

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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