



CS PART III SECTION 5
GOVERNANCE AND ETHICS

THURSDAY: 20 May 2021.

Time Allowed: 3 hours.

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

QUESTION ONE

ROCK ATHI LIMITED (RAL)

Rock Athi Limited (RAL) was incorporated in August 2014 as a business to business (B2B) company. RAL had applied for listing in Securities Exchange (SE) in 2017 but was not successful. The company deals with real estate and asset property. The company deals in construction of commercial, industrial and residential housing units.

RAL is made up of seven directors, five of whom are non-executive, three of the five non-executive are considered independent directors whose status are reviewed annually by nominating committee. The Board consist of directors with diverse experience and background. The chairman of the board, James Tall also owns an auditing firm, James Tall and Company which provided external auditing services to RAL.

Directors fee policy included basic retainer fee, committee attendance fee and share options. Executive directors did not receive directors fee but a mix of a good salary and allowances. In 2017, the company approved a share option scheme to employees and directors where the combination on shares they held was 40 percent of the company share capital. The new owners demanded a fresh audit conducted by a different firm other than James Tall and Company. Motshi and Company were appointed and conducted an audit on the company accounting records and practices, which revealed the following; that the finance manager and the accountant did not have the requisite accounting knowledge and experience and had failed to adhere to a number of accounting standards. Financial reports did not reveal the true financial position for the last two years. Budget reports did not capture main projects undertaken, projection and expected cash flows.

The company did not have a whistle-blowing policy and a comprehensive human resource policy. The finance manager was the son-in-law to one of the directors and the Human Resource Director was also the daughter of another director, all were recently hired. Peter Wahomeh who joined the company as the project manager with a diploma in project management recently resigned after the company had spent huge amounts in his training and development abroad. After completing an 18 months training, he tendered his resignation unexpectedly.

In March 2018, the company spent 200 million shillings in corporate social responsibility. The employees had not been paid upto five months salaries in arrears. The Chief Executive Officer (CEO) also bought himself a luxurious car costing Sh.10 million. The CEO contract expired in September 2019 and the organisational culture allowed the CEO to retire with his or her vehicle as an appreciation. A few directors were involved in some contracts which they did not disclose their interest.

Devine Company supplied RAL with construction materials and had signed a secret agreement with the finance and procurement officers that once their bids were approved they would get 20% kickbacks. In spite of Devine Company materials prices being high and products quality not meeting the exact specifications, they continued to be the dominant suppliers. The officers were worried that accumulation of large sums of money in their accounts would attract attention and scrutiny from the banks and therefore they opened several accounts in the names of close relatives where Devine Company would transfer the loot. To conceal the scheme, the company set up two other different firms and opened bank accounts using business names; where they would receive illicit payment. A few board members were privy to this and continued to dance to the tune of corruption.

Required:

- (a) Whistle-blowing arrangements that were missing in Rock Athi Limited (RAL) were increasingly seen as an important component of an organisation's corporate governance framework.

Required:

Draft a whistle-blowing policy for RAL that could help deter and uncover the prevailing instances of fraud and corruption in the company. (10 marks)

- (b) Citing five key potential conflicts of interest highlighted in the case, examine how they undermine corporate governance in RAL. (10 marks)
- (c) Evaluate eight roles that the Board of RAL was expected to discharge in defining the organisation's ethical environment. (8 marks)
- (d) Outline six characteristics of an independent director, that the Board of RAL was required to consider during the appointment of independent directors. (6 marks)
- (e) Analyse information that the directors of RAL were required to disclose to the new company auditors and other board members. (6 marks)

(Total: 40 marks)

QUESTION TWO

- (a) Distinguish between a "Unitary Board" and a "Two Tier Board". (4 marks)
- (b) Propose six best practices relating to audit committees. (6 marks)
- (c) Outline five responsibilities of the board in relation to shareholders rights. (5 marks)

(Total: 15 marks)

QUESTION THREE

- (a) Analyse how legitimacy theory could be applied in enhancing the corporate social responsibility (CSR) of a company. (5 marks)
- (b) Premier Decor signed a non-disclosure agreement with Arcute Consultants. Examine four circumstances under which Arcute Consultants would not be held liable for disclosure and use of confidential information. (4 marks)
- (c) Explain three ways which institutional investors could use to improve corporate governance of their companies. (6 marks)

(Total: 15 marks)

QUESTION FOUR

- (a) Outline five items that should be included by company directors when preparing a board work plan for the organisation. (5 marks)
- (b) In a corporate governance seminar, one of the facilitators noted that, "most of the directors in different companies ignore symptoms of poor corporate governance".

With reference to the above statement, discuss five symptoms of poor corporate governance. (10 marks)

(Total: 15 marks)

QUESTION FIVE

- (a) Cyber security is today's most pressing corporate governance issue, but one which boards of directors and management find challenging to address.

With reference to the above statement, propose four ways of managing cyber security threats currently affecting many companies. (8 marks)

- (b) Examine seven challenges faced by professional bodies in their roles in promoting governance and ethics in developing countries. (7 marks)

(Total: 15 marks)