

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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