



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC402
COURSE TITLE : CORPORATE GOVERNANCE AND PROFESSIONAL ETHICS FOR ACCOUNTANTS
DURATION : 3 Hours
LEVEL : 4.1
DATE : 15 FEB 2022

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue.
2. Answer all 4 questions. All questions carry equal marks
3. Start a new question on a new page.
4. Show all workings
5. The number of marks for each question or part question is shown in brackets []

Question One

There has been a debate in the country of Ngunguland for some years about the most appropriate way to regulate corporate governance. Several years ago, there were a number of major corporate failures and 'scandals' caused in part by a number of single powerful individuals dominating their boards. Business leaders and policy-makers were sceptical about a rules-based approach, and this led the Ngunguland stock exchange to issue guidance in the 'Ngunguland Code' as follows:

'Good corporate governance is not just a matter of prescribing particular corporate structures and complying with a number of rules. There is a need for broad principles. All stakeholders should then apply these flexibly to the varying circumstances of individual companies.'

Given the causes of the Ngunguland corporate governance failures, there was a debate about whether the separation of the roles of chairman and chief executive should be made a legal requirement. This resulted in the stock exchange issuing guidance that whilst a rules-based or 'box ticking' approach would specify that 'the roles of chairman and chief executive officer should never be combined... We do not think that there are universally valid answers on such points.'

One company to take advantage of the flexibility in Ngunguland's principles-based approach was Mabhumbo Company. In July 2017, Mabhumbo Company announced that it had combined its roles of chairman and chief executive in a single role carried out by one individual. In accordance with the Ngunguland listing rules, it made the following 'comply or explain' statement in its 2018 annual report:

'Throughout the year the company complied with all Ngunguland Code provisions with the exception that from 1 July 2017 the roles of chairman and chief executive have been exercised by the same individual, Themba Mahaka. We recognise that this has been out of line with best practice. We understand the concerns of shareholders but believe that we have maintained robust governance while at the same time benefiting from having Mr Mahaka in control. On 31 July 2019 Mr Mahaka will step down as executive chairman, remaining as chairman until we conclude our search for a non-executive chairman to succeed him, no later than March 2020.'

Required:

(a) Briefly distinguish between rules and principles-based approaches to corporate governance. Critically evaluate the Ngunguland stock exchange's guidance that 'all stakeholders should then apply these flexibly to the varying circumstances of individual companies.'

[11

marks]

(b) Explain why a separation of the roles of chairman and chief executive is considered best practice in most jurisdictions.

[3 marks]

(c) Assess the 'comply or explain' statement made by Mabhumbo Company in its 2018 annual report.

[3 marks]

(d) Critically elaborate on any three basic theories of Corporate Governance.

[8 marks]

[Total 25marks]

Question Two

Magure and Hla is an established audit practice in Bindura Town and has a large share of the audit services market among local businesses. Because Bindura Town is a relatively isolated area, many clients rely on Magure and Hla for accounting and technical advice over and above the annual audit. This has meant that, over time, Magure and Hla has also developed expertise in compliance advice, tax, strategy consulting and other professional services.

Because non-audit work is important to Magure and Hla, staff have 'business growth' criteria strongly linked with bonuses and promotion. This means that many of the professional accountants in the firm actively seek to increase sales of non-audit services to businesses in the Bindura Town area, including from audit clients. The culture of the firm is such that everybody is expected to help out with any project which needs to be done, and this sometimes means that staff help out on a range of both audit and non-audit tasks. The lines between audit and non-audit services are sometimes blurred and staff may work on either, as workload needs demand. Managing partner Abby Hla told staff that the non-audit revenue is now so important to the firm that staff should not do anything to threaten that source of income.

Abby Hla said that she was thinking of beginning to offer a number of other services including advice on environmental reporting and the provision of environmental auditing services. She said she had spoken to local companies which were looking to demonstrate their environmental sustainability and she believed that environmental reporting and auditing might be ways to help with this. She said she was confused by the nature of environmental reporting and so was not sure about what should be audited.

Required:

- (a) Explain 'ethical threat' and 'ethical safeguard' in the context of external auditing, and discuss the benefits of effective ethical safeguards for Magure and Hla. **[8 marks]**
- (b) Explain 'environmental audit' and assess how environmental reporting and auditing might enable companies to 'demonstrate their environmental sustainability' as Abby Hla suggested. **[8 marks]**
- (c) Some corporate governance codes prohibit audit firms such as Magure and Hla from providing some non-audit services to audit clients without the prior approval of the client's audit committee. This is because it is sometimes believed to be against the public interest.

Required:

Explain 'public interest' in the context of accounting services and why a client's audit committee is a suitable body to advise on the purchase of non-audit services from Magure and Hla. **[9 marks]**

[Total 25marks]

(a) According to the fraud triangle framework, there are three factors that must be present at the same time in order for fraud to occur. Elaborate on these factors using the Silver Bird's case above and discuss the likelihood that these factors might contribute to the occurrence of the alleged financial shenanigans

[13 marks]

(b) You are a manager working in the public sector audit department of Sidhuna & Co. You are responsible for the audit of Bindura Hospital, for the year ended 31 March 2020. You have recently visited the audit team, who are currently on site performing the fieldwork, to review the work performed to date and to discuss their progress. During your visit the audit senior informed you of the following matter:

During a review of the valuation of medical inventories, including medicines used in a variety of treatments at the hospital, it was noted that a number of items had passed their recommended use by dates. These were recorded on an inventory spreadsheet maintained by the financial controller and were easy to spot because they were highlighted in red. One of the audit team inspected a sample of the inventories in question and confirmed that their use by dates had expired. When asked about this, the financial controller stated that the audit team must be mistaken. The audit team requested to look at the spreadsheet again but he refused. The next day the finance director confronted the audit team accusing them of extending their investigations 'beyond their remit'. He also threatened to remove them from the premises if they continued to ask questions which were not relevant to the audit of the hospital's financial statements. Since then the audit team have been unable to complete their audit of medical inventories. They have also noted that the room where the inventories were previously kept has been emptied.

Required:

Identify and explain the ethical and professional issues raised and recommend any actions which should be taken in respect of the matter described by the audit senior. [12 marks]

[Total 25marks]

Question Four

(a) You are an audit manager at Thomas & Co responsible for the audit of Friday Co, a subsidiary of Valentine Co. A different audit firm is responsible for the audit of Eastenbank Co and the Eastenbank Group financial statements.

The audit of the financial statements of Friday Co for the year ended 31 July 2020 is nearing completion, but the following issues require your attention before the auditor's report is signed and your final communication is made to the group auditor in response to their request for information. The draft financial statements of Friday Co recognise a loss before tax of \$100,000.

Friday Co has been loss making for several years and it generates insufficient cash to meet its significant debt obligations. The company relies on support from Eastenbank Co in order to continue trading. The management of Eastenbank Co has confirmed verbally that it will continue to support Friday Co, but has not provided a formal letter of support despite a number of requests.

You are aware that Eastenbank Co is the subject of a major lawsuit following an industrial accident which resulted in significant pollution of local agricultural land and, most seriously,

loss of life. You attempted to discuss the matter with the directors of Eastenbank Co but they refused, saying that it had already been investigated by the group auditor. The group auditor informed you that the case is ongoing and that they have obtained satisfactory representations from both management and legal advisers stating that they were confident of successfully defending the claim. When you asked for copies of the representations, the group auditor refused saying it was a matter relevant to the parent company and that it was not relevant to the audit of Friday Co.

Shortly after making your enquiries, you received a phone call from the group engagement partner who said that the board of Eastenbank Co was concerned that you might modify the auditor's report of Friday Co. He also said that, as the only person with full oversight of audit matters relating to the Eastenbank Group, he did not think that it would be necessary to modify the auditor's report of Friday Co and that he would oppose any attempt to do so. He suggested that if the debt in the financial statements of Friday Co was the reason for seeking parental support that he would transfer it to the Group and the letter of support would no longer be necessary.

Required:

Discuss how professional scepticism should be applied to the statements made by the management and auditors of Eastenbank Co regarding the outstanding legal case. **[10 marks]**

(b) Describe the role and objectives of International Federation of Accountants (IFAC) and explain how it contribute to global financial stability through the International Ethics Standard Board of Accountants (IESBA).

[15 marks]

[Total 25marks]

END OF EXAMINATION QUESTION PAPER