

# KASNEB

CPA PART III SECTION 5

CICT PART III SECTION 5

CIFA PART III SECTION 5

CCP PART III SECTION 5

## STRATEGY, GOVERNANCE AND ETHICS

WEDNESDAY: 23 November 2016.

Time Allowed: 3 hours.

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

### QUESTION ONE

#### KILA KITU PETROLEUM LIMITED (KKPL)

Kila Kitu Petroleum Limited (KKPL) was a major petroleum retailer which had earlier collapsed due to poor strategy implementation that led to extreme financial distress. The company was formed in 1965 as a state owned entity and was privatised in 1972 through floatation of shares at the securities exchange. The company operated petrol stations all over Africa. KKPL commanded market leadership between 1974 and 1982 before it started implementing a grand expansion strategy that increased its petrol stations in Africa and an ambitious automation programme using short term sources of funds.

A combination of poor economic performance, high interest rates, adverse exchange rates and internal governance problems led to the gradual demise of the giant petroleum company. In 1985, KKPL closed down 15 perennial loss making petrol stations in the region. The company also raised Sh.3 billion through a rights issue the same year. During this time, the directors sold many of the shares they held at KKPL through the open market. The rights issue and open market sale enabled the directors to reduce their shareholding in the company from 20% to less than 7%. Soon after the rights issue, the board of directors declared the company insolvent.

It took the intervention of the government to come to the rescue of creditors and shareholders. The government intervened through a bailout which enabled the company to pay the suppliers their dues. The government also directed the management of KKPL to develop a turnaround plan. In the plan, the company pledged to live up to its core values of integrity, transparency, accountability, commitment and professionalism. Culpable officers who had brought the company to its death bed were to be punished. A number of directors were taken to court and a new management team was appointed to lead the company out of the challenges it was facing.

Josephine Mulwa, a distinguished professional accountant who had turned around several companies which had previously faced similar problems as those faced by KKPL was appointed as the new Chief Executive Officer (CEO). Her appointment was to take effect from 15 September 2013 and she was to serve for a renewable term of six years.

In the year 2014, the company recorded its first profits after many years of making losses. The company however, did not declare dividends. Shareholders of KKPL expressed their disappointment during the company's annual general meeting (AGM) as they had invested heavily in the company with the hope of reaping high returns in future. One enraged shareholder was quoted as having said "How long shall it take before we get dividends when we still have all these debts to pay and expansion plans to undertake? We are so disappointed. Do not make us feel worse with more disappointments". From the annual financial statements, it was evident that the company was highly geared.

Josephine Mulwa did not last long as the CEO of KKPL as the company was yet again declared insolvent on 12 July 2016. She was ousted by the board of directors over what the board termed as gross misconduct and negligence in her performance of duties. Several other directors were also sacked and replaced. The board engaged the services of Vkinsim Associates to carry out forensic investigations on the company.

The forensic audit revealed that:

- A cartel of senior managers had formed companies that supplied KKPL with goods that it sold at higher prices than the market rates.
- The goods supplied by the cartels were of low quality. This drove away customers leaving KKPL with goods that it could not sell, yet it had paid for them.
- The company borrowed more money from financial institutions to pay suppliers who were ironically its staff members.

- The money raised through the rights issue could not be fully accounted for.
- The top management manipulated the books of account to reflect profits yet the company was making losses.
- The company was operating under a highly competitive environment where key competitors were more aggressive and responsive to the changes in the market.
- Due to high inflation rates and the weakening local currency against international currencies, the company was forced to review prices of its products upwards yet the demand for the products was declining.

It was evident that for KKPL to survive and post significant returns to its shareholders, business process re-engineering was inevitable and KKPL had to rethink its business model.

**Required:**

- (a) Examine five corporate governance issues in the management of Kila Kitu Petroleum Limited (KKPL). (10 marks)
- (b) Assess the recourse available to shareholders of KKPL in the light of the fraud which was revealed through the forensic audit. (10 marks)
- (c) Analyse the conduct of the top management of KKPL which could lead to the immediate former CEO, Josephine Mulwa being disciplined by the Institute of Public Accountants where she is a member. (10 marks)
- (d) Assuming that you have been approached by KKPL to formulate a recovery plan for the company:
- (i) Discuss five schools of thought whose principles you could utilise during the strategy formulation. (5 marks)
- (ii) Propose five steps that KKPL could follow if it decided to undertake a divestiture. (5 marks)
- (Total: 40 marks)**

**QUESTION TWO**

- (a) Assess the relevance of Henri Fayol's principles of management to the practice of management in organisations today. (7 marks)
- (b) Analyse eight roles of an organisational mission statement to a business. (8 marks)
- (Total: 15 marks)**

**QUESTION THREE**

- (a) Explain five responsibilities of the chairman of an audit committee. (5 marks)
- (b) Discuss six steps that guide the strategic decision-making process in an organisation. (6 marks)
- (c) Beeball Limited and Amrol Limited recently signed a strategic partnership alliance to undertake joint construction of a road project.
- With reference to the above statement, evaluate the challenges both firms are likely to experience from the strategic partnership alliance. (4 marks)
- (Total: 15 marks)**

**QUESTION FOUR**

- (a) Examine five components of a strategic plan. (5 marks)
- (b) Discuss six roles of a conflict of interest policy in an organisation. (6 marks)
- (c) Suggest four possible reasons for the current rise in unethical practices in the corporate world. (4 marks)
- (Total: 15 marks)**

**QUESTION FIVE**

- (a) Argue the case against corporate social responsibility. (6 marks)
- (b) As the Chief Executive Officer (CEO) of a newly established company, suggest five measures that you would take to stimulate innovation in the company. (5 marks)
- (c) With reference to responsibilities on risk management, explain four contents of an enterprise risk management policy. (4 marks)
- (Total: 15 marks)**

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