

PILOT PAPER – 2023-2027 SYLLABUS

SL4.4 Corporate Governance & Ethics

Strategic Level

No of Pages: 08 No of Questions: 05

Time allowed: 3 Hours and 15 Minutes (Including 15 minutes of reading time).

Total Marks: 100

Exam Structure

This exam is consisting of two parts.

Part-1

- One compulsory essay question.
- 40 marks in total

Part- II:

- Four Essay Questions (Question No 02-05)
- Each 20 marks and 60 marks in total
- Select any 03 questions from part-II

Answer only four (04) questions including question no. 01

Other Instructions

- The answers should be in **English** language.
- Begin each answer on a separate page in the answer booklet.
- Only non-programmable calculators are permitted to use.

Part I – Compulsory Question

QUESTION NO: 01

Pramu Garment Manufacturing & Export (Pvt) Limited (PGM&E) is a garment manufacturing and export company established in the year 2005. PGM&E manufactures high-quality sportswear for men under the "Pramu" brand, which is one of the successful local brands that has also entered the international market. The main buyers of Pramu products are in Europe and the USA. The company has recently launched an international marketing campaign to enter the Australian market.

However, due to the current financial crisis in Sri Lanka, the company is facing difficulties in opening a Letter of Credit (L/C) to import essential raw materials from China, even though PGM&E has adequate Dollars to import them on time.

Mr. Pramuditha Dissanayake is the Chairman/Managing Director of the company, holding 50% of the shares, while his elder brother Mr. Ananda Dissanayake and elder sister Mrs. Chandi Jayawardena are also directors of the company, holding 10% and 15% ownership, respectively. His younger sister Miss. Lakmali Dissanayake holds 20% of the shares, and 5% of the ownership was given to their brother-in-Law, Mr. Hemal Fonseka, who was later appointed as a director of the company. A significant majority of the company's shares are held by family members, giving them significant control over decision-making processes. However, minority shareholders have expressed their dissatisfaction with some of the decisions made by the directors, feeling that their interests are not adequately represented.

A good friend of Mr. Pramuditha Dissanayake, Mr. Robert Dahanayake, who is an expert in international marketing with 20 years of experience in similar companies, was appointed as an independent director in the year 2015. The youngest daughter of Ananda Dissanayake, Miss. Champi, recently got married to Mr. Jagath Dahanayake, a Chartered Accountant who is the eldest son of Mr. Robert Dahanayake. On the same day of the wedding, Mr. Jagath Dahanayake was appointed as a director of the company. Later, Mr. Jagath Dahanayake was appointed as the head of the Finance/Head of Strategist team of the company.

The Chairman is keen to have a joint venture partnership with the intended Australian buyers, Bayan Holding Pty Limited (BJH), which is one of the largest fashion retailers in Australia, to market Pramuditha branded products in Australia. Mr. Robert pointed out that it is important to revisit PGM&E's corporate governance framework and improve the governance requirements, if necessary, before initiating the discussion with BJH. The Board appointed a committee headed by Mr. Robert Dahanayake to review and submit the recommendation.

Mr. Robert recently brought to the notice of the board that due to the shortage of Dollars in the banks, he could approach a bank and get an opportunity to sell the excess dollars at the bank's published rate + Rs.40 markup to the importers who want dollars for their imports. However, the bank only pays the official rate, and the markup should be collected from the importer. The board of directors agreed in principle and requested Mr. Robert to implement it if he is comfortable accounting for the markup income as an exchange gain.

The company also recruited Miss. Nayana Wickramasinghe, a Chartered Secretary with five years of experience, as a company secretary. Assuming you are the recently appointed Company Secretary, draft a report to the board on the following requirements in order to educate the Board of Directors on rule-based corporate governance and ethical behavior.

YOU ARE REQUIRED TO:

1.1. **Explain** the concept of corporate governance and outline its significance in the implementation for a company like PGM&E.

(06 Marks)

1.2. **Examine** the Agency theory and the Stewardship theory and their relevance to PGM&E.

(05 Marks)

1.3. **Discuss** the rule-based approach to corporate governance with its advantages and disadvantages.

(07 Marks)

1.4. **Comment** on the major role that should be played by the Board of Directors of the company in the implementation of the appropriate corporate governance framework with reference to the intended joint venture partnership with Bayan Holding Pty Limited (BJH).

(05 Marks)

1.5. **Examine** the status of the independent directorship of Mr. Robert Dahanayake currently, referring to the "Code of Best Practice on Corporate Governance – 2017 of Sri Lanka".

(05 Marks)

1.6. **Explain** the deontological and teleological approaches to ethics.

(05 Marks)

1.7. **Discuss** the proposed transaction by Mr. Robert regarding the excess dollars, emphasizing the ethical theories discussed above (1.6).

(07 Marks)

[Total 40 Marks]

Part II – Answer any 03 questions.

QUESTION NO: 02

Mini Express Retailer (Pvt) Ltd (MER) is a mini supermarket chain established by Mr. Henry Caldera in the year 2015 to cater to customers for their urgent requirements. During the Covid-19 pandemic period, Mr. Henry introduced the "MER.Speed" app for its customers to order online, and MER delivers the orders within 24 hrs from the time the order is accepted. The online payment gateway has been implemented with its banker. The IT consultant is a freelancer, and he does not visit regularly. When there is an issue, the IT consultant addresses it via remote access or visits physically depending on the issue. Daily reports are generated as a summary of daily transactions for the Chairman, and he is happy to see the daily turnover of each outlet. There are more than 25 outlets located in the main cities. Mr. Pramuka Gamage, a newly appointed Management Accountant, commented at the usual monthly meeting that he has observed that the company is in a vulnerable position since there is no proper internal control system to mitigate the risk of cyber fraud either from outside or internally, and also, the higher management offers incentives to each outlet based on actual turnover against targeted monthly gross revenue, resulting in inflated revenue by the managers.

YOU ARE REQUIRED TO:

- 2.1. **Discuss** the existing internal control system for the online ordering, delivery, and payment system of MER referring to the Committee of Sponsoring Organizations (COSO) Internal Control-Integrated Framework.

(05 Marks)
- 2.2. **Evaluate** the adequacy of the existing internal control system related to the online ordering, delivery, and payment system of MER.

(05 Marks)
- 2.3. **Assess** possible IT-related (Cyber) frauds that can take place under the current controlling system of MER.

(04 Marks)
- 2.4. **Recommend** appropriate strategies to enhance the existing internal controls system of MER.

(06 Marks)

[Total 20 Marks]

QUESTION NO: 03

PART A

ABC PLC is a manufacturing company listed on the Colombo Stock Exchange with more than 100,000 shareholders. The company did not pay dividends for the last two years, 2020/21 and 2021/22, to its shareholders considering the uncertainty of the corporate sector due to the pandemic and the economic crisis. The company earned a decent profit but has decreased by 30% and 25%, respectively, compared to the past years. The board of directors try to explain to its unhappy foreign and local shareholders the current situation and promised that they would declare dividends if the country returns to normal. A group of shareholders lobbying against the decision demanded to close down loss-making and underperforming divisions and cut directors' remuneration as well as benefits offered to the higher management.

YOU ARE REQUIRED TO:

- 3.1. **Discuss** shareholders' rights and shareholder activism referring to the current situation of ABC PLC.

(06 Marks)

- 3.2. **Examine** possible disadvantages of shareholder activism to ABC PLC and **advise** possible strategies to explain and convince the current status of the company to the shareholders.

(07 Marks)

PART B

You have been appointed as a consultant to the board of directors of Exim Holding PLC, a listed quoted public company. The chairman of the company, Mr. Daniel Perera, has requested you prepare a board note to enable him to discuss with the board covering the following:

YOU ARE REQUIRED TO:

- 3.3. **Discuss** the areas that the Board should pay attention to in order to strengthen the existing corporate governance framework, considering the impact of the pandemic and the economic downturn in Sri Lanka.

(07 Marks)

[Total 20 Marks]

QUESTION NO: 04

ABC Holding PLC (ABCH) was established in 2005 as a public company listed on the Colombo Stock Exchange. Mr. Dharshana Manathunga is the present CEO of ABCH. He is a dynamic leader who has graduated from Harvard University. He works hard to create value for the shareholders of ABCH. At a recent Board meeting, he pointed out that one of the key objectives of the board of directors is to formulate appropriate strategies to create value for its shareholders. The share price of ABCH is a key performance indicator, and Mr. Manathunga requested his management team to act accordingly. X&Y Associates is the external auditors of ABCH since its inception, and the partner in charge of the ABCH audit, Mr. Nihal Mendis, is a friend of Mr. Manathunga. The Finance Director of ABCH requested their external auditors to limit the scope of the audit and reduce the audit fee for this year since the company is currently facing tight cash flow issues and also to minimize the loss incurred in the last quarter of the financial year 2021/22 due to the Covid-19 pandemic. Meanwhile, at the review of the external audit, a junior staff member of X&Y Associates commented that ABCH has not valued its inventory and some financial assets at fair value as per IFRS requirements, and the explanation given by the Finance Director was not acceptable. Due to the Covid-19 pandemic, the fair value of some of the inventories and financial assets as of 31st March 2022 has shown a lower value compared to its book value. Mr. Manathunga approached his friend in X&Y Associates and requested to keep the book values of those assets since this will have an adverse impact on ABCH's share price.

YOU ARE REQUIRED TO:

- 4.1. **Critically evaluate** the importance of having professional behavior by the external auditor of a company in relation to the implementation of good corporate governance of that company.

(08 Marks)
- 4.2. **Discuss** ethical and professional issues faced by X&Y Associates in relation to the audit of ABCH.

(06 Marks)
- 4.3. **Discuss** the available remedies and actions for X&Y Associates to overcome those issues effectively.

(06 Marks)

[Total 20 Marks]

QUESTION NO: 05

Company X is a multinational corporation operating in the technology sector. It has recently embraced digital transformation, incorporating advanced technologies and data-driven strategies into its operations. The company has recognized the importance of implementing effective corporate governance measures, ensuring sustainability practices, and mitigating cyber risks to maintain its competitive edge and safeguard its stakeholders' interests.

YOU ARE REQUIRED TO:

5.1. **Discuss** the concept of Digital Corporate Governance and its significance in the context of modern business operations.

(05 Marks)

5.2. **Discuss** the importance of sustainability practices for companies such as Company X in the technology sector. Provide examples of sustainable initiatives that can benefit both the company and the environment.

(05 Marks)

5.3. Identify three major cyber threats and **discuss** how they can impact a company, such as Company X, in terms of its operations and reputation.

(05 Marks)

5.4. **Present** three strategies or practices that can enhance cybersecurity and protect the digital assets of a specific company, such as Company

(05 Marks)

[Total 20 Marks]

-End of the Question Paper-