



**NAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE, HUMAN SCIENCES AND EDUCATION**

DEPARTMENT OF ECONOMICS, ACCOUNTING & FINANCE

QUALIFICATION: BACHELOR OF ACCOUNTING (HONOURS)	
QUALIFICATION CODE: 08BOAH	LEVEL: 8
COURSE CODE: GRE811S	COURSE NAME: CORPORATE GOVERNANCE, RISK AND ETHICS
SESSION: JULY 2023	PAPER: THEORY AND APPLICATION
DURATION: 3 HOURS	MARKS: 100

SECOND OPPORTUNITY EXAMINATION QUESTION PAPER	
EXAMINERS:	Kuhepa Tjondu
MODERATOR:	Mr. M. Tondota

<p style="text-align: center;">INSTRUCTIONS</p> <ul style="list-style-type: none">• This question paper is made up of FOUR (4) questions.• Answer All the questions and in blue or black ink.• Show all your working in the answer sheet.• Start each question on a new page in your answer booklet and show all your workings.• Questions relating to this paper may be raised in the initial 30 minutes after the start of the paper. Thereafter, candidates must use their initiative to deal with any perceived error or ambiguities and any assumption made by the candidate should be clearly stated.
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PERMISSIBLE MATERIALS

Non-programmable calculator/financial calculator

THIS QUESTION PAPER CONSISTS OF 6 PAGES (Including this front page)

QUESTION 1

[25 MARKS]

KK is a large listed company. When a non-executive directorship of KK Limited became available, Johnny Samora was nominated to fill the vacancy. Johnny is the brother-in-law of KK's chief executive Kennedy Kavena. Johnny is also the CEO of Samora Supplies Ltd, KK's largest single supplier and is, therefore, very familiar with KK and its industry. He has sold goods to KK for over 20 years and is on friendly terms with all of the senior officers in the company. In fact last year, Samora Supplies appointed KK's finance director, Susana Shaningwa, to a non-executive directorship on its board. The executive directors of KK all know and like Johnny and so plan to ask the nominations committee to appoint him before the next AGM.

KK has recently undergone a period of rapid growth and has recently entered several new overseas markets, some of which, according to the finance director, are riskier than the domestic market. Kennedy Kavena, being the dominant person on the KK board, has increased the risk exposure of the company according to some investors. They say that because most of the executive directors are less experienced, they rarely question his overseas expansion strategy. This expansion has also created a growth in employee numbers and an increase in the number of executive directors, mainly to manage the increasingly complex operations of the company. It was thought by some that the company lacked experience and knowledge of international markets as it expanded and that this increased the risk of the strategy's failure. Some shareholders believed that the aggressive strategy, led by Kennedy Kavena, has been careless as it has exposed KK Limited to some losses on overseas direct investments made before all necessary information on the investment was obtained.

As a large listed company, the governance of KK is important to its shareholders. Fin Brun is one of KK's largest shareholders and holds a large portfolio of shares including 8% of the shares in KK. At the last AGM he complained to KK's chief executive, Kennedy Kavena, that he needed more information on directors' performance. Fin said that he didn't know how to vote on board reappointments because he had no information on how they had performed in their jobs. Mr Kavena said that the board intended to include a corporate governance section in future annual reports to address this and to provide other information that shareholders had asked for. He added, however, that he would not be able to publish information on the performance of individual executive directors as this was too complicated and actually not the concern of shareholders. It was, he said, the performance of the board as a whole that was important and he (Mr Kavena) would manage the performance targets of individual directors.

Required:

(a) Explain the term 'conflict of interest' in the context of non-executive directors and discuss the potential conflicts of interest relating to KK and Samora Supplies if Johnny Samora were to become a non-executive director of KK Limited. (8 marks)

(b) Assess the advantages of appointing experienced and effective non-executive directors to the KK board during the period in which the company was growing rapidly. (7 marks)

(c) Explain the typical contents of a 'best practice' corporate governance report within an annual report and how its contents could help meet the information needs of Fin Brun. (10 marks)

QUESTION 2

[25 MARKS]

B Bank is a large international bank. It employs 6,000 staff in 250 branches and has approximately 500,000 borrowers and over 1,500,000 savers. The bank, which was founded in 1856, has an excellent reputation for good customer service. The bank's share price has increased, on average, by 12% in each of the last ten years.

There has been much adverse media coverage in many countries, including B Bank's home country, about the alleged excessive bonuses received by the directors of banks. A meeting of central bank governors from many nations failed to reach agreement on how to limit the size of directors' bonuses. The governor of the central bank in B Bank's home country is particularly concerned about this issue, and consequently put forward the following proposal:

'Directors of banks will be asked to pay a fee to the bank for the privilege of being a director. This fee will be set by the remuneration committee of each bank. Directors will be paid a bonus based solely on appropriate profit and growth indicators. The more the bank succeeds, the higher will be the bonus. This proposal directly links performance of the bank to directors' pay. I see this as a more realistic option than simply limiting salaries or bonuses by statute as proposed at the recent central bank governors' conference.'

The constitution of the board of B Bank is in accordance with the internationally agreed code of corporate governance.

Overall board strategy has been to set targets based on previous (profitable) experience, with increased emphasis on those areas where higher potential profits can be made such as mortgage lending (this is discussed below). The bank's executive information systems are able to compute relative product profitability, which supports this strategy. This strategy generated substantial profits in recent years. The last major strategy review took place four years ago. Up until the last couple of years, non-executive directors have not queried the decisions of the executive directors. However government help for other banks in the last couple of years has led to some of B Bank's non-executive directors questioning the bank's approach to managing its risks, and whether it ought to focus more on lower-risk activities and introduce stronger control systems.

One of the major sources of revenue for the bank is interest obtained on lending money against securities such as houses (termed a 'mortgage' in many countries) with repayments being due over periods varying between 15 and 25 years. Partly as a result of intense competition in the mortgage market, the values of the mortgages advanced by B Bank regularly exceed the value of the properties, for example B Bank has made advances of up to 125% of a property's value. Internal reports to the board estimate that property prices will reverse recent trends and will rise by 7% per annum for at least the next ten years, with general and wage inflation at 2%. B Bank intends to continue

to obtain finance to support new mortgages with loans from the short-term money-markets.

Required:

(a) Evaluate the proposal made by the governor of the central bank. **(8 marks)**

(b) Assess the risk management strategy in B Bank (except for consideration of directors' remuneration). Your assessment should include recommendations for changes that will lower the bank's exposure to risk. **(12 marks)**

(c) Analyse the impact of B Bank adopting a more risk-averse approach towards managing the risks relating to the activities it undertakes and the controls it operates to manage these risks. **(5 marks)**

QUESTION 3

[25 MARKS]

Susana Paulus was recently appointed as a non-executive member of the internal audit committee of Fluck and Grootman, a public listed company producing complex engineering products. Barney Chester, the executive finance director who chairs the committee, has always viewed the purpose of internal audit as primarily financial in nature and as long as financial controls are seen to be fully in place, he is less concerned with other aspects of internal control. When Susana asked about operational controls in the production facility Barney said that these were not the concern of the internal audit committee. This, he said, was because as long as the accounting systems and financial controls were fully functional, all other systems may be assumed to be working correctly.

Susana, however, was concerned with the operational and quality controls in the production facility. She spoke to production director Aaron Hangero, and asked if he would be prepared to produce regular reports for the internal audit committee on levels of specification compliance and other control issues. Mr Hangero said that the internal audit committee had always trusted him because his reputation as a manager was very good. He said that he had never been asked to provide compliance evidence to the internal audit committee and saw no reason as to why he should start doing so now.

At board level, the non-executive chairman, George Allejandra, said that he only instituted the internal audit committee in the first place in order to be seen to be in compliance with the stock market's requirement that Fluck and Grootman should have one. He believed that internal audit committees didn't add materially to the company. They were, he believed, one of those 'outrageous demands' that regulatory authorities made without considering the consequences in smaller companies nor the individual needs of different companies. He also complained about the need to have an internal auditor. He said that Fluck and Grootman used to have a full time internal auditor but when he left a year ago, he wasn't replaced. The audit committee didn't feel it needed an internal auditor because Barney Chester believed that only financial control information was important and he could get that information from his management accountant.

Susana asked Mr Allejandra if he recognised that the company was exposing itself to increased market risks by failing to have an effective audit committee. Mr Allejandra said he didn't know what a market risk was.

Internal control and audit are considered to be important parts of sound corporate governance.

Required:

(a) (i) Describe five general objectives of internal control. **(5 marks)**

(ii) Explain the organisational factors that determine the need for internal audit in public listed companies. **(5 marks)**

(b) Criticise the internal control and internal audit arrangements at Fluck and Grootman as described in the case scenario. **(10 marks)**

(c) Define 'market risk' for Mr Allejandra and explain why Fluck and Grootman's market risk exposure is increased by failing to have an effective audit committee. **(5 marks)**

QUESTION 4

[25 MARKS]

It was the final day of a two-week-long audit of Van Buren Company, a longstanding client of Fillmore Pierce Auditors. In the afternoon, Anne Hayes, a recently qualified accountant and member of the audit team, was following an audit trail on some cash payments when she discovered what she described to the audit partner, Zachary Lincoln, as an 'irregularity'. A large and material cash payment had been recorded with no recipient named. The corresponding invoice was handwritten on a scrap of paper and the signature was illegible.

Zachary, the audit partner, was under pressure to finish the audit that afternoon. He advised Anne to seek an explanation from Frank Monroe, the client's finance director. Zachary told her that Van Buren was a longstanding client of Fillmore Pierce and he would be surprised if there was anything unethical or illegal about the payment. He said that he had personally been involved in the Van Buren audit for the last eight years and that it had always been without incident. He also said that Frank Monroe was an old friend of his from university days and that he was certain that he wouldn't approve anything unethical or illegal. Zachary said that Fillmore Pierce had also done some consultancy for Van Buren so it was a very important client that he didn't want Anne to upset with unwelcome and uncomfortable questioning.

When Anne sought an explanation from Mr Monroe, she was told that nobody could remember what the payment was for but that she had to recognise that 'real' audits were sometimes a bit messy and that not all audit trails would end as she might like them to. He also reminded her that it was the final day and both he and the audit firm were under time pressure to conclude business and get the audit signed off.

When Anne told Zachary what Frank had said, Zachary agreed not to get the audit signed off without Anne's support, but warned her that she should be very certain that the irregularity was worth delaying the signoff for. It was therefore now Anne's decision whether to extend the audit or have it signed off by the end of Friday afternoon.

Required:

(a) Explain why 'auditor independence' is necessary in auditor-client relationships and describe three threats to auditor independence in the case. **(9 marks)**

Anne is experiencing some tension due to the conflict between her duties and responsibilities as an employee of Fillmore Pierce and as a qualified professional accountant.

(b) (i) Compare and contrast her duties and responsibilities in the two roles of employee and professional accountant. **(6 marks)**

(ii) Explain the ethical tensions between these roles that Anne is now experiencing. **(4 marks)**

(c) Explain how absolutist (dogmatic) and relativist (pragmatic) ethical assumptions would affect the outcome of Anne's decision. **(6 marks)**

THE END

