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UNIVERSITY OF RUHUNA**FACULTY OF MANAGEMENT AND FINANCE****Bachelor of Business Administration Degree Programme 3000 Level
Second Semester End Examination - March 2022****Academic year 2020/2021****ACC32113 – Corporate Governance****Duration: Three hours****The question paper contains 05 questions.****Answer all questions.**

01. Provide answers to questions A-D based on the below case study**Profit manipulation at NIB**

In January 2021, an employee of the National Investment Bank (NIB) revealed that there were cases of unauthorized foreign currency derivatives trading that resulted in total losses of LKR 360 million. The below conditions highlight the problems that led to this loss.

At NIB, the foreign currency trading operations were managed by a separate department in which the scandal and foreign exchange loss arose. The department has involved in income smoothing (earnings management) by entering incorrect dealing rates into the system. This allowed profits and losses to be shifted from one day or one period to another.

The risk management philosophy at NIB was similar to the approach widely used by other major financial institutes at that time. However, the internal control system of NIB was last updated eight years back. It was the responsibility of the internal audit function to ensure effective operation and compliance with the bank's policies and procedures. The head of the internal audit reported relevant information mainly to three parties: the Audit Committee, Risk Management Committee, and the CEO. However, profit and risk responsibility had to be delegated to the officers with varying layers of supervision, monitoring and reporting procedures to be followed. These officers overrode risk management controls. When the Risk Unit of the bank complained about this problem to their supervisor, no action has been taken. In fact, these officers pressured the Risk Unit to approve the options transactions. Although the Risk Unit eventually did not approve these transactions, they were overridden when the head of global markets gave his approval.

It was also found that the supervisors, such as the General Manager of the Markets Division, had failed to follow through the entire review procedure. Management seemed to focus heavily on the profits and ignore the potential problems. Monitoring was simply limited to headline profit and loss statements, suggesting that there was a lack of understanding with regard to the underlying risks undertaken by the officers.

A confidential survey of foreign currency trading department staff showed that some were concerned about the department's practices. However, this survey was an ad-hoc survey conducted to meet a requirement of an Internal Audit. Management did not submit the survey results to the board of directors. NIB had no whistleblower policy.

Management simply kept the directors in the dark. Additionally, the directors trusted the management deeply and relied only on information and reports supplied by management. Collectively, the inaction of both parties allowed the scandal to go unnoticed for a long time. The directors were so trusting that they even failed to ask for the annual management letter from the external auditor when the management did not provide it. These letters highlighted the auditor's concerns about the foreign trading department.

The two principal board committees – risk and audit – also failed to probe further and provide sufficient oversight for the firm's audit and risk management activities. Had the audit and risk committees actively sought information and provided oversight over their areas of responsibility, they probably would have discovered the warnings from auditors.

- A. Explain why corporate control is important by referring to the above case study. (04 Marks)
- B. Evaluate the problems of the board of NIB by referring to the functions of the board of directors. (06 Marks)
- C. Do you think NIB had adequate internal controls? Support your answer by referring to the case study. (06 Marks)
- D. What do you recommend to improve the corporate governance at NIB? (06 Marks)

(Total Marks 22)

02.

- A. List two (2) organizations that work towards uplifting corporate governance in Sri Lankan public listed companies and explain their role. (04 Marks)
- B. Differentiate between the governance of the not-for-profit and the profit-orientated organizations with examples. (04 Marks)
- C. Discuss the possibility of converging different corporate governance practices worldwide into a single set of practices. (04 Marks)

(Total Marks 12)

03.

- A. Briefly explain the conflict of interest between owners and managers, and state three types of agency costs resulting from this conflict of interest. (04 Marks)
- B. Briefly explain four approaches available to minimize managerial opportunism. (04 Marks)
- C. Discuss how management behavior is viewed in agency theory and stewardship theory. (04 Marks)

(Total Marks 12)

04.

- A. Briefly explain three (3) types of directors commonly seen in companies. (04 Marks)
- B. Explain three (3) board committees found in most corporate governance codes. (04 Marks)
- C. "The unitary board structure is not the perfect governance mechanism for corporations. There are many in-built paradoxes." Comment on this statement.

(04 Marks)

(Total Marks 12)

05.

- A. Outline the differences between CEO and Chairperson. (04 Marks)
- B. What is whistleblowing? Briefly explain the importance of whistleblowing and how the company should protect a whistleblower's rights. (04 Marks)
- C. Discuss the main changes that a company can make through establishing a Code of Ethics in their corporate structure. (04 Marks)

(Total Marks 12)
