



CS PART III SECTION 6

GOVERNANCE AND SECRETARIAL AUDIT

MONDAY: 30 November 2020.

Time Allowed: 3 hours.

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

QUESTION ONE

POTS AND PANS LIMITED (PPL)

Pots and Pans Limited (PPL) is a fairly successful franchise food retailer that has rarely been out of the news in the last year. The company's admission in September 2018 that it had understated its half year profits by Sh.89 million in an attempt to under pay royalties to the Franchiser has raised questions about the competency and composition of the company's board of directors (BOD) and the use of inappropriate accounting policies. Prior to the appointment of two non-executive directors on 7 October 2019, PPL's board did not have independent directors leave alone having any with a financial management background and experience. This weakness in financial expertise suggested the board was unlikely to have the necessary knowledge and expertise to effectively question and challenge the company's executives on financial matters.

While the external auditors in the company's 2017 annual report and financial statements discussed the "risk of manipulation" in the recognition of business income, this did not prevent the company from treating a contingency liability as having crystallised and being treated as an actual cost which understated the anticipated profits. The accounting treatment adopted was, one would assume, accepted by the audit committee and the profit figures subsequently signed-off by the board. The issue only subsequently emerged when one of the company's employees questioned the accounting treatment under the company's whistle blowing programme.

A media correspondent, writing about PPL in a weekly business magazine, suggested the issues of board composition and income and cost recognition point to failure in the current system of corporate governance of PPL. He pointed out that although the codes of Corporate Governance do not expressly require non-executive directors to have financial management experience, the adoption of inaccurate estimates of business income and treatment of costs reflects a "failure to establish adequate regulatory mechanisms for curbing abuses of corporate power". He suggested that reform is urgently needed and regulators needed to move in with speed. He recommended the immediate constitution of a board audit and risk committee at PPL.

On 30 November 2018, PPL held an extraordinary general meeting to update and reassure investors on its financial position. The company acknowledged that its profits had been understated by Sh.89 million against an initial estimate of Sh.150 million. The understatement was the result of a deliberate incorrect recognition and treatment of a contingency liability. Together with updating the investors on its results, the company announced that the chairman of the board would be stepping down from his position and that the board had suspended the Chief Executive Officer (CEO) and that the Chief Operating Officer (COO) would take over in an acting capacity until a new substantive CEO was recruited.

On 4 December 2018, the capital markets regulator and the Economic Crimes Bureau announced they had launched a criminal investigation into the alleged accounting irregularities at PPL. In early January 2019, the shareholders held another extraordinary meeting and resolved to appoint a governance auditor to carry out a comprehensive audit into the governance practices at PPL.

Required:

- (a) As the Governance Auditor appointed by PPL, advise the shareholders of PPL on five ways on how sound corporate governance practice could make it more difficult for companies to experience malpractices and imminent failure. (5 marks)
- (b) Explain to the directors of PPL their responsibilities on financial reporting. (5 marks)

- (c) Examine five ways in which non-executive directors (NEDs) could be made more effective and independent. (5 marks)
 - (d) Discuss five roles of the audit and risk committee that the regulator recommended to be reconstituted at PPL. (5 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Explain how a governance auditor would rely on information obtained from the following sources in the process of conducting a governance audit:
 - (i) In-house certified secretary. (4 marks)
 - (ii) Regulatory oversight bodies. (4 marks)
 - (b) Analyse four roles that the Institute of Certified Secretaries (ICS) is expected to play in governance and secretarial audit practice. (8 marks)
 - (c) In the course of planning for a governance audit, among the activities to be undertaken by the governance auditor before the actual process of audit is to arrange a preliminary meeting with the client.

Explain how such a meeting will be of benefit both to the governance auditor and the client. (4 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Governance audit tools cover the governance audit parameters within which the entity is subjected to audit.

With reference to the above statement, propose seven such parameters within which governance audit is conducted. (7 marks)
 - (b) Discuss four general principles of governance audit. (8 marks)
 - (c) Examine five supporting documents that should accompany the self-assessment tool during the Institute of Certified Secretaries (ICS) Champion of Governance Award process for participating institutions. (5 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Analyse how the use of the work of experts could be applied by a governance auditor to make judgement on his findings. (3 marks)
 - (b) Explain how the terms of engagement of a governance auditor in the context of form and content of the engagement letter may vary for different governance audits. (4 marks)
 - (c) Explain five responsibilities of management in relation to governance control systems and risk management. (5 marks)
 - (d) Discuss four post governance audit events that a governance auditor might include in the governance audit report. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) With reference to Mwongozo, the Code of Governance for State Corporations, discuss five responsibilities of the board in stakeholder engagement. (5 marks)
 - (b) Develop terms of reference (TOR) for a governance peer reviewer. (10 marks)
 - (c) Suggest five recent drivers of good governance and secretarial audit in your country. (5 marks)
- (Total: 20 marks)**
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