country in 1946 during the colonial period to promote commerce and international relations between Maloa and its neighbours.

LFL has had a good corporate governance reputation and has received a number of governance awards over the years. In 2016, LFL was ranked fourth in a Corporate Governance Index administered by the Country's Corporate Secretarial Professional Body. The award assessed participating institutions; corporate governance, transparency, stakeholder relations, legal compliance and compliance with varied codes of corporate governance, structure of the board, directors compensation, integrated reporting and corporate social responsibility.

LFL believes in effective board and executive management, board composition, diversity and experience are key parameters in the appointment of board members. LFL believes that board diversity brings in new skills and perspectives to the board. Term limits also ensure board members are constantly changed to ensure an independent and diverse board. The board is led by a Chairman and other non-executive board members who hold directorships in other organisations and bring a wealth of board experience.

In 2016 LFL had a board of nine members, six executive and three non-executive and four board Committees. These were Audit Committee, Remuneration Committee, Finance Committee and Nomination Committee.

In the past couple of years LFL board has experienced significant changes in board and executive management. Four senior managers have left the Company. They held key positions such as Chief Finance Officer, Chief Maintenance Officer, Chief Operating Officer and Chief Manager Corporate Communications.

In the financial year 2017/2018 two non-executive directors resigned citing personal reasons and there was no reappointment leaving LFL with only seven directors. Despite being a public organisation, LFL had a good financial performance and safety track record. However, it had its own challenges the most pressing being overcrowding on the ferries. Other customer complaints have been on long queues, lateness and pick pockets on the ferries. In 2018, LFL announced a fare hike of 3% citing rising costs of fuel in international oil markets. The previous fare hike had been in 2010. Commuters grudgingly accepted the fare hike but on the other hand expected better services. The commuters felt that despite the hike, there was no improvement in service delivery leading to increased discontent among them.

On the morning of 17 November 2018, LFL services experienced a major disruption. ~~Two ferries,~~ one on the South-West service and another on the Middle Service stalled Mid-lake leaving passengers stranded on the ferries and onshore. Engineers were dispatched and were able to carry out repair after two hours, after which the ferry services resumed. Again on 8 December 2018 ferry services were disrupted on the East-North service when two ferries collided mid-lake. There were no fatalities but a number of passengers were injured and two vehicles were tossed overboard and sunk. The management reassigned one ferry from the Middle line to serve the East-North service as salvage and recovery activities went on. After three days of transport chaos and public outcry, LFL contracted one of the small private ferry to ease services. Commuters complained that this was too little too late. Also during the crisis, the company issued a number of contradictory statements and inaccurate information which it later corrected.

Due to these mishaps, State Department of Transport and Infrastructure appointed a 7 member taskforce to investigate the recent incidents. This led to the withdrawal of the affected ferries for inspection and repairs, causing major disruptions again. The task force reported that the ferries were not maintained and serviced according to the manufacturers' service schedules and by authorised service dealers, and that LFL was using unlicensed and inexperienced Coxswains. It also established that the Coxswains were overworked due to staff shortages. The taskforce established that the LFL response to the emergencies was slow, haphazard and unplanned. The task force further established that the budget allocated for maintenance and repairs was inadequate.

The incidents at LFL led to a public outcry with the demand that the CEO, should step down. He called a press conference and communicated that he was not ready to step down. However, due to mounting Public Pressure for accountability he resigned on 18 January 2019. This created a succession challenge to LFL due to the fact that there were no senior managers qualified to be appointed to the position on acting capacity until a substantive CEO was recruited. Following the CEO's resignation, the board resolved to appoint the remaining non-executive director to assume executive responsibility while the board recruited a new CEO.

Required:

(a) Evaluate five duties of the directors of Lakeside Ferry Limited (LFL) in relation to stakeholder relationship management. (10 marks)

(b) Analyse four weakness of the risk management and crisis management procedures at LFL. (8 marks)

(c) Citing four reasons, justify whether the board of directors of LFL should be held responsible for the challenges before, during and after the ferry services disruptions. (8 marks)

(d) "There was a number of resignations of senior management staff over a very short period of time prior to the ferry services disruptions threatening the sustainability of LFL business processes".

Advise the board of LFL on five steps that it should take in implementing oversight of corporate sustainability. (10 marks)

(e) Propose four benefits of succession planning strategy to LFL. (4 marks)

(Total: 40 marks)

QUESTION TWO

(a) Analyse five obligations of the shareholders towards the management of a company. (5 marks)

(b) As a governance consultant, advise on six key issues to be covered during the training and development workshop of a new board of directors. (6 marks)

(c) Summarise four objectives of conflict of interest register. (4 marks)

(Total: 15 marks)

QUESTION THREE

(a) Citing five reasons, justify the need for investors education in promoting good corporate governance. (5 marks)

(b) Describe the "policy board model" for non-profit organisations. (4 marks)

(c) A board charter helps the board in directing the organisation to maximise long-term value of services provided to all stakeholders.

Citing six benefits of a board charter, support the above statement. (6 marks)

(Total: 15 marks)

QUESTION FOUR

(a) With reference to the shift in corporate governance practices, describe the following terms.

(i) Outward accountability. (2 marks)

(ii) Collaborative governance. (2 marks)

(iii) e-governance. (2 marks)

(b) Social audit is one of the ways through which companies manage risks. Argue four cases against social audit. (4 marks)

(c) Examine five merits of the stakeholder theory of good corporate governance. (5 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Outline six components of an effective compliance programme. (6 marks)

(b) Propose five strategies that could be employed to minimise insider trading. (5 marks)

(c) Suggest four advantages of the virtual organisation model that is currently embraced by many organisations. (4 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

WEDNESDAY: 27 November 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

STETHO HEALTHCARE LIMITED (SHL)

Stetho Healthcare Limited (SHL) is one of the leading medical insurers in this region. Established 35 years ago in Kenya, the company has steadily grown to have a presence in over seven countries in East and Southern Africa. Over the years the company has experienced very minimal changes in the top management. John Mooley, the current Executive Chairman has decided to retire having served in the combined role for over ten years out of the full 35 year career at SHL. Succession planning at SHL has not been considered an issue since Don Smith had been operating as the Chief Operating Officer (COO) for a number of years and everyone has opined that he is the next in line as he is progressing very well, very promising and he enjoys board support.

Don Smith has trebled the size of the company through an aggressive acquisition strategy, taking the company into lucrative markets around the region where he bought, restructured and turned around struggling small medical insurers. The Board of Directors is quite pleased with their Chief Executive Officer (CEO) and COO's performance. The board has eleven members with seven being company executives and the other four being prominent personalities sourced from the regional markets where SHL operates in. The four non-executive directors were sourced by the Executive Chairman due to their key expertise in SHL's regional markets. None have regular contact with shareholders and fellow board members. The board meets irregularly and mainly meets to review current financial performance. Don Smith, as the COO has complete freedom to act and this is widely seen as the reason for the company's positive trading position in a highly competitive medical insurance industry.

Shareholders of SHL are also pleased with performance. However, apprehension and reservations are being felt and expressed by some shareholders due to the impending retirement of the Executive Chairman who was seen as the moderating influence on the COO's ambitions. Some institutional investors have expressed their concerns about the sustainability of the corporate governance structures and corporate strategy, especially whether adequate financial resources exist within SHL to support it in case of any risk, and whether risks associated with unknown markets make the company overexposed and vulnerable. The Corporate Secretary has also advised the Board of Directors (BOD) on the inadequacies of the current board structure, remuneration of directors which appears haphazard and determined solely by the Executive Chairman and the need for board members reappointments to be performed based as determined through formal board evaluation. The board has only one committee, that is the Executive Committee composed of the Executive Chairman, COO and other executive directors which only meets to discuss those issues the board feels need to be allocated more time than what is available during its infrequent board meetings.

While the company has recognised the need to have foreign directors who have influence in their own countries, the Corporate Secretary has pointed out that the board needs to be directly accountable to the shareholders of SHL. He has recommended the establishment of a two-tier board structure, the main board and an advisory board and creation of a remuneration committee.

Required:

(a) Discuss five changes to the governance structure that you would recommend for Stetho Healthcare Limited (SHL). (10 marks)

(b) Assuming SHL creates an advisory board as advised by the Corporate Secretary, explain five roles it could execute in its governance structure. (5 marks)

(c) Propose five ways through which the board of SHL could address the sustainability and corporate strategy issues raised by the institutional investors. (5 marks)

(d) Advise the board of SHL on five oversight roles that it was expected to discharge to enhance good governance in operations of the company. (10 marks)

(e) Citing five reasons, justify to the board of SHL the need for conducting board evaluation. (5 marks)

(f) Summarise the responsibilities of a remuneration committee that the SHL corporate secretary advised the board to constitute. (5 marks)

(Total: 40 marks)

QUESTION TWO

(a) Your organisation has adopted a performance measurement system based on the concept of tripple bottom line.

Explain how this approach might benefit the organisation. (3 marks)

(b) The general position in matters of ethics could lie around the challenges in legislating it. Yet, ethical conduct is a desirable characteristic in people's conduct in business.

Discuss two aspects giving rise to the challenge in legislating ethics. (4 marks)

(c) In a corporate governance seminar, one of the facilitators noted that "It appears that organisations are strangled with too many accountability overseers that comprise; the board audit committee, the internal audit function, the external audit function and in some cases the regulator and finally the shareholders".

Required:
Justify whether there is need of the above listed oversight functions in the context of value to the organisation. (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Analyse how the resource dependency theory could aid decision makers in promoting good corporate governance. (5 marks)

(b) Explain the importance of stakeholder management in corporate governance. (5 marks)

(c) A major risk facing organisations currently is non-compliance with laws and regulations.

Evaluate five roles of the board in ensuring compliance. (5 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Summarise two disadvantages of a patron board model. (2 marks)

(b) Examine five aspects of integrated reporting. (5 marks)

(c) Discuss four major impediments that stand in the way of corporate governance convergence among different countries. (8 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Describe five duties of directors in relation to conflict of interest and disclosure. (5 marks)

(b) In a professional practice environment one may be able to identify three major barriers to error disclosure, probably with clear consequences to the professional practitioner.

With reference to the above statement, analyse the impact of the following barriers to error disclosure from a professional perspective:

(i) Legal action. (2 marks)

(ii) Loss of trust. (2 marks)

(iii) Loss of professional reputation. (2 marks)

(c) Organisations which are committed to an active corporate social responsibility (CSR) have adopted the provision of CSR services through registered foundations.

Assess how this practice could help to promote greater value to the recipients. (4 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 23 May 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

KENLY BUS TRANSPORTERS (KBT)

Kenly Bus Transporters (KBT) is a leading transport company in Kenya and operates four subsidiary companies. KBT was incorporated as a private limited company in 2011 and went public in 2017 through a conversion. KBT has consistently performed well as reflected in its reported net revenue of Ksh.353 million in 2018.

As a leading passenger transport company in Kenya, KBT currently has a fleet of more than 1,000 vehicles, serving more than 1 million passengers per month, on more than 35 different routes throughout Nairobi metropolitan city. KBT core business lines include regular bus services, taxi services, car rental services and charter bus services. The company plans to expand both its taxi and non-taxi businesses through geographical expansion and new business activities while continuing to invest in improving efficiency across all business segments.

Following its initial public offer (IPO), KBT approached Lilly Registrars, a leading certificate secretarial and corporate governance consultancy firm to support the company's efforts to strengthen its corporate governance (CG) framework and policies. KBT targeted to go beyond compliance with local regulations and align the company's governance with international leading practices and standards.

The decision to engage Lilly Registrars was a strategic move which was in line with KBT's overall growth strategy. KBT groups dramatic transformation from a modest family owned business into a professionally managed listed company and became one of the country's leading transport service providers that required a significant reconfiguration in the company's governance structure and practices.

The company wanted to set an example at the top that highlights the importance of corporate governance. However, since many of the members of the Board of Directors (BOD) were relatives, the leadership knew they needed to develop formal board charters and terms of reference (TORs) for Board Committees to clearly articulate the roles of the BOD and clarify the responsibilities of each governance body within the organisation.

In terms of internal controls, KBT's internal audit function needed improvement and dedicated resources to monitor systemic corporate risks. Regarding the treatment of shareholders, the company did not have policies to address conflicts of interest, insider trading or related party transactions, which was problematic since family members were represented in the BOD of both KBT and affiliated companies. The founders of KBT understood that better governance would bring added value and that value creation would come from better management of risks. By spearheading a review of its CG, KBT showed its proactive stance and foresight.

In April 2015, Lilly Registrars conducted a governance and secretarial audit of KBT's CG practices and developed a practical, action-oriented plan to help the company improve its governance structures and practices. In collaboration with Lilly Registrars, KBT developed a comprehensive CG manual to clearly outline how the company should be governed. To enhance the effectiveness of its board and clearly delineate their roles and responsibilities from management, TORs were created for BOD members as well as board-level committees and the corporate secretary. The composition of the BOD was reviewed to ensure that boards would be led by capable, independent members equipped with expertise necessary to steer the company moving forward. The company also committed itself to establish a "whistle blowing" policy in the organisation to ensure accountability and transparency on the part of the board and executive management.

To improve the capacity of monitoring risks, the company strengthened its Internal Audit Unit and established a more formal risk management framework. With expectations of transforming from a privately held family business to a rapidly growing public company, restructuring was needed. The founders explored the development of a best practice family governance framework, including a family constitution in order to set the vision, values and policies regulating the family relationships with the business and ensure continuity of KBT for generations to come.

The governance audit carried out by Lilly Registrars identified challenges in the following key governance areas facing the company:

- Commitment to corporate governance.
- Board effectiveness.
- Management control.
- Disclosure and transparency.
- Shareholder and stakeholders relations.
- Risk management.

In their report to the KBT board, Lilly Registrars have made recommendations on how to address the above challenges.

Required:

(a) Discuss five ways in which Kenly Bus Transporters (KBT) could improve board effectiveness. (10 marks)

(b) One of the challenges facing KBT is risk management. Analyse five responsibilities of the KBT's board in risk management. (10 marks)

(c) Advise the board of KBT on eight obligations of shareholders of KBT as a listed company. (8 marks)

(d) Regulators of capital markets provide for the minimum threshold in the regulation of listed companies, otherwise self regulation is encouraged.

With reference to the above statement, outline six benefits of self-regulation to the board of KBT and the transport industry. (6 marks)

(e) Propose six strategies that the board of KBT could employ to minimise insider trading. (6 marks)

(Total: 40 marks)

QUESTION TWO

(a) Explain the following corporate governance models:

(i) Consensus board model. (2 marks)

(ii) Competency board model. (2 marks)

(b) Summarise three disadvantages of an advisory board. (3 marks)

(c) Examine four benefits that could accrue to a company that engages in corporate social responsibility (CSR). (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Distinguish between "transaction cost theory" and "agency theory" of governance. (2 marks)

(b) Impactful social investment requires the conduct of a social audit.

Analyse five challenges an organisation could face when conducting a social audit. (5 marks)

(c) Corporate disclosure and transparency, whether imposed on the firm by regulators or supplied voluntarily by the firm, is beneficial to shareholders if it creates value.

Required:

With reference to the above statement, discuss four mechanisms for enhancing corporate disclosures and transparency in a firm. (8 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Explain three benefits of having a whistle blowing policy. (3 marks)

(b) Analyse four objectives of stakeholder mapping in corporate governance. (4 marks)

(c) Examine four functions of the Ethics and Anti-Corruption Commission (EACC) or similar body in your country. (4 marks)

(d) Evaluate four objectives of a legal and compliance audit. (4 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Recent times have witnessed spectacular corporate failures despite financial auditors issuing unqualified audit reports.

With reference to the above statement, suggest five measures that a governance auditor could recommend for adoption to improve corporate audits. (5 marks)

(b) Discuss five governance and ethical issues surrounding the pervasive adoption of information communication technology (ICT) in organisations. (10 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 29 November 2018. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

MOONSHINE COMPANY LIMITED (MCL)

Incorporated in 2008, Moonshine Company Limited (MCL) produced tomato puree concentrate for sale to multinational and local companies in the food and beverages industry. It had two subsidiaries, plastic and paper packaging for the food industry.

Since listing its shares in the securities exchange at a price of Sh.17 per share in March 2009, MCL had issued a number of profit warnings and had been plagued by corporate governance and audit issues.

In March 2010, MCL became the first company (since August 2009) to close below its Initial Public Offer (IPO) price at Sh.9 per share. Analysts attributed MCL's low market share price to inherent problems with its business model – a single product business which was highly leveraged.

As of 30 June 2011, many lead companies at the securities exchange began to issue profit warnings. As MCL did not issue a profit warning, its reported net loss of Sh.9.4 million for the six months period ended 30 June 2011 shocked the market. In a statement to the securities exchange authority, MCL directors attributed the financial loss to increase in administrative expenses, selling and distribution expenses and finance costs.

The independent directors (IDs) were unaware of the financial loss until four days before the release of the financial results. In reaction, the IDs commissioned a special audit and investigation carried out by Lituma Accounting Firm to review the circumstances surrounding the financial loss.

The special audit uncovered numerous accounting and governance irregularities which included:

- Understatement of cost of sales and stock, asset overvaluation and prepaid freight charges classified as receivables.
- Loans to directors were classified as accounts receivables and unauthorised loans were advanced to management, although the Articles of Association expressly prohibited management and board awarding themselves loans.
- The company did not file returns.
- The company did not have a corporate secretary.
- Dividends had been paid out of a capital reserve.
- Board minutes authorising key policy decisions and changes were not maintained.
- MCL board operated without board committees.

The IDs called an urgent meeting to review the special audit findings. The meeting resolved, among other things, to suspend the Managing Director (MD) and the Chief Finance Officer (CFO) and to appoint the General Manager as the acting Managing Director. The Managing Directors of the subsidiaries were also suspended. However, within the same month, the MD and the CFO were reinstated by the executive directors. The IDs did not cast their votes in the decision to reinstate the officers as they had realised that their votes could not influence the decisions made as the executive directors held the majority of the group shares.

To make matters worse, the group company reported that it might suffer an estimated loss of Sh.10 million in the second half of the year due to the shortage of raw materials and unfavourable weather conditions. The external auditors, XYN CPA, also raised a red flag on whether MCL was a going concern. The profit warnings continued into the first half of year 2012 with a reported net loss of Sh.15 million.

In 2013, the MD implemented a major restructuring strategy across the firm in the hope of turning operations around. The two loss making subsidiaries were sold.

The MD's efforts in rebuilding the company initially appeared to be effective and the company returned to marginal profitability in 2013 and 2014. Good news came in July 2015 when a foreign based company Starshine Company Limited (SCL) decided to invest its manufacturing assets valued at Sh.17 million in MCL thereby acquiring a 24% stake in MCL.

However, the joint venture with SCL did not turn around the situation. More profit warnings came in 2016 and 2017. MCL's financial statements raised a serious red flag with net current liabilities reported at Sh.54 million and negative operating cash flows of Sh.12.74 million. This prompted the newly appointed auditors KLM CPA to warn investors of potential going concern risks. Amid the mounting cash flow problems, the CFO resigned on July 2017. With a net loss of Sh.36 million in 2018, mounting debts and lawsuits, the situation got out of control. MCL was placed under statutory management and the shares were officially suspended from trading at the securities exchange.

Required:

(a) Analyse five challenges that were faced by independent directors of Moonshine Company Ltd. (MCL). (10 marks)

(b) Justify five actions that MCL shareholders or the board could have taken after the special audit findings, to salvage the company from imminent failure. (10 marks)

(c) Discuss three areas where the board and management of MCL failed in terms of compliance with the rule of law, governance and ethics. (6 marks)

(d) Advise the board of MCL on five responsibilities that they failed to discharge in relation to:

(i) Financial reporting. (5 marks)

(ii) Internal controls. (5 marks)

(e) Propose four terms of reference that could have guided the board of MCL in appointing the various committees of the board that were inexistent. (4 marks)

(Total: 40 marks)

QUESTION TWO

(a) Analyse five roles of the board in relation to stakeholder engagement. (5 marks)

(b) Propose four guiding principles for an effective board succession planning. (4 marks)

(c) Summarise six differences between "agency theory" and "stewardship theory". (6 marks)

(Total: 15 marks)

QUESTION THREE

(a) Explain the components of the "Triple Bottom Line" accounting framework in corporate sustainability. (3 marks)

(b) Suggest three ethical dilemmas that might be faced in corporate social responsibility (CSR). (3 marks)

(c) The concept of sustainability and social investment brings together the following types of governance:

- Economic governance.
- Corporate governance.
- Environmental governance.

Required:

Highlight three roles of each of the above types of governance. (9 marks)

(Total: 15 marks)

QUESTION FOUR

(a) In a corporate governance seminar, one of the facilitators noted that, "it is not always possible to foresee every situation that could give rise to real, or potential conflict of interest. However, there are certain ways that the board member or an employee is expected to react in instances where conflict of interest arises".

With reference to the above statement, suggest seven actions that the board member or an employee should take in instances where conflict of interest arises. (7 marks)

(b) Information technology (IT) risk management is a critical component of corporate governance. The chief information officer (CIO) is required to identify key areas of risk in order to discuss, strategise and budget for, with the support of management and the board of the organisation.

In relation to the above statement, propose four key areas of risk that the CIO needs to discuss, strategise and budget for. (8 marks)

(Total: 15 marks)

QUESTION FIVE

(a) (i) In the context of corporate governance models, explain "carver board model". (2 marks)

(ii) Organisations in the non-profit sector are increasingly adopting the advisory board model of governance.

Outline five roles of an advisory board. (5 marks)

(b) Discuss the following current trends in corporate governance:

(i) Social media governance. (2 marks)

(ii) Women on corporate boards. (2 marks)

(iii) Shareholder social activism. (2 marks)

(iv) Corporate compliance risks. (2 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 24 May 2018. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

SOLAR BANK LIMITED (SBL)

Solar Bank Ltd. (SBL) was incorporated on 12 January 2015 and headquartered in the capital of a developing country. SBL's core business is to provide personal and business financial services including digital banking. It has established a branch network in major towns in the country. The organisational structure of the bank allows risk management responsibility on business development and internal operational processes to be delegated to smaller units with varying layers of supervision, monitoring and reporting procedures to be followed. Ultimately, the audit and governance committee of the board is responsible for risk management and other aspects of corporate governance compliance.

In April 2017, an employee of SBL revealed anonymously to the Chief Executive Officer (CEO) that there were intermittent cases of fraud and money laundering involving briefcase companies and staff of the bank. Two months later, the internal audit unit also reported to the management that during a routine check on operational and compliance risks, it had noted breaches of procedures in opening new business accounts with huge deposits from sources which were highly suspect in terms of ethical business practices. The funds deposited would be withdrawn by the new customers immediately in form of cash or transferred electronically to individual and business accounts in other banks. It was apparent that the risk management policy and operational procedures were not being followed. The management seemed to have informally consented to these types of "new business transactions" since nothing was done to stop them. The bank did not have a whistle blowing policy. In the absence of management response on issues raised by the internal audit unit, the matter was not reported at the quarterly audit and governance committee meeting held in June 2017.

The media reports on 15 July 2017 were a big shock to the board and management of SBL. It was reported that SBL was involved in laundering the proceeds of corruption. The matter had come to the attention of the regulatory authority through a case filed in court by a government agency which had lost colossal sums of money wired to briefcase companies as payments for goods and services provided to the agency. The regulatory authority had in turn requested the Corruption Eradication Commission (CEC) to move with speed and investigate the bank.

The management had simply kept the directors in the dark. The directors trusted the management and relied heavily on management reports presented at board meetings. The board hardly sought independent external professional advice on any matter. During the last board meeting, the risk management report as presented by the chairman of the audit and governance committee was inconclusive.

Required:

(a) Discuss five dysfunctional characteristics of the board of Solar Bank Ltd. (SBL) citing appropriate remedial action in each case. (10 marks)

(b) Examine the following types of risks likely to be faced by SBL as a result of management's excessive focus on short-term results:

(i) Reputational risk. (4 marks)

(ii) Compliance risk. (3 marks)

(iii) Operational risk. (3 marks)

(c) (i) Evaluate the role of the audit and governance committee in ensuring effective internal control environment of SBL. (5 marks)

(ii) Advise the board of SBL on the importance of the internal control environment in the organisation. (3 marks)

(d) (i) Citing four reasons, justify why SBL should embrace corporate compliance practices. (8 marks)

(ii) Propose four measures that SBL should put in place to enhance compliance practices within the company. (4 marks)

(Total: 40 marks)

QUESTION TWO

(a) Discuss four fundamental principles usually incorporated in professional codes of ethics. (4 marks)

(b) Explain three qualifying disclosures that an employee could use as a defense in a court case relating to unfair dismissal for whistle blowing. (3 marks)

(c) Analyse four ways in which insider trading could be conducted in an organisation. (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Examine four ways through which a company could promote shareholders' rights. (4 marks)

(b) Explain five reasons why good governance is important to organisations. (5 marks)

(c) Argue six cases against companies engaging in corporate social responsibility (CSR) activities. (6 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Evaluate three guiding principles in regard to board remuneration. (3 marks)

(b) Analyse five activities that companies could engage in to ensure environmental sustainability. (5 marks)

(c) Corporate governance reporting requires the directors of a company to include a corporate governance statement in the annual report.

With reference to the above statement, summarise seven contents of the corporate governance statement. (7 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Citing four reasons, explain why many organisations do not carry out board performance evaluation exercise. (4 marks)

(b) Discuss five assumptions of deontological theory of ethics. (5 marks)

(c) In an international governance seminar, one of the facilitators noted that "The board should be assisted by a suitably qualified, competent and experienced corporation secretary. Therefore, the board should empower the corporation secretary to efficiently and effectively execute his or her duties and responsibilities".

With reference to the above statement, analyse six principle duties of the corporation secretary. (6 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 30 November 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

HAPPY VALLEY CLUB (HVC)

Happy Valley Club (HVC) is a private members club that was established in 1957 and registered as a company limited by guarantee. The club's board is made up of 15 directors who are all members of the club. The club has the following committees; membership committee, finance committee, nomination committee, banqueting committee, recruitment committee, governance committee, disciplinary committee and recreation committee. Each committee is made up of 5 members who also serve in more than one committee. Some of the committees have not met in the last 18 months. The chairperson of each committee determines the agenda, procedure of conducting meetings and frequency of meetings. Most committee meetings have been adjourned due to lack of quorum.

The governance committee made changes to the Articles of Association and the company secretary requested to file the amended Articles with the Registrar of Companies. The financial performance of the club in the last three years has been in decline. The club posted a deficit in the last financial reporting period. A number of members have resigned from the club citing poor service delivery. The club has been sued by a number of suppliers due to non-payment for supplies delivered to the club.

The foregoing challenges have caused infighting within the board and the Annual General Meeting for the year 2016 was not held as scheduled and as per legislation hence the company has defaulted in filing the annual returns.

The Registrar of Companies caused the club to convene a general meeting. During the general meeting, members voted out the previous chairman for failing to provide leadership to the club. They resolved to appoint a business consultant to investigate the club's affairs. The consultant's report to the club highlighted the following key observations:

- The club lacked a strategic plan.
- The club obtained a credit facility through the chairman and the general manager acting as guarantors without board approval.
- The board members did not have appointment letters, pre-requisite skills and experience.
- Three senior staff members were recruited without the participation of the recruitment committee and they are related to the chairman.
- Formulation of procurement policy and selection of vendors for major contracts that exceeded the Chief Executive Officer's limit was done by the General Manager.
- The board held only two meetings in the last financial period.
- Three directors had borrowed money from the club and this fact had not been disclosed in any report.

The consultant also made a number of recommendations under the following topics:

- Composition of the board.
- Members education.
- Risk management.
- Transparency and disclosure.
- Board charter.
- Board work plan.

The board and management have resolved that the consultant's report be implemented fully.

Required:

(a) Advise the board of Happy Valley Club (HVC) on four best practices on an effective board composition. (8 marks)

(b) As part of sensitisation to members of HVC, examine six responsibilities of shareholders of a company. (6 marks)

(c) Explain three actions that were undertaken in HVC that were reserved for the board and not management. (6 marks)

(d) Explain three areas in which the board of HVC has failed in its responsibility to the members. (6 marks)

(e) Analyse how implementation of the recommendations made by the consultant under the following topics could help in improving the corporate governance of HVC:

(i) Board charter. (4 marks)

(ii) Board work plan. (4 marks)

(f) Citing six reasons, justify to the board of HVC the need for a code of corporate practices and conduct. (6 marks).

(Total: 40 marks)

QUESTION TWO

(a) In the context of good governance. explain the meaning of the phrase "market based corporate governance system". (2 marks)

(b) Suggest five characteristics of an effective measurement tool for enterprise risk management. (5 marks)

(c) Citing four reasons, justify why the roles of the chief executive officer and that of the chairman should be split. (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Summarise four merits that could accrue to an employee from adhering to professional standards and personal integrity. (4 marks)

(b) Suggest six factors that an individual should consider before accepting a gift from a client. (6 marks)

(c) Good corporate governance requires all companies to have a code of ethics.

Propose five ways on how a company could demonstrate commitment to the code of ethics. (5 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Outline three ways on how the resource dependency theory could promote good corporate governance. (3 marks)

(b) Analyse four objectives of social audit. (4 marks)

(c) Discuss four principles of stakeholder management suggested by Max Clarkson (1922-1998). (8 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Analyse five possible risks an individual could face as a whistleblower. (5 marks)

(b) In an international governance seminar, one of the facilitators noted that "Most of the developing countries are currently facing governance and ethical challenges in public service".

With reference to the above statement, discuss five factors underlying governance and ethical challenges in public service. (10 marks)

(Total: 15 marks)

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KASNEB

CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 25 May 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

NENKAS LAND LIMITED (NLL)

Nenkas Land Limited (NLL) was incorporated on 25 October 1999 as a Business to Business (B2B) company and listed at Nolland Securities Exchange (NSE) on 12 January 2001. In 2004 the company added to its product line real estate and related property market, corporate investment, transport and logistics. The company also expanded its operations to East and Central Africa.

The NLL board of directors was made up of seven directors, five of them being non-executive directors. Five of the directors had background in engineering and operations management. The chairman Levy Turdor was the only one with relatively diverse background in financial and security markets. The directors did not possess adequate knowledge and experience in board matters and there was no induction or training programme for the directors. There was also no formal process of board evaluation and there was no nominations committee. In 2009 the audit committee of the company reviewed a wide range of reports and relevant papers and gave the company a clean bill of health. Soon after, the external auditor, Racy Young and Associates raised the following issues:

- Lack of timely communication to the shareholders.
- Financial statements did not adhere to accounting standards and compliance.
- A major investment worth shillings 700 million was approved by the Chief Executive Officer and the board chair without NLL's board involvement.
- The company secured a loan of shillings 170 million charged on the company's assets without the consent of the board and the knowledge of shareholders.

In 2012 upon realising that the company's performance was declining, four of its directors resigned. Racy Young and Associates also tendered notice of intention to resign as the company's auditor. Behind the scene, Durya Molly, the company engineer entered a secret deal with two former college mates Hussein Levy and Erick Tolly to start a similar business under the name HED Holdings. Hussein Levy was to pump in family finances, Erick Tolly to provide the leadership and Durya Molly who had access to his employer's confidential information and other intellectual data like production forecasts, emerging housing designs, pricing, favourable suppliers, customer listings and product specifications was to support the new business with this data. Durya Molly promised his partners in the newly established company, constant supply of customers in return for a share of 20% of the proceeds paid as kickbacks. The communication in emails was coded to avoid suspicion and a number of clients were directed by NLL marketing manager in collusion with Durya Molly to HED Holdings as part of the wider scheme.

The performance of NLL continued to worsen whereas HED Holdings registered growth of 25% in two successive years. In March 2014, NSE delisted NLL shares citing bad governance, negative working capital and non compliance with the listing requirements. Two months later, Durya Molly and the marketing manager resigned to pursue their lucrative business, citing poor remuneration, existence of severe conflict of interest, inadequate controls and directors lack of prompt and accurate disclosures and self dealing. Within five months after the exit of Durya Molly, NLL management unearthed the fraudulent scheme. Investigations began in 2015 with an aim of instituting a civil suit against Durya Molly and the marketing manager.

Required:

(a) Highlight eight corporate governance weaknesses in Nenkas Land Limited (NLL). (8 marks)

(b) Advise the board of directors of NLL on five matters reserved for the board. (10 marks)

(c) Propose six ways of enhancing committee effectiveness at NLL. (6 marks)

(d) Summarise five responsibilities the board of NLL was expected to discharge towards its stakeholders. (5 marks)

(e) Citing six roles, justify to the board of NLL the need for establishing a nomination committee. (6 marks)

(f) The board is required under corporate governance framework to ensure that timely and accurate disclosures are made on all material matters regarding the company.

In relation to the above statement, examine five matters that the board of NLL was required to disclose. (5 marks)
(Total: 40 marks)

QUESTION TWO

(a) Many organisations prefer self regulation as opposed to legislative regulation.

In reference to the above statement, highlight five benefits of self regulation. (5 marks)

(b) With reference to corporate governance, discuss reasons why stakeholder mapping is important to an organisation. (6 marks)

(c) Analyse four challenges an organisation could face while carrying out a social audit. (4 marks)
(Total: 15 marks)

QUESTION THREE

(a) Propose six measures that companies could put in place to protect confidential information. (6 marks)

(b) Analyse six benefits of corporate environmental responsibility. (6 marks)

(c) Examine three criticisms against stakeholder theory. (3 marks)
(Total: 15 marks)

QUESTION FOUR

You have been contracted by XYZ to carry out an induction training for its newly appointed board.

Required:

(a) Explain to the board three potential areas of liability to the directors. (6 marks)

(b) Summarise five duties of XYZ Ltd. directors in relation to conflict of interest and disclosure. (5 marks)

(c) Advise the directors of XYZ Ltd. on four consequences of a weak risk management system in the company. (4 marks)
(Total: 15 marks)

QUESTION FIVE

(a) Analyse five hindrances to regular and effective board evaluation. (5 marks)

(b) Recent times have witnessed spectacular corporate failures despite auditors issuing unqualified audit reports.

Suggest five measures that could be adopted to improve corporate audits. (5 marks)

(c) Examine five potential impacts of an adverse corporate governance report to an organisation. (5 marks)
(Total: 15 marks)

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KASNEB

CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 24 November 2016. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

ELIXIR BANK LTD. (EBL)

Elixir Bank Limited (EBL) is a middle tier bank operating in the East African region and internationally. EBL provides financial services in four main areas; retail banking, corporate banking, small and medium-sized enterprises (SMEs) banking and insurance.

The bank adopts a service differentiation strategy and uses its research and development capabilities to introduce innovative banking services leveraging on technology.

The board of directors consisted of seven directors, with three independent directors (IDs); John Smith, James Roy and Jill Wallen. John Smith was appointed as the lead independent director. He sat on the boards of five other listed companies and also held other key positions, such as being a director of the National Trade Union Congress (NTUC). James Roy sat on the boards of other listed companies and was a senior executive in a healthcare group of companies, holding senior positions such as Executive Director (ED) and Chief Executive Officer (CEO) in hospitals and companies in the group. Jill Wallen had no prior experience as a director. All the three IDs were members of the remuneration committee, nominating committee and audit committee of the bank.

The four executive directors held key management positions in EBL as follows: Ted Rich was the Executive Chairman and CEO. Tim Kelly the Chief Operating Officer (COO), Tom Molly the Chief Technology Officer (CTO) and Theof Steve, Chief Financial Officer (CFO).

The board had diverse competences in business management, finance, accountancy, economics and healthcare. The board held meetings four times in a year, while the committees of the board held several meetings.

The troubles at the bank started when Ted Rich, the CEO and Chairman of the bank, pledged his entire stake of 56.29 per cent in the bank as collateral for a personal loan from Scotch Bank, an international bank. A loan default of shillings 3 billion by London Holdings (LH) an investment firm wholly owned by Ted Rich triggered the unravelling of the ownership of EBL. LH was a controlling shareholder of EBL, a fact that was unknown to many.

When Ted Rich defaulted on the loan in March 2016, Scotch Bank seized his shares in EBL and sold off the entire stake in the open market, causing Ted Rich to lose control of the bank. The forced sale of his shares triggered a premature redemption of convertible bonds worth shillings 1.2 billion, as the bond agreement included a covenant which required Ted Rich to remain in control of the bank.

The severity of the issue emerged when PVC, the bank's auditors issued an audit disclaimer on EBL financial statements due to going concern issues. TPL, a corporate advisory firm was then appointed as EBL's independent financial advisor to assess the implications of the default, as well as to recommend measures to be implemented in order to guarantee the going concern of EBL.

When EBL failed to produce its first quarter financial results in April 2016, PVC was engaged to review significant cash transactions between the months of January and March 2016 which were connected with Ted Rich's loan default. The CFO's resignation at the end of April 2016 on "personal reasons" raised eyebrows among the board members. No action was taken by the management to appoint a new CFO.

The other executive directors, the CEO, CTO and COO caused a shock in the market when on 5 May 2016 they tendered their resignation without giving any reasons. The independent directors pleaded with the executive directors to remain on board to ensure continuity. On May 29, 2016 they rejoined EBL. However it emerged that, when they were away, the key management had retained control of overseas branches and had access to the overseas branches bank accounts.

The audit report revealed that, at least shillings 1 billion worth of cash transactions were made without any prior approval or authorisation from the board. The audit report also exposed other dubious transactions which included siphoning money from the bank.

The individuals responsible for the dubious transactions made it difficult for PVC when the firm went to conduct audits in the branches overseas. Accounting branch officers were advised not to cooperate with the auditors and therefore forced them to leave the bank premises. They were unwilling to verify statements from the auditors and it appeared that two sets of books of account were maintained. PVC could not continue with the audit as a result of frustration.

The key management traded accusations and counter accusations in public where IDs accused EDs of misusing their power as directors. The EDs responded by claiming that the financial controller appointed by the board had misused the bank's funds through paying of professional fees to PVC and TPL instead of repaying the corporate bond.

To protect the interests of depositors and other creditors, the financial regulator placed the bank under statutory management and closed all its branches.

Required:

(a) Analyse the composition of the board of Elixir Bank Ltd. (EBL), citing four ways in which it complies with the best practices in good governance. (8 marks)

(b) Discuss three potential conflicts of interest existing within EBL. (6 marks)

(c) Examine eight roles that the lead independent director was expected to discharge in EBL. (8 marks)

(d) Propose five governance measures that EBL could adopt in order to overcome the challenges it was facing. (10 marks)

(e) (i) Summarise to the board of EBL four mandatory matters that the audit committee is required to review. (4 marks)

(ii) Advise EBL audit committee on four powers they could exercise in order to improve the bank's operations. (4 marks)

(Total: 40 marks)

QUESTION TWO

(a) Examine four likely challenges encountered in protecting confidential business information from potential security risks. (8 marks)

(b) Arcute Company Ltd. was established in mid 2016, and has recently constituted a board comprising new and inexperienced members.

Assuming that you have been hired to train and induct the members, propose seven topics that you would include in your training manual. (7 marks)

(Total: 15 marks)

QUESTION THREE

(a) One of the best practices in corporate governance is conducting a formal and rigorous evaluation of the performance of board of directors.

Citing three reasons, highlight the significance of board evaluation. (3 marks)

(b) Evaluate four roles of ethical theories in regulating behaviour of members of an organisation. (4 marks)

(c) Examine four ways through which corporate organisations may implement corporate social responsibility (CSR) initiatives to address environmental issues. (8 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Outline five objectives of investor education programmes. (5 marks)

(b) In an enterprise risk management seminar, one of the facilitators noted that "Enterprise risk management consists of interrelated components that are derived from the way management runs an enterprise and are integrated with the management process".

With reference to the above statement, discuss five components of enterprise risk management. (10 marks)

(Total: 15 marks)

QUESTION FIVE

(a) In the context of legitimacy theory, explain the following types of organisational legitimacy:

(i) Normative. (1 mark)

(ii) Pragmatic. (1 mark)

(iii) Cognitive. (1 mark)

(b) Many countries today have put in place institutional and regulatory frameworks to promote good governance in organisations. Despite this fact, many firms continue to be faced with financial frauds and scandals.

With reference to the above statement, suggest four adverse consequences of poor corporate governance. (4 marks)

(c) The board of XYZ Ltd. has approached you as the company secretary for advice on the various internal governance controls that the board should put in place.

Advise the board of XYZ Ltd. on four internal governance controls. (8 marks)

(Total: 15 marks)

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KASNEB

CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 26 May 2016. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

KITE LINK LTD. (KLL)

Kite Link Ltd. (KLL) was incorporated on 29 October 2007 as a business to business (B2B) and was listed in the Common Security Exchange (CSE) in 2009. In 2010, KLL added the real estate development and related services to the group's core business with an emphasis on the Kenyan property market. Through its subsidiaries and associated companies, KLL businesses spanned from property development, project management to customised housing in Kenya, Uganda and Tanzania. The company's three main areas of investment are development projects for both commercial and industrial purposes, corporate capital investments and provision of consultancy services.

KLL's board of directors comprised seven members, five of whom were non-executive directors. Three of the five non-executive directors of KLL were considered as independent directors, whose appointment was renewed annually by the nominating committee. The directors possessed diverse experience and skills with majority holding business management degrees from reputable universities and relevant professional qualifications.

The board of KLL was chaired by Luka Mose. The finance and accounting unit was headed by Eric Tolo, an executive director who was also a partner at Tolo and Associates, the accounting firm that has been providing accounting services to KLL for an undisclosed number of years. The board of directors in KLL were compensated in the form of directors fees, committee attendance fees and share options. Executive directors were not paid directors fees but instead were entitled to salary, allowances, bonuses and share options.

The audit committee of KLL comprised three directors; two of whom were non-executive independent directors including the chairman of the audit committee. Members of the audit committee had a background in accounting and finance. The audit committee held meetings several times in a year. According to the company's corporate governance report, the audit committee reviewed a wide range of reports and relevant papers from the management and external auditors. Management staff and the company's auditors were invited from time to time to attend such meetings in order to provide additional information as appropriate.

KLL's Nominating Committee (NC) comprised two non-executive independent directors, including the chairman of the nominating committee and one executive director. The nominating committee made recommendations to the board for the re-election of directors and appointment of potential candidates as directors and members of the committees. The nominating committee also evaluated the performance of the board.

One of the issues faced by the KLL board was the review and oversight of the accounting practices of the company. Eric Tolo would prepare the accounts, which would then be approved by the staff of Tolo and Associates. Luka Mose, the chairman of the board in consultation with the audit committee authorised Eric Tolo, the head of finance and accounting unit to perform internal audit roles in KLL without informing the Nomination Committee or seeking board approval.

In September 2014, EZ Certified Public Accountants, KLL auditors since 2008 raised concern for lack of timely communication and sharing of information between the finance and accounting unit and Tolo and Associates. The issues of inadequate accounting knowledge and non-compliance from its reporting entities in Uganda and Tanzania were also raised.

Investment proposals by KLL in Uganda and Tanzania were not presented to the KLL board for evaluation and approval. In addition, the budget report of a project in Kenya did not include proper detailed budgeting and projections and there were no timely cash flows and project reporting by KLL. Further, an inter-company loan of Sh.100 million taken to finance its operations in Tanzania which matured in May 2015, was signed and extended by Luka Mose, the Chairman without notifying the board of KLL.

Successive resignation of members of KLL's senior management became a matter of concern in July 2015 with the resignation of the deputy managing director. On 2 October 2015, EZ Certified Public Accountants gave notice to the company of its intention to resign as the company's auditor, just three days after being reappointed in the Annual General Meeting (AGM) of the company. In November 2015, Eric Tolo resigned from KLL.

KLL directors while drafting the governance report for the year ended 31 December 2015, acknowledged the existence of several conflicts of interest including duality of roles and inadequacy of management controls. It also admitted to lack of prompt disclosures of project cash flows and lack of board approvals.

Required:

(a) Analyse five good governance practices adopted by Kite Link Limited (KLL). (10 marks)

(b) Evaluate five governance challenges faced by KLL. (10 marks)

(c) Discuss five responsibilities of KLL's board towards:

(i) The management. (5 marks)

(ii) Board members. (5 marks)

(d) Propose five ways through which the directors and management of KLL could manage instances of conflict of interest. (10 marks)

(Total: 40 marks)

QUESTION TWO

(a) In the context of good governance, discuss the following policies adopted by various companies:

(i) Whistle blower policy. (3 marks)

(ii) Chinese wall policy. (4 marks)

(b) Analyse four features of a good ethics and compliance programme implemented by companies in your country. (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) Citing three reasons, justify the importance of an independent and balanced board of directors. (3 marks)

(b) Outline six propositions of resources dependence theory. (6 marks)

(c) Companies undertaking corporate social responsibility must take ethical issues into consideration.

Analyse six ethical issues that should be considered while undertaking corporate social responsibility. (6 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Examine four roles of the board in relation to enterprise risk management. (8 marks)

(b) Suggest seven items that should be included in the report on corporate governance, in the annual report of companies. (7 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Suggest four ways in which non-disclosure of accurate financial statements might negatively impact the company. (4 marks)

(b) Argue five cases in favour of board committees. (5 marks)

(c) Evaluate six ways in which a certified secretary (CS) could contribute to the efficiency of the board. (6 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

THURSDAY: 26 November 2015. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

MAGARI INTERNATIONAL LTD. (MIL)

In 2007, two business associates came together and bought a controlling interest in a listed company. The company, then known as Magari International Ltd. (MIL) was one of the leading companies in its area of operations. Indeed, there were products in the market which the company distributed on behalf of the manufacturer that reflected its identity in the market.

The two business associates formed two private companies through which they acquired controlling interest in MIL. Between these two companies, their other individual nominees and themselves, they controlled over 85% of the issued and paid up capital of MIL.

At the time of acquisition by the two business associates, MIL assets base was extremely healthy. The assets included commercial property from which MIL was earning rental income.

The two business associates soon began to differ on business decisions taken by the board of directors which they had appointed comprising of seven members. None of the two sat on the board, but their appointed nominees formed the board membership. Indeed, in the first five years, three Chief Executive Officers (CEOs) had left the company. The board itself did not appear to have the final authority and powers over the business of the company.

Being a listed company, the regulator questioned the board on more than one occasion, why there was such a large turnover of senior management, including the CEOs.

In 2012, their differences reached a breaking point and they sought the court's intervention. While they were busy fighting in court corridors, the board operations in terms of major business decisions stalled, because the nominee board members could not agree on a common direction. They took sides with the individuals who put them on the board. Management was unable to operate effectively, business suffered with key staff opting to seek employment elsewhere. Suppliers were not paid on time, and most of them opted to take legal action to recover their money. The organisation engaged a number of lawyers to deal with the legal cases.

The court after considering all the grievances and the concerns of all the parties, and the effect of any decision on other shareholders and stakeholders, decided not to award a winding up order, but instead directed them to seek the help of a consultant in corporate governance in an effort to salvage MIL.

In 2013, they engaged the services of a corporate governance consultant who advised them on the need for good corporate governance, objectives of corporate governance, how the composition and the structure of the board should be and ways of eliminating the barriers to visionary board leadership so that MIL could be able to achieve its vision. They were also informed on the various roles that their nominee directors should perform in order to promote good governance in MIL.

The parties considered the views, advice and the recommendations of the consultant and unanimously agreed to implement them. This marked the beginning of MIL turnaround. The board started operating effectively, staff morale and revenue increased culminating in improved shareholders and stakeholders confidence.

Required:

(a) Identify five governance issues that require to be addressed by management in order to help Magari International Ltd. (MIL) to operate as a viable business. (10 marks)

(b) Discuss five barriers to visionary leadership, that the board of MIL could eliminate in an effort to achieving its goals. (10 marks)

(c) Analyse five roles that the nominee directors of MIL were expected to perform in promoting good governance. (10 marks)

(d) Citing five reasons, justify the need for good corporate governance to the management and board members of MIL. (10 marks)

(Total: 40 marks)

QUESTION TWO

(a) Propose five reasons why companies get involved in corporate social responsibility (CSR) activities. (10 marks)

(b) Discuss the assertion that divulging confidential information is not necessarily harmful. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Explain the following theories of good governance:

(i) Stewardship theory. (3 marks)

(ii) Agency theory. (3 marks)

(iii) Stakeholder theory. (3 marks)

(b) Examine six benefits of separation of the roles of the chairman of the board and the Chief Executive Officer (CEO) in a company. (6 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Suggest five model questions that could be used during performance evaluation of the board of directors. (5 marks)

(b) (i) Explain the term "reputation risk" as used in enterprise risk management. (2 marks)

(ii) It is believed that the saying "image is everything" is true, with respect to managing reputational risks facing the organisation.

In relation to the above statement, analyse four threats to reputational risk that an organisation might be exposed to. (8 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Summarise seven contents of a board charter. (7 marks)

(b) Citing four reasons, justify why good ethical practice is necessary for the business. (8 marks)

(Total: 15 marks)

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CS PART III SECTION 5

GOVERNANCE AND ETHICS

PILOT PAPER

September 2015. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

MAHIGA LIMITED

Mahiga Limited is a large diamond mining company providing employment to more than 10,000 people directly and approximately 100,000 people indirectly. The Northern part of the County where Mahiga Limited is located and has been operating from for the last fifty years is a rural setup where members have few opportunities. The County is the poorest in the country in terms of average income with two-thirds of the County's population living in extreme poverty. Although the company has a policy of employing at least 30% from the local community, this has been difficult to implement since majority from the local community are uneducated and therefore do not meet qualifications as required by Mahiga Limited. For this reason, the company has been getting most of its employees from the southern part of the country from where all its shareholders and directors come from. In comparison with other companies, the employees of Mahiga Limited are highly paid. However, the company has been experiencing extremely high turnover. In addition, several employees have either died or suffered from work related ailments. The earnings of Mahiga Limited have been increasing for the last fifty years partly because of the high price of diamond in the global market. The company is among the highest tax payers and employers in the country.

As part of its Corporate Social Responsibility, the company has been financing political parties as well as political activists. For a political party or activist to qualify for such financing, such group has to convince the Board of Mahiga Limited that it has a good manifesto and policies that would improve the lives of citizens as well as promote governance in the County. Last year, the local communities took the company to court complaining that their health and those of their livestock were adversely affected by the gases, dust and chemicals discharged by the company. The High Court ruled in favour of the company. This year, local politicians started inciting the local communities to vandalize property of the company citing among others the above complaints. The company sued the said politicians and some of them are already in police custody. However, the conflict seems to be escalating with the local community turning to attack employees of the company. Not only has this conflict led to the stalling of the company's operations but it has resulted into political fallout at the Northern County.

(a) Critically anlayse the governance concerns in Mahiga Limited. (10 marks)

(b) You have recently been appointed as the company secretary of Mahiga Limited. As a governance expert, advise the company on the best way of improving governance practices. (10 marks)

(c) Advise the Board of Mahiga Limited on three alternative methods of solving conflicts other than through the courts. (10 marks)

(d) Outline advantages and disadvantages of the above identified methods of solving conflicts. (10 marks)
(Total: 40 marks)

QUESTION TWO

(a) Explain the meaning of the term "ethics". (3 marks)

(b) Discuss the importance of good corporate governance to the achievement of a country's development agenda. (12 marks)
(Total: 15 marks)

QUESTION THREE

"Corporate Governance is a myth not a reality; it is an unnecessary cost with no significant corresponding benefits to an organisation". This was a remark by a Chief Executive Officer of a listed company.

Critically analyse the above statement. **(15 marks)**

QUESTION FOUR

Explain the roles of the following in promoting the practice of good governance in an organisation:

(a) Board of Directors. (3 marks)

(b) Board Chairman. (3 marks)

(c) Audit Committee. (3 marks)

(d) Company Secretary. (3 marks)

(e) External Auditor. (3 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Describe the role of information communication in the practice of corporate governance. (8 marks)

(b) Discuss the advantages of having independent directors in the Board of a company. (7 marks)

(Total: 15 marks)

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