STUDY MANUAL

CORPORATE GOVERNANCE (PEB7)

NIGERIAN COLLEGE OF ACCOUNTANCY

ANAN

a premium brand of choice

ASSOCIATION OF NATIONAL ACCOUNTANTS OF NIGERIA (ANAN)

CONTENTS

MODULE ONE

1.0 INTRODUCTION TO THE CONCEPT OF CORPORATE GOVERNANCE

AIM

The course will consider the fundamental issue of how corporation are governed. It aims to develop an understanding of what constitutes good corporate governance and what the impact is of regulations and codes of practice. Thus, the focus is on the debates around how to improve the functioning of corporate institutions and aims to develop an understanding of what constitutes good corporate governance and what the impact is of regulations and codes of practice. Without proper governance, companies potentially face challenges both internal and external to the organization. For example, attracting investors may be difficult if investors are not convinced that there are adequate controls, check and balances that a governance framework can provide. This course provides a clear understanding of main current corporate governance codes and associated reporting and compliance requirement.

1.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. corporate governance
ii. financial reporting and independence of auditor
iii. ethics as it affects Governance

iv. the Board, their roles, Composition, Remuneration and their Relationships with Shareholders and Stakeholders
v. the application of best Practice in Governance and the Concept of Comply or Explain
vi. Governance Problems for Global Companies and groups

1.2 Introduction

Corporate governance refers to the set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled such that it can fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial for all stakeholders in the long term. Stakeholders in this case would include everyone ranging from the board of directors, management, shareholders to customers, employees and society. The management of the company hence assumes the role of a trustee for all the others (NCA 2016).

In the opinion of Bragg (1999), corporate governance refers to the system of structures, rights, duties, and obligations by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. To achieve the corporate governance’s objective there is need to employ the Best Practice which is defined as any improvement over existing systems (Bragg 1999).

OECD 2014 define corporate governance as a set of relationships between a company management, its board, shareholder's and other stakeholders. Corporate governance is meant to provide the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined.

Corporate governance is a set of rules that define the relationship between stakeholders, management and board of directors of a company and influence how that company is operating.

There has been renewed interest in the corporate governance practices of modern corporations particularly in relation to accountability since the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud and then again after the recent financial crisis in 2008. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in Australia (HIH, One.Tel) are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

Purpose of Good Governance

Good Corporate Governance ensures that the business environment is fair and transparent and that companies can be held accountable for their actions. Conversely, weak Corporate Governance leads to waste, mismanagement, and corruption. It is also important to remember that although Corporate Governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only Good Governance can deliver sustainable Good Business Performance.

A company that is well-governed is one that is accountable and transparent to its shareholders and other stakeholders. Conversely, weak corporate governance leads to waste, mismanagement, and corruption. It is also important to remember that although corporate governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only good governance can deliver sustainable good business performance.

Benefits of Corporate Governance to Companies

Compliance with the CG principles can benefit the owners and managers of companies and increase transparency and disclosure by:

a. Improving access to capital and financial markets
b. Help to survive in an increasingly competitive environment through mergers, acquisitions, partnerships, and risk reduction through asset diversification

c. Provide an exit policy and ensure a smooth inter-generational transfer of wealth and divestment of family assets, as well as reducing the chance for conflicts of interest to arise (very important for the investors).

d. Also, adopting good CG practices leads to a better system of internal control, thus leading to greater accountability and better profit margins.

e. Good CG practices can pave the way for possible future growth, diversification, or a sale, including the ability to attract equity investors – nationally and from abroad – as well as reduce the cost of loans/credit for corporations.

f. Many businesses seeking new funds often find themselves obliged to undertake serious corporate governance reforms at a high cost and upon the demand of outsiders, often in a time of crisis. When the foundations are already in place investors and potential partners will have more confidence in investing in or expanding the company's operations.

The Benefits to Shareholders

The following are benefits to the shareholders:

a. Good CG can provide the proper incentives for the board and management to pursue objectives that are in the interest of the company and shareholders, as well as facilitate effective monitoring.

b. Better CG can also provide Shareholders with greater security on their investment.

c. Better CG also ensures that shareholders are sufficiently informed on decisions concerning fundamental issues like amendments of statutes or articles of incorporation, sale of assets, etc.

The Benefits to the National Economy

The following are the benefits to an economy:

a. Empirical evidence and research conducted in recent year's supports the proposition that it pays to have good CG. It was found out that more than 84% of the global institutional investors are willing to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record.
b. The adoption of CG principles - as good CG practice has already shown in other markets - can also play a role in increasing the corporate value of companies.
c. "If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country suffer the consequences." (Arthur Levitt, former chairman of the US Securities & Exchange Commission)

1.3 Principles of Corporate Governance

Contemporary discussions of corporate governance tend to refer to principles raised in three documents released since 1990: The Cadbury Report (UK, 1992), the Principles of Corporate Governance (OECD, 1998 and 2004), the Sarbanes-Oxley Act of 2002 (US, 2002). The Cadbury and OECD reports present general principles around which businesses are expected to operate to assure proper governance.

The Sarbanes-Oxley Act, informally referred to as Sarbox or Sox, is an attempt by the federal government in the United States to legislate several of the principles recommended in the Cadbury and OECD reports (OECD, 2004). These are:

- **Rights and equitable treatment of shareholders**: Organisations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.
- **Interests of other stakeholders**: Organisations should recognise that they have legal, contractual, social, and market driven obligations to non-shareholders, stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.
- **Role and responsibilities of the board**: The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.
- **Integrity and ethical behavior**: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organisations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.
- **Disclosure and transparency**: Organisations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also

implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the Organisation should be timely and balanced to ensure that all investors have access to clear, factual information.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in the wake of a series of high-profile corporate scandals. It established a series of requirements that affect corporate governance in the U.S. and influenced similar laws in many other countries. The law required, along with many other elements, that:

- The Public Company Accounting Oversight Board (PCAOB) be established to regulate the auditing profession, which had been self-regulated prior to the law. Auditors are responsible for reviewing the financial statements of corporations and issuing an opinion as to their reliability.
- The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) attest to the financial statements. Prior to the law, CEOs had claimed in court they hadn't reviewed the information as part of their defence.
- Board audit committees have members that are independent and disclose whether or not at least one is a financial expert, or reasons why no such expert is on the audit committee.
- External audit firms cannot provide certain types of consulting services and must rotate their lead partner every 5 years. Further, an audit firm cannot audit a company if those in specified senior management roles worked for the auditor in the past year. Prior to the law, there was the real or perceived conflict of interest between providing an independent opinion on

the accuracy and reliability of financial statements when the same firm was also providing lucrative consulting services.

OECD Principles

One of the most influential guidelines has been the OECD Principles of Corporate Governance published in 1999 and revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines.

Building on the work of the OECD, other international Organisations, private sector associations and more than 20 national corporate governance codes formed the United Nations Intergovernmental Working Group of Experts on International Standard of Accounting and Reporting (ISAR) to produce their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

- Auditing
- Board and management structure and process
- Corporate responsibility and compliance in organisation
- Financial transparency and information disclosure
- Ownership structure and exercise of control rights
-

External corporate governance controls

External corporate governance controls encompass the controls external stakeholders exercise over the Organisation. Examples include:

- Competition.

- debt covenants.
- demand for and assessment of performance information (especially financial statements).
- government regulations.
- managerial labour market.
- media pressure.
- Takeovers.

1.4 Financial Reporting and the Independent Auditor

The board of directors has primary responsibility for the corporation's external financial reporting functions. The Chief Executive Officer and Chief Financial Officer are crucial participants and boards usually have a high degree of reliance on them for the integrity and supply of accounting information. They oversee the internal accounting systems, and are dependent on the corporation's accountants and internal auditors.

Emerging issues and developments in Corporate Governance

i. Executive Pay

Increasing attention and regulation (as under the Swiss referendum "against corporate Rip-offs" of 2013) has been brought to executive pay levels since the financial crisis of 2007-2008. Research on the relationship between firm performance and executive compensation does not identify consistent and significant relationships between executives' remuneration and firm performance. Not all firms experience the same levels of agency conflict, and external and internal monitoring devices may be more effective for some than for others. Some researchers have found that the largest CEO performance incentives came from ownership of the firm's shares, while other researchers found that the relationship between share ownership and firm performance was dependent on the level of ownership. The results suggest that increases in ownership above 20% cause management to become more entrenched, and less interested in the welfare of their shareholders.

ii. Separation of Chief Executive Officer and Chairman of the Board roles

Shareholders elect Board of Directors, who in turn hire a Chief Executive Officer (CEO) to lead management. The primary responsibility of the board relates to the selection and retention of the CEO. However, in many U.S. corporations, the CEO and Chairman of the Board roles are held by the same person. This creates an inherent conflict of interest between management and the board. Critics of combined roles argue the two roles should be separated to avoid the conflict of interest.

Advocates argue that empirical studies do not indicate that separation of the roles improves stock market performance and that it should be up to shareholders to determine what corporate governance model is appropriate for the firm.

OECD Principles of Corporate Governance

1. Ensuring the Basis for an effective Corporate Governance Framework.

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate

the division of responsibilities among different supervisory, regulatory and enforcement authorities.

A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

B. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

C. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

D. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

2. The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

A. Basic shareholder rights should include the right to:

i. Secure methods of ownership registration;

ii. Convey or transfer shares;

iii. Obtain relevant and material information on the corporation on a timely and regular basis;

iv. Participate and vote in general shareholder meetings;
v. Elect and remove members of the board; and
vi. Share in the profits of the corporation.

B. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:

i. Amendments to the statutes, or articles of incorporation or similar governing documents of the company;
ii. The authorisation of additional shares; and
iii. Extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

i. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
ii. Shareholders should have the opportunity to ask questions from the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

iii. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

iv. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner:

i. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

ii. Anti-take-over devices should not be used to shield management and the board from accountability.

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated:

i. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

ii. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

G. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

3. The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same series of a class should be treated equally:

i. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any change in voting rights should be subject to approval by those classes of shares which are negatively affected.

ii. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

iii. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

iv. Impediments to cross border voting should be eliminated.

v. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

1.5 Governance and Ethics, Corporate Ethics, Corporate Codes of Professional Ethics

The corporate world has always had some rules, standards and norms for doing business. However, these are generally changing with some social and cultural basis which can be different country by country, even though we might expect universal rules.

Defining Ethics

Ethics shows a corporation how to behave properly in all its business and operations. However, business ethics is characterized by conflicts of interests. Businesses attempt to maximize profits as a primary goal on one hand while they face issues of social responsibility and social service on the other. Ethics is a set of rules prescribing what is good or evil, or what is right or wrong for people. In other words, ethics is the values that form the basis of human relations, and the quality and essence of being morally good or evil or right or wrong. Business ethics means honesty, confidence, respect and fair acting in all circumstances. However, such values as honesty, respect and confidence are rather general concepts without definite boundaries. Ethics can also be defines as overall fundamental principles and practices for improving the level of wellbeing of humanity.

A business which does not respect ethical criteria and fails to improve them will disrupt its integrity and unity i.e., its capacity to achieve its goal, and will lead to internal or external conflict. Corporate ethics is the honest, respectful and fair conduct by a business and its representatives in all of its relations. A predicate question to the role of ethics in business is the question of why businesses engage in ethical practices. Some authors, notably Milton Friedman (1962), would strongly deny that a business has a responsibility to any group but the firm's shareholders.

However, ethical behavior and ethical business has effects not only on stakeholders, and shareholders but also on the entire economy. We believe that when we act ethically in business decision-making process this will ensure more effective and productive utilization of economic resources.

1.6 Role of Board, Composition, Remuneration of Directors, Accounting and Audit, Relations with Shareholders and Stakeholders

The Board of Directors

Governing bodies of all Organisations whether designated as Boards of Directors, Board of Trustees or otherwise, hereafter called Boards of Directors, should be completely independent directors and these Directors should preferably constitute the majority of all Directors, with the possible exception of privately held companies (Fredrick, Lipman, Reith Lipman 2006). According to (Skousen, Glover, Prawitt 2005), Boards are typically made up of 3 to 15 individuals that collectively have the expertise and experience to help direct a company. According to Code of Corporate Governance by Securities and Exchange Commission in Nigeria (SEC) Part II.

Responsibilities of the Board

- The Board is accountable and responsible for the performance and affairs of the company. It should define the company's strategic goals and ensure that its human and financial resources are effectively deployed towards attaining those goals.
- The principal objective of the Board is to ensure that the company is properly managed. It is the responsibility of the Board to oversee the effective performance of the Management in order to protect and enhance

shareholder value and to meet the company's obligations to its employees and other stakeholders.

- The primary responsibility for ensuring good corporate governance in the company lies with the Board. Accordingly, the Board should ensure that the company carries on its business in accordance with its Articles and Memorandum of Association and in conformity with the laws of the country, observing the highest ethical standards and on an environmentally sustainable basis.

- The Board shall define a framework for the delegation of its authority or duties to management specifying matters that may be delegated and those reserved for the Board. The delegation of any duty or authority to the Management does not in any way diminish the overall responsibility of the Board and its directors as being accountable and responsible for the affairs and performance of the company.

Duties of the Board

The duties of the Board shall include the following:

(a) Formulation of policies and overseeing the management and conduct of the business;

(b) Formulation and management of risk management framework;

(c) Succession planning and the appointment, training, remuneration and replacement of board members and senior management;

(d) Overseeing the effectiveness and adequacy of internal control systems;

(e) Overseeing the maintenance of the company's communication and information dissemination policy;
(f) Performance appraisal and compensation of board members and senior executives;
(g) Ensuring effective communication with shareholders;
(h) Ensuring the integrity of financial reports;
(i) Ensuring that ethical standards are maintained; and
(j) Ensuring compliance with the laws of Nigeria.

Composition and Structure of the Board

- The Board should be of a sufficient size relative to the scale and complexity of the company's operations and be composed in such a way as to ensure diversity of experience without compromising independence, compatibility, integrity and availability of members to attend meetings.

Membership of the Board should not be less than five (5).

- The Board should comprise a mix of executive and non- executive directors, headed by a Chairman. The majority of Board members should be non-executive directors, at least one of whom should be an independent director.
- The members of the Board should be individuals with upright personal characteristics, relevant core competences and entrepreneurial spirit. They should have a record of tangible achievement and should be knowledgeable in Board matters. Members should posses a sense of

accountability and integrity and be committed to the task of good corporate governance.

- The Board should be independent of Management to enable it carry out its oversight function in an objective and effective manner.

Officers of the Board include:

The Chairman

(a) The Chairman’s primary responsibility is to ensure effective operation of the Board such that it works towards achieving the company’s strategic objectives. He should not be involved in the day-to-day operations of the company. This should be the primary responsibility of the Chief Executive Officer and the management team.

(b) For all public companies with listed securities, the positions of the Chairman of the Board and Chief Executive Officer shall be separate and held by different individuals. This is to avoid over-concentration of powers in one individual which may rob the Board of the required checks and balances in the discharge of its duties.

(c) The Chairman of the Board should be a non-executive director.

(d) The Chairman’s functions should include the following:

i. Providing overall leadership and direction for the Board and the Company;

ii Setting the annual Board plan;

iii Setting the agenda for Board meetings in conjunction with the CEO and the Company Secretary;

iv. Playing a leading role in ensuring that the Board and its Committees are composed of the relevant skills, competencies and desired experience;

v. Ensuring that Board meetings are properly conducted and the Board is effective and functions in a cohesive manner;

vi Ensuring that Board members receive accurate and clear information in a timely manner, about the affairs of the Company to enable directors to take sound decisions;

vii. Acting as the main link between the Board and the CEO as well as advising the CEO in the effective discharge of his duties;

viii. Ensuring that all directors focus on their key responsibilities and play constructive role in the affairs of the company;

ix. Ensuring that induction programmes are conducted for new directors and a continuing education programme is in place for all directors;

x. Ensuring effective communication and relations with the Company's institutional shareholders and strategic stakeholders;

xi. Taking a lead role in the assessment, improvement and development of the Board; and

xii. Presiding over general meetings of shareholders.

The Chief Executive Officer/Managing Director

(a) The Chief Executive Officer (CEO) or Managing Director (MD) should be the head of the management team and is answerable to the Board.

(b) The CEO/MD should be knowledgeable in relevant areas of the company's activities. He should demonstrate industry, credibility and integrity and should have the confidence of the Board and Management;

(c) The CEO/MD and the senior management should establish a culture of integrity and legal compliance which should be assimilated by personnel at all levels of the company.

(d) The functions and responsibilities of the CEO/MD should include the following:

i. Day-to-day running of the company;

ii. Guiding the development and growth of the company;

iii Acting as the company's leading representative in its dealings with its stakeholders.

(e) The authority of the CEO/MD and the relationship between the office and the Board should be clearly and adequately described in a letter of appointment.

(f) The Board may delegate such of its powers to the CEO/MD as it may deem appropriate or necessary to ensure smooth operation of the company.

(g) The remuneration of the CEO/MD should comprise a component that is long-term performance related and may include stock options and bonuses which should however be disclosed in the company's annual reports.

Executive Directors

(a) Executive directors, like the CEO/MD, should be persons knowledgeable in relevant areas of the company's activities in addition to possessing such other qualifications as may be needed for their specific assignments or responsibilities.

(b) Executive directors should be involved in the day-to-day operations and management of the company. In particular, they should be responsible for the departments they head and should be answerable to the Board through the CEO/MD.

(c) Executive directors should not be involved in the determination of their remuneration.

(d) The remuneration of executive directors should comprise a component that is long-term performance related and may include stock options and bonuses which should however be disclosed in the company's annual reports.

(e) Executive directors should not receive the sitting allowances or director's fees paid to non-executive directors.

Non-Executive Directors

(a) Non-executive directors should be key members of the Board. They should bring independent judgment as well as necessary scrutiny to the proposals and actions of the Management and executive directors especially on issues of strategy, performance evaluation and key appointments.

(b) Non-executive directors should accordingly be persons of high calibre with broad experience, integrity and credibility.

(c) Non-executive directors should be provided with a conducive environment for the effective discharge of their duties. Adequate and comprehensive information on all Board matters should be provided in a timely manner.

Board papers should be made available to them at least one week ahead of Board or committee meetings.

Independent Directors

(a) An independent director is a non-executive director who:

i. Is not a substantial shareholder of the company, that is one whose shareholding, directly or indirectly, does not exceed 0. 1% of the company's paid up capital;

ii. Is not a representative of a shareholder that has the ability to control or significantly influence Management;

iii. Has not been employed by the company or the group of which it currently forms part, or has served in any executive capacity in the company or group for the preceding three financial years;

iv. Is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;

v. Is not a professional adviser to the company or the group, other than in a capacity of a director;

vi. Is not a significant supplier to or customer of the company or group;

vii. Has no significant contractual relationship with the company or group and is free from any business or other relationship which could materially interfere with his/her capacity to act in an independent manner; and

viii. Is not a partner or an executive of the company's statutory audit firm, internal audit firm, legal or other consulting firm that have a material association with the company and has not been a partner or an executive of any such firm for three financial years preceding his/her appointment

(b) An independent director should be free of any relationship with the company or its management that may impair, or appear to impair the director's ability to make independent judgments.

(c) Every public company should have a minimum of one independent director on its Board.

1.7 Applying Best Practice in Governance, Concept of Comply or Explain

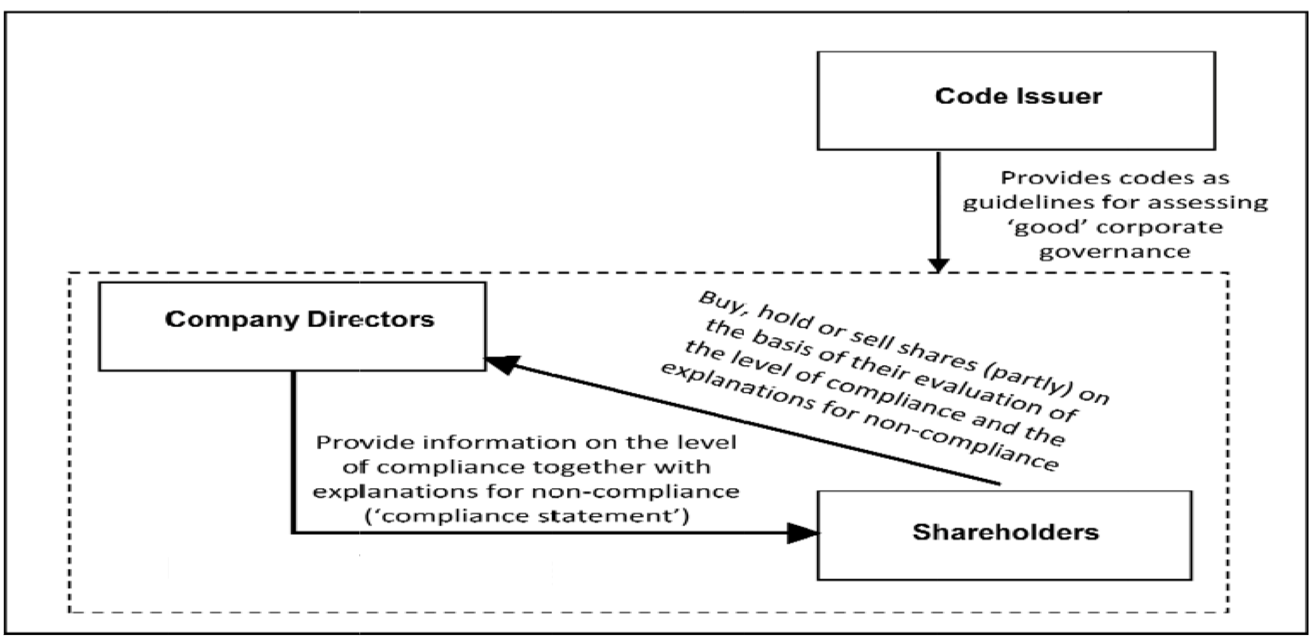
The comply-or-explain principle is a central element of most codes of corporate governance. Originally put forward by the Cadbury Committee in the UK as a practical means of establishing a code of corporate governance whilst avoiding an inflexible 'one size fits all' approach, it has since been incorporated into code regimes around the world. Seidl, Sunderson &Roberts (2009) . Despite its wide application very little is known about the ways in which managers apply the principle – in particular, how they make use of the option to 'explain' deviations. In the wake of corporate scandals like Polly Peck (UK), BCCI (UK), British & Commonwealth (UK), Maxwell (UK), Mirror Group (UK), Enron (US), World Com (US), Holzmann (Germany), Metallgesellschaft (Germany), Bayerische Hypo- und Vereinsbank (Germany) there have been increasing calls for more effective regulation of corporate behaviour in general and the actions of company directors in particular. In response to that, various laws on issues of corporate governance have been passed in many countries around the world. In addition, in recent years there has been a strong trend towards the adoption of 'soft law' (Mörth, 2004) or ‘soft regulation’ (Sahlin-Andersson, 2004) in the form of *codes of corporate governance.*

The basic idea behind comply-or-explain is to allow for some flexibility in the application of the rules set out in the code. The codes are explicitly meant to be applied flexibly. It is not intended that all companies covered by the code should follow all provisions. Rather, where individual rules do not fit the particular organizational setting, companies are *expected* to deviate. examples: size; ownership structures, international ownership, and requirements of the capital markets of other countries.)

The Combined Code states clearly that: departures from the Code should not be automatically treated as breaches’ (Financial Reporting Council, 2006: 7),

Companies should rather have the possibility of tailoring the modalities of corporate governance to their individual situations and of optimizing them with regard to efficiency criteria’

It is the essential genius of comply-or-explain that companies can be said to be in conformance with the code as a whole whilst deviating from individual rules.



1.8 Governance Problems for Global Companies and groups

Global entities encounter the following governance issues. They include

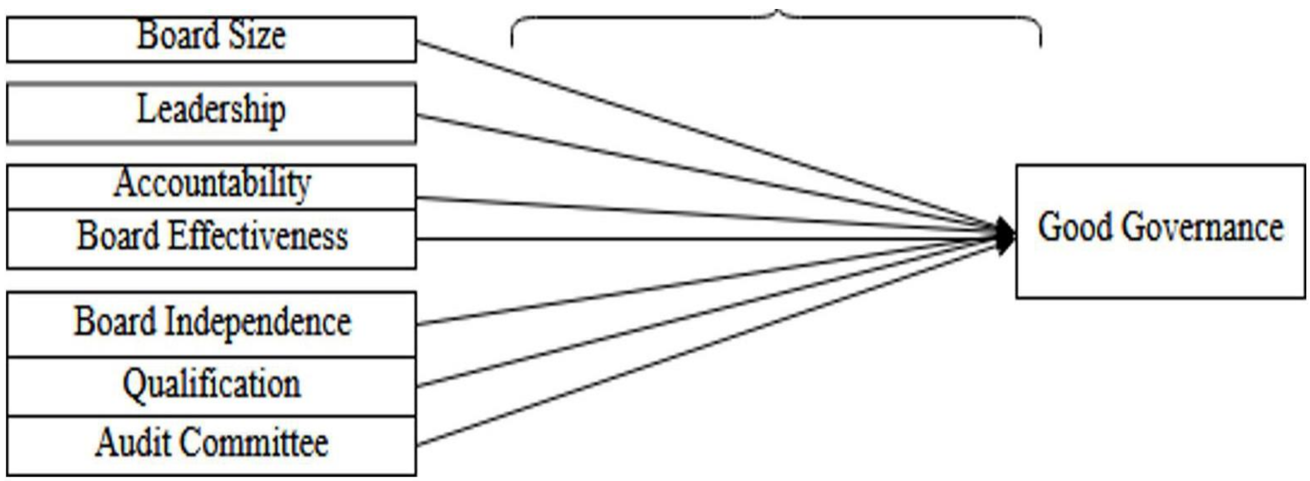
- Companies are often run as if they were the managing director's or CEO's personal freedom;
- Those at the helm are only about the principal shareholders' interests, any benefit to other shareholders is only consequential;
- Majority of directors are unaware that they are agents of shareholders and their position is one of trust and faith
- Participation of non-executive directors in meetings whether of the board or any committee thereof is inversely proportional to the health of the bottom line-better the bottom-line lesser the participation.
- Most directors do not consider it necessary to update themselves on changes in laws, regulations;
- Non-executive directors do not see themselves as watchdog of the owners.
- Boardrooms are invariably filled up by 'yes' men who do not raise relevant questions.
- Except in a crisis, even nominee directors tend to play a passive role at board meetings and do not oppose the proposals of the management.

Visible Challenges

- Differentiating the Roles of Board and Management.
- Deciding the Board composition.

- Separating the Role of CEO and Chairperson.
- Re-electing the Board of Directors.
- Directors and Executives' Remuneration.
- Protecting Shareholders Rights.
- Social Responsibility of the organization.

1.9 Governance Issues in the Public Sector



Model for the issues in public sector governance

Differences between the Public Sector Governance and Private Sector Governance.

	Private Sector	Public Sector
Mandate	Profit maximisation, considering corporate interests only	Welfare maximisation, considering community interests, involving trade-offs
Goals	Generally clear	Often deliberately vague to satisfy different stakeholders
Performance metrics	Standardised financial ratios	Financial ratios meaningless. Other performance indicators used
Efficiency	Technical efficiency basic requirement	Economic efficiency is often at cost of technical efficiency. Effectiveness often more important
Costs	Firm's own costs used for decisionmaking	Community costs, including externalities, deadweight losses
Prices	Generally constrained by market Allocation on ability to pay	Dependent on policy – from free provision through to prohibitive Allocation often on welfare grounds
Revenue	From sales	Mainly from tax, also from some natural monopolies
Investment criteria	Based on firm's interests and cost of capital	Community interests and unclear cost of capital
Financial controls	Often through profit centres Cash flow crucial to survival	Because revenue and expenses are separated, most control is through cost centres Cash not an operating constraint, but government has a macro monetary role
Sovereign risk	External	Internal
Product choice	Decided by corporation	Mandated by government – cannot abandon "lossmaking" activities
Products	Goods & Services	At Commonwealth level, mainly monetary transfers
Policy	Incidental activity (marketing, product changes)	Core activity
Organization definition	Often defined by core or distinctive competencies	Often pieced together from bits and pieces of market failure – departments have to house many disparate activities

Ownership	Often complex with partially owned entities	Usually simple, but relation to assets complex – many assets held in trust rather than outright ownership Unique asset of taxation authority
Power	Related to economic strength, checked by government and the law	Strong coercive power, capacity to change own rules
Stakeholders legally defined	Shareholders, free to own or dispose of shares, with power related to holding	Voters, with limited capacity to opt in or out (Migration)
Other stakeholders	Employees, creditors, suppliers, communities	Same set of stakeholders, but weighting of communities much heavier
System boundaries	Well-defined – corporation and its environment	Poorly defined – public policy reaching into all areas of life – complex systems
Governance	Directors and managers	Agency heads, ministers, executive government, parliament – tensions between loci of authority
Continuity	Occasional takeovers, mergers	Regular hostile takeover bid, sometimes successful
Accountability	Defined by standards, generally for shareholders and creditors, otherwise closed to public	Wide, more open, fluid
Legal constraints	Binding	Can change legislation
Motivation assumption	Instrumental, personal	Public service Generally lower pay
Legacy	Protection, highly regulated economy	Job security, many GBEs overstaffed with low productivity

Source: Mulyadi, Anwar & Ikbal (2016)

MODULE 2

2.0 GOVERNANCE ASPECTS OF THE FINANCIAL REPORTING COUNCIL ACT 2011 & 2018 AND REGULATIONS

1.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. Governance aspects of the financial reporting council act and regulations
ii. Statutory duties of directors
iii. Liabilities af a director
iv. Rights and privileges of board of directors

2.2 Duties of Directors and reporting and Disclosure Requirement

- EDs should have a broad understanding of the Company's business in addition to possessing such other qualifications as may be needed for their specific assignments or responsibilities.
- EDs should support the MD/CEO in the proper implementation and achievement of the Company's strategic imperatives, as well as prudent management of the Company's financial and other resources.
- EDs should declare any conflict of interest on appointment and annually thereafter. In the event that they become aware of any potential conflict of interest at any other point, they should disclose this to the Board at the first possible opportunity. Actions following disclosure should be subject to the Company's Conflict of Interest Policy.

- An ED may be appointed NED in any other Company, provided such appointment is not detrimental to his responsibilities as an ED and is in accordance with Board-approved policy.
- EDs should not sit on the committees responsible for remuneration, audit, or nomination and governance.
- The responsibilities and authority of EDs should be clearly set out in a contract of employment.

Non-Executive Directors

- Non-Executive Directors bring to bear their knowledge, expertise and independent judgment on issues of strategy and performance on the Board.
- NEDs should be chosen on the basis of their wide experience, knowledge and personal qualities and are expected to bring these qualities to bear on the Company's business and affairs.
- NEDs should constructively contribute to the development of the Company's strategy.
- NEDs should not be involved in the day-to-day operations of the Company, which should be the primary responsibility of the MD/CEO and the management team.
- NEDs should have unfettered access to the EDs, Company Secretary and the Internal Auditor, while access to other senior management should be through the MD/CEO.
- To facilitate the effective discharge of their duties, NEDs should be provided in a timely manner, with adequate facilities, administrative

support and quality and comprehensive information relating to the management of the Company and on all Board matters.

Independent Non-Executive Directors

- Independent Non-Executive Directors bring a high degree of objectivity to the Board for sustaining stakeholder trust and confidence.
- An Independent Non-executive Director (INED) should represent a strong independent voice on the Board, be independent in character and judgment and accordingly be free from such relationships or circumstances with the Company, its management, or substantial shareholders as may, or appear to, impair his ability to make independent judgment.
- An INED is a NED who:
  - Does not possess a shareholding in the Company the value of which is material to the holder such as will impair his independence or in excess of 0.01% of the paid up capital of the Company.
  - is not a representative of a shareholder that has the ability to control or significantly influence Management;
  - has not been an employee of the Company or group within the last five years;
  - is not a close family member of any of the Company's advisers, Directors, senior employees, consultants, auditors, creditors, suppliers, customers or substantial shareholders;
  - does not have, and has not had within the last five years, a material business relationship with the Company either directly,

or as a partner, shareholder, Director or senior employee of a body that has, or has had, such a relationship with the Company;

- has not been a senior executive of the Company's regulator within the last five years;
- does not render any professional, consultancy, or other advisory services to the Company or the group, other than in the capacity of a Director;
- does not receive, and has not received additional remuneration from the Company apart from a Director’s fee and allowances, and does not participate in the Company’s share option or a performance-related pay scheme, and is not a member of the Company’s pension scheme; and
- has not served on the Board for more than nine years from the date of his first election.

➢ The above-mentioned criteria for establishing the independent status of an INED are not exhaustive, but should be considered as examples of some of those relationships or circumstances which may impair, or appear to impair, an INED’s independent judgment.

➢ The Board should annually ascertain and confirm the continued independence of each INED of the Company.

➢ Reclassification of an existing NED into an INED on the same Board is not desirable.

2.3 Statutory Duties of Directors, and the concept of Duty of care and skill and Fiduciary duty on which these statutory duties are based

Statutory Duties of Directors

The primary responsibility of the Board of Directors is to ensure effective and efficient management of a company. Generally, their duties to the company are non-exhaustive as the Directors can be called upon at any time when necessary to represent the company and they are expected to reflect the duties required of them.

The statutory duties of Directors as prescribe by CAMA 2004 are discussed as follows:

1. Duty to promote the success of the company
2. Fiduciary duty/relationship
3. Duty of care and skill
4. Duty not to accept secret benefits
5. Conflict of interest

1. **Duty to promote the success of the company**: A Director is required to always carry out this duty in good faith. It is the mandate of a Director to promote the success of the company he/she represents. In so doing, the Director needs to take into consideration the relationship the company has with its shareholders, employees, suppliers and clients.

2. **Fiduciary duty/relationship:** A fiduciary duty is the highest standard of care. It is an obligation of one party to act in the best interest of another. The obligated party is typically a fiduciary i.e. a person who has been charged with the

care of money or property. In this regard, a Director has a fiduciary duty towards the company in the dispensation of his/her duties. A fiduciary relationship exists between a Director and the company causing a Director to always act in the best interest of the company. Section 279 of CAMA, stated that *'a Director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf'.*

3. **Duty of care and skill**: This duty emanates from the manner in which a Director is expected to execute his obligations. Every Director must exercise a degree of care, diligence and skill which a reasonably prudent Director would exercise in comparable circumstances. In determining the reasonableness of a Director, CAMA presupposes the reasonable man test wherein it is implied that every Director should owe a duty to behave as a reasonable person would or higher given their status. Failure to take reasonable care in accordance with the above may be grounds for an action for negligence and breach of duty. This is a potential liability for Directors and we will discuss same in further detail below.

4. **Duty not to accept secret benefits**: Section 287 of CAMA prohibits a Director from accepting bribe, gift or commission, in cash or kind, from any person in relation to transactions the Director has performed on behalf of the company. A Director in breach of the above provision commits a breach of duty and the company can recover the actual gift from the said Director and sue him/her for damages sustained.

5. **Conflict of Interest**: A conflict of interest arises where an individual or corporation is vested in multiple interests whether financial or otherwise which could possibly pervert the motivation or decision making of that individual or corporation. There is an equitable principle and common law duty for directors to avoid conflicts of duty and interest so as to not allow his/her personal interest interfere with the performance of his/her duties.

There are certain circumstances where a conflict of interest may arise including but not limited to where a Director:

i. Is a Director of two or more competing companies; or
ii. Uses property, opportunity or confidential information contained in the course of the management of one company for the benefit of the other company or to his own or other person's advantage;
iii. Will receive a personal benefit/profit i.e. has significant shareholdings in the company that they are directors or a competing company;
iv. Deciding their remuneration.

The law provides that as soon as a Director is aware that there is a possible conflict of interest between his/her personal interests and the interests of the company, it is the duty of that director to immediately declare his/her interests to the company.

Disclosure by Directors of interests is discussed in Section 277 of CAMA which states, *"it shall be the duty of a director who is in any way directly or indirectly interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company".*

2.4 Liabilities of Director

The following are liabilities of a director as provided by CAMA 2004:

a. Directors are personally liable for any breach of duty or negligent act occurring in the discharge of his/her duties as a director.
b. The company can sue the Director for any misconduct. CAMA provides that a duty imposed by the company on any given Director shall be enforceable against the Director by the company (Section 279 (9)).
c. The Act also makes provisions for others to bring actions on behalf of the company in the event the action is of the interest of the director i.e. shareholders and/or creditors, Derivative Action or Class Action.
d. There is no limit on directors liabilities under Nigerian law save for where CAMA or any other applicable rules/laws prescribe particular punishments. Where a company prefers that a Director's liability be limited, it is required to state so in its memorandum.
e. Joint Liability – the duty of care and skill is a collective duty of board members. Consequently, every Director is personally responsible for all actions taken by the board to which he/she is a member. Unless his/her absence is justified, he/she is not relieved of his/her liabilities.

2.5 Rights and Priviledges

Unless the constitution of the company or director contract of service expressly provides for certain remuneration of directors, a company director is not entitled to remuneration by way of payment for service rendered to the company. However, CAMA provides that remuneration of directors shall from, time to time, be determined by company in a general meeting. The law further provides that directors are entitled to be paid sitting allowances and other honorarium including travelling, hotel and other expenses properly incurred in attending meetings or in connection with the company’s business.

The directors enjoy dual status (as alter ego and servants of the company) their service contracts would always provide remuneration which is payable even where the articles of association are silent about it.

MODULE 3

3.0 GOOD BOARDROOM PRACTICES

3.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. Responsibilities of the board chairman and company secretary
ii. Appointments to the board.
iii. Role of the company secretary in the efficient provision of information
iv. Directors and external professional advice
v. Board performance evaluation.

3.2 Responsibilities of the chairman and company secretary

Chairman

The Chairman is responsible for providing overall leadership of the Company and the Board, and eliciting the constructive participation of all Directors to facilitate effective direction of the Board.

i. The Chairman's primary responsibility is to ensure the effective operation of the Board such that the Board works as a group towards achieving the Company's strategic objectives. He should also provide guidance to the MD/CEO and be available to him for regular communication.

ii. The Chairman of the Board should be a NED and not be involved in the day-to-day operations of the Company, which should be the primary responsibility of the MD/CEO and the management team.
iii. The MD/CEO or an Executive Director (ED) should not go on to be the Chairman of the same Company. If in very exceptional circumstances the Board decides that a former MD/CEO or an ED should become Chairman, a cool-off period of three years should be adopted.
iv. The Chairman´s functions should include the following:
v. presiding over meetings of the Board of Directors and general meetings of shareholders;
vi. agreeing an annual Board plan with the Board;
vii. setting the agenda for Board meetings
viii. ensuring that the Board and its committees are composed of the relevant skills, competencies and desired experience;
ix. ensuring that Board meetings are properly conducted;
x. ensuring that the Board is effective and functions in a cohesive manner;
xi. ensuring that all Directors focus on their key responsibilities and play a constructive role in the affairs of the Company;
xii. ensuring that induction programmes are conducted for new Directors and a continuing education programme is in place for all Directors;
xiii. ensuring effective communication and relations with the Company’s shareholders and other stakeholders; and

xiv. taking a lead role in the assessment, improvement and development of the Board.

xv. The Chairman is responsible for ensuring that management provides the Directors with accurate, timely and adequate information.

xvi. The Chairman should meet with NEDs without the EDs present at least annually.

Company Secretary

The Company Secretary plays an important role in supporting the effectiveness of the Board by assisting the Board and management to develop good corporate governance practices and culture within the Company.

i. Without prejudice to the provisions of extant laws, the Company Secretary should be a person with relevant qualifications and competence necessary to effectively discharge the duties of his office. The Board should ensure that the person appointed has the gravitas and objectivity to provide independent guidance and support at the highest level of decision-making in the Company.

ii. Where the Company Secretary is an employee of the Company, he should be a member of senior management and should be appointed through a rigorous selection process similar to that of new Directors.

iii. The Company Secretary should be properly empowered by the Board to discharge his duties and responsibilities.

iv. The Company Secretary should have both functional and administrative responsibilities. The functional responsibility is to the Board through the Chairman, while administratively, he reports to the MD/CEO.

v. The Board should approve the performance evaluation of the Company Secretary.

vi. In addition to his statutory functions, the Company Secretary should carry out the following duties and responsibilities:

vii. Provide the Board and Directors individually, with detailed guidance as to how their responsibilities should be properly discharged in the best interest of the Company.

viii. Coordinate the induction and training of new Directors.

ix. Assist the Chairman and MD/CEO in coordinating activities regarding the annual Board plan and with the administration of other strategic issues at the Board level.

x. Notify Board members of upcoming meetings of the Board and its committees as well as other matters that warrant their attention.

xi. Compile Board papers and ensure that the Board's discussions and decisions are clearly and properly recorded and communicated to relevant persons in a timely manner.

xii. Provide a central source of guidance and advice to the Board and the Company on matters of ethics, conflict of interest and good corporate governance.

xiii. Under the direction of the Chairman, the Company Secretary's responsibilities include ensuring good information flow within the Board and its committees and between senior management and NEDs.

xiv. Subject to the provisions of extant laws, the appointment and removal of the Company Secretary should be a matter for the Board.

3.3 Appointments to the board: nominations committee, contribution of nominations committee to good governance, Information and professional development for board members, induction and ongoing training

Appointment to the Board

A written, clearly defined, rigorous, formal and transparent procedure serves as a guide for the selection of Directors to ensure the appointment of high-quality individuals to the Board.

- The Board should approve the criteria for appointing Directors, as recommended by the committee responsible for nomination and governance. Such criteria should take cognizance of the strengths and weaknesses of the existing Board, integrity, required competence and skills, knowledge and experience, capacity to undertake the responsibility as well as diversity, including gender diversity. In the case of specialised businesses, possession of requisite technical skill should be taken into account.
- The committee responsible for nomination and governance should ensure that proposed Directors are fit and proper persons before recommending them to the Board for consideration for directorship positions.
- Shareholders should be provided with biographical information of proposed Directors to guide the decision. Such information should include:

(a) name, age, qualifications, country of primary residence and the ownership interest represented, if any;

(b) whether the appointment is for ED, NED or INED, and any proposed specific area of responsibility or Board committee roles if any;

(c) work experience and occupation;

(d) current directorships and appointments;

(e) direct and/or indirect shareholding in the Company and/or its subsidiaries; and

(f) any other relevant information.

➢ Every Director should receive a letter of appointment or contract of employment, specifying the terms and conditions of his appointment or employment.

➢ The letter of appointment or contract of employment should cover the following issues:

(a) duration of the appointment or tenure;

(b) details of the remuneration;

(c) summary of the rights, fiduciary duties and other responsibilities of the Director;

(d) requirement to disclose any material interests in the Company and other entities carrying on business or providing services to the Company;

(e) specific requirements, such as Board or Board committee meeting attendance;

(f) formal induction programme or training for the Director to attend;

(g) copy of Board Charter, Code of Business Conduct and Ethics and the Director's responsibility to observe same;

(h) board performance evaluation process used by the Company; and

(i) any other relevant information.

- The Company should state the processes used in relation to all Board appointments in its annual report.
- Subject to the provisions of extant laws and the recommendation of the committee responsible for nomination and governance based on the results of the individual Directors' performance appraisal, Board members may offer themselves for re-election.
- NEDs should serve for a reasonable period on the Board. However, it is necessary to reinforce the Board by continually injecting new energy, fresh ideas and perspectives. The Board should ensure the periodic appointment of new Directors to replace existing NEDs.
- The tenure for the MD/CEO and the EDs should be determined by the Board. In determining the tenure of an ED, the Board should take into cognizance his performance, the existing succession planning mechanism, continuity of the Board and the need for continuous refreshing of the Board.
- The tenure for INEDs should not exceed three terms of three years each.
- On resignation, Directors should submit a written letter of resignation to the Chairman.
- Where a Director has concerns about the running of the Company which cannot be resolved and he elects to resign from the Board, such concerns should be detailed in a written statement to the Chairman for circulation to the Board.

3.4 Role of the company secretary in the efficient provision of information

- Without prejudice to the provisions of extant laws, the Company Secretary should be a person with relevant qualifications and competence necessary to effectively discharge the duties of his office. The Board should ensure that the person appointed has the gravitas and objectivity to provide independent guidance and support at the highest level of decision-making in the Company.

- Where the Company Secretary is an employee of the Company, he should be a member of senior management and should be appointed through a rigorous selection process similar to that of new Directors.
- The Company Secretary should be properly empowered by the Board to discharge his duties and responsibilities.
- The Company Secretary should have both functional and administrative responsibilities. The functional responsibility is to the Board through the Chairman, while administratively, he reports to the MD/CEO.
- The Board should approve the performance evaluation of the Company Secretary.
- In addition to his statutory functions, the Company Secretary should carry out the following duties and responsibilities:
- Provide the Board and Directors individually, with detailed guidance as to how their responsibilities should be properly discharged in the best interest of the Company.
- Coordinate the induction and training of new Directors.
- Assist the Chairman and MD/CEO in coordinating activities regarding the annual Board plan and with the administration of other strategic issues at the Board level.

- Notify Board members of upcoming meetings of the Board and its committees as well as other matters that warrant their attention.
- Compile Board papers and ensure that the Board's discussions and decisions are clearly and properly recorded and communicated to relevant persons in a timely manner.
- Provide a central source of guidance and advice to the Board and the Company on matters of ethics, conflict of interest and good corporate governance.
- Under the direction of the Chairman, the Company Secretary's responsibilities include ensuring good information flow within the Board and its committees and between senior management and NEDs.
- Subject to the provisions of extant laws, the appointment and removal of the Company Secretary should be a matter for the Board.

3.5 Directors and external professional advice

- The Board should ensure that Directors, especially NEDs, have access to independent professional advice where they consider it necessary to discharge their responsibilities as Directors.
- The Board should ensure that such independent professional advice is obtained as set out in the Company's governance policies and at the Company's expense.
- In order to effectively perform its oversight function and monitor management's performance, the Board should meet at least once every quarter.

- Every Director should endeavour to attend all Board meetings. The attendance record of Directors should be among the criteria for the re-election of a Director.
- Minutes of meetings of the Board and its committees, as a record of what transpired at those meetings, should be prepared and sent to Directors on a timely basis. Such minutes should be formally reviewed and approved by the members of the Board or relevant Board committee at its next meeting.

3.6 Effectiveness of the board, its committees and individual board members performance evaluation of the board, Re-election of board members …. Retirement by rotation, Boardroom ethics.

- The Board should determine the number and composition of its committees as well as ensure that each is comprised of Directors with relevant skills and competencies.
- Only Directors may be members of Board committees, while members of senior management may be required to attend committee meetings.
- The terms of reference and composition of such committees should be set out in the Board-approved committee charter, which should be reviewed periodically.
- The membership of Board committees should be reviewed and refreshed periodically.
- Each committee should be composed of at least three members with a majority of INEDs where possible.

- To facilitate adequate oversight, the Board should establish committees responsible for nomination and governance, remuneration, audit and risk management.
- The Board may combine any of the responsibilities mentioned in section 6.1.6 on Board committees, taking into consideration the size, needs and other requirements of the Company.
- The Chairmen of Board committees should be appointed by the Board. Individual Board committee Charters will indicate where INEDs are required.
- The Board should ensure that, in appointing members of the Board committees, there is a balanced distribution of power in respect of membership across committees so that no individual has the ability to dominate decision making and undue reliance is not placed on any individual.
- The Company Secretary, or any other officer in the office of the Company Secretary, should be the secretary of all Board committees.
- The agenda for the meetings of Board committees should be developed in consultation with the respective committee Chairmen.
- The timing of committee meetings should be well coordinated for the effective discharge of their duties.
- The Chairman of each Board committee, at the next meeting of the Board, should present a written report of the key recommendations made at all the meetings of the committee held since the last Board meeting.
- Members of Board committees should devote sufficient time to the committees' work.

- Board Committees may engage a consultant at the expense of the Company for the purpose of obtaining independent external expertise in carrying out their responsibilities. This should be done in line with the Company’s policies.
- Board Committees should be accountable to the Board for their own activities and performance.

MODULE 4

4.0 REPORTING TO SHAREHOLDERS AND EXTERNAL AUDITORS

4.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. Parties to Financial Reports
ii. Financial reporting in relation to going concern
iii. Board membership, Orientation and Training of Directors
iv. Whistle-blowing Policy
v. Rotation of External Auditors
vi. reliability of financial reporting: true and fair view
vii. Directors' responsibility for the financial statement

4.2 Parties to Financial Reports

The key points to highlight in relation to the financial reporting process are:

- **Management** are responsible for preparing the financial statements and for the effective operation of the internal control system and related processes. External providers, such as accounting firms, may be engaged by management to perform some of these tasks.
- **Directors** (trustees, councillors, or those charged with governance more broadly) are responsible for overseeing the financial reporting processes

undertaken by management. They have ultimate responsibility for ensuring that legislative requirements in relation to financial reporting, such as filing with regulator bodies and providing financial information to investors / shareholders, are complied with.

• **External auditors** (if an audit is required or the organisation has elected to have one) carry out the independent audit of the financial statements. External auditors report to the shareholders or investors through an external audit report. Engagement with the external auditors is generally undertaken by the directors on behalf of the shareholders. Dayto-day interaction during the audit process is usually between the external auditor and management.

• **Stakeholders**, such as shareholders, investors and other providers of debt capital are the 'consumers' in the financial reporting supply chain. They use the information in the financial reports and make decisions based on this information. Other stakeholders, such as customers, suppliers, employees, volunteers, potential funders and the wider community, may also have an interest in the financial performance of an organisation and use the information in the financial reports to make decisions.

• **Regulators**, depending on the type of organisation and the jurisdiction it is operating in, are responsible for overseeing the entity's financial reporting compliance, and in some jurisdictions, the external auditors.

• **Audit committees** are common in larger organisations. This is where the board sets up a separate sub-committee, often referred to as an audit committee, to oversee the financial reporting and audit processes. Such a committee should report back regularly to the full board so that all directors are up-todate and engaged with financial reporting matters.

4.3 Financial reporting, going concern status (review of future solvency) responsibilities of the board, executive management and the external auditors

General Meetings

The informed use of shareholder rights and the effective exercise of the ownership function are key elements of corporate governance. In order to ensure that all shareholders are able to receive the general meeting information in advance with sufficient time for reflection and consultation, dates and methods of notification are indicated in the corporate governance frameworks of all jurisdictions. The minimum period of notification in advance of the meeting is 21 days.

General Meetings are important platforms for the Board to engage shareholders to facilitate greater understanding of the Company's business, governance and performance. They provide shareholders with an opportunity to exercise their ownership rights and express their views to the Board on any areas of concern.

Conduct of shareholders' meeting

The Nigerian Code of Corporate Governance provides the following recommendations:

i. General Meetings should be conducted in an open manner allowing for free discussions on all issues on the agenda. Sufficient time should be allocated to shareholders, particularly minorities, to participate fully and contribute effectively at the meetings.

ii. The Chairmen of all Board committees and of the Statutory Audit Committee should be present at General Meetings of the Company to respond to shareholders' queries and questions.

iii. The venue of a General Meeting should be accessible to shareholders, to ensure that shareholders are not disenfranchised on account of the choice of venue.

iv. Notices of General Meetings shall be at least 21 days from the date on which the meeting will be held. Copies of the annual reports, audited financial statements and all other information pertaining to any resolution to be voted upon – including voting or proxy instructions and relevant papers – or that will enable members prepare adequately for the meeting should be despatched along with the notice.

v. The Board should ensure that unrelated issues for consideration are not lumped together at General Meetings. Statutory business should be clearly and separately set out. Separate resolutions should be proposed and voted on for each substantial issue.

vi. The Board should ensure that decisions reached at General Meetings are properly and fully implemented as governance directives.

Shareholder Engagement

The establishment of a system of constant dialogue with shareholders balances their needs, interests and expectations with the objectives of the Company.

- The Board should develop a policy that ensures appropriate engagement with shareholders. The policy should be hosted on the website of the company.
- The Chairman of the Board, or other designated persons as specified in the policy referred to in section 17.1, may interact with shareholders in order to help develop a balanced understanding of shareholder issues and ensure that their views are communicated to the Board.
- The Board should encourage institutional investors to:

▪ Positively influence the standard of corporate governance and promote value creation in the companies in which they invest.

▪ Monitor conformance with the provisions of this Code and raise concerns as appropriate.

▪ The Board should ensure that dealings of the Company with shareholder associations are always transparent and in the best interest of the Company.

Protection of Shareholder Rights

Equitable treatment of shareholders and the protection of their statutory and general rights, particularly the interest of minority shareholders, promote good governance.

- The Board should ensure that:

a. shareholders at annual general meetings preserve their effective powers to appoint and remove Directors of the Company;
b. all shareholders are treated fairly and equitably. No shareholder, however large his shareholding or whether institutional or otherwise, should be

given preferential treatment or superior access to information or other materials;

c. minority shareholders are adequately protected from abusive actions by controlling shareholders;

d. the Company promptly renders to shareholders documentary evidence of ownership interest in the Company and related instruments.

e. Where these are rendered electronically, the Board should ensure that they are rendered to shareholders promptly and in a secure manner; and

f. all shareholders understand the ownership structure of the Company, and support them in this by making available, current information on the ultimate beneficial owners of the major shareholdings or any shareholders owning, controlling or influencing 5% or more of the company's shares.

 Directors, at all times, should act in good faith and with integrity in the best interests of all shareholders, and provide adequate information to shareholders to facilitate their investment decisions.

4.4 Meetings of the Board

To effectively perform its oversight function and monitor management's performance, the Board should meet at least once every quarter.

Every director should be required to attend at least two-thirds of all Board meetings. Such attendance shall be among the criteria for the re-nomination of a director except where there are cogent reasons which the Board must notify the shareholders of at the annual general meeting.

(a) Establish the criteria for Board and Board Committee memberships, review candidates' qualifications and any potential conflict of interest, assess the contribution of current directors in connection with their re-nomination and make recommendations to the Board;

(b) Prepare a job specification for the Chairman's position, including an assessment of time commitment required of the candidate;

(c) Periodically evaluate the skills, knowledge and experience required on the Board;

(d) Make recommendations on experience required by Board Committee members, Committee appointments and removal, operating structure, reporting and other Committee operational matters;

4.5 Appointment to the Board

13.1. The Board should develop a written, clearly defined, formal and transparent procedure for appointment to the Board of directors.

13.2. The criteria for the selection of directors should be written and defined to reflect the existing Board's strengths and weaknesses, required skills and experience, its current age range and gender composition.

13.3. The Board should ascertain whether nominees for the position of directors are fit and proper and are not disqualified from being directors.

13.4. Shareholders should be provided with biographical information of proposed directors including:

(a) Name, age, qualification and country of principal residence;

(b) Whether the appointment is executive, non-executive or independent and any proposed specific area of responsibility;

(c) Work experience and occupation in the preceding ten years;

(d) Current directorships and appointments with statutory or regulatory authorities in the preceding five years;

(e) Shareholding in the company and its subsidiaries; and

(f) Any real or potential conflict of interest, including whether he is an interlock director.

13.5. A section of the company's annual report should state the processes used in relation to all Board appointments.

4.6 Board Remuneration

i. Companies should develop a comprehensive policy on remuneration for directors and senior management. Levels of remuneration should be sufficient to attract, motivate and retain skilled and qualified persons needed to run the company successfully.

The remuneration policy should:

(a) Define the criteria and mechanism for determining levels of remuneration and the frequency for review of such criteria and mechanism;

(b) Define a process, if necessary with the assistance of external advisers, for determining executive and non-executive directors' compensation; and

(c) Provide how and to what extent executive directors' reward should be linked to corporate and individual performance.

ii. The Board should approve the remuneration of each executive director including the CEO individually, taking into consideration direct relevance of skill and experience to the company at that time.

iii. Only non-executive directors should be involved in decisions regarding the remuneration of executive directors.

iv. Where share options are adopted as part of executive remuneration or compensation, the Board should ensure that they are not priced at a discount except with the authorization of the SEC. Any such deferred compensation should not be exercisable until one year after the expiration of the minimum tenure of directorship.

v. Where share options are granted as part of remuneration to directors, the limits should be set in any given financial year and be subject to the approval of the shareholders in general meeting.

vi. Compensation for non-executive directors should be fixed by, the Board and approved by shareholders in a general meeting. However, the fees and allowances or other incentives tied to corporate performance, paid to non-executive directors, should not be at a level that could compromise their independence.

vii. Companies should disclose in their annual report, details of shares of the company held by all directors, including on an “if converted” basis. This disclosure should include indirect holdings.

viii All directors should be required to disclose their share holding whether on a proprietary or fiduciary basis in the public company in which they are proposed to be appointed as directors, prior to their appointment.

ix. The Board should undertake a periodic “peer review” of its compensation and remuneration levels to ensure that the company remains competitive.

x. The company’s remuneration policy and all material benefits and compensation paid to directors should be published in the company’s annual report.

4.7 Conflict of Interest

16.1. Companies should adopt a policy to guide the Board and individual directors on conflict of interest situations. Such a policy should include the following principles:

(a) Directors should promptly disclose any real or potential conflict of interest that they may have regarding any matters that may come before the Board or its Committees.

(b) A director should abstain from discussions and voting on any matter in which the director has or may have a conflict of interest.

(c) If a director is not certain whether he is in a conflict of interest situation, the director concerned should discuss the matter with the Chairman of the Board or with the Company Secretary for advice and guidance.

(d) If any question arises before the Board as to the existence of a real or perceived conflict, the Board should by a simple majority determine if a conflict exists. The director or directors potentially in the conflict of interest situation shall not participate in any discussion and shall not vote on the issue.

(e) Directors who are aware of a real, potential or perceived conflict of interest on the part of a fellow director, have a responsibility to raise the issue promptly for clarification, either with the director concerned or with the Chairman of the Board.

(f) Disclosure by a director of a real, potential or perceived conflict of interest or a decision by the Board as to whether a conflict of interest exists should be recorded in the minutes of the meeting.

4.8 Insider Trading

Directors of public companies, their immediate families, that is, spouse, son, daughter, mother or father, and other insiders as defined under Section 31.5 of the Investments and Securities Act (ISA) 2007 and the SEC Rules and Regulations, in possession of price sensitive information or other confidential information, shall not deal with the securities of the company where such would amount to insider trading as defined under the ISA.

4.9 Orientation and Training of Directors

18.1. The Board should establish a formal orientation programme to familiarise new directors with the company's operations, strategic plan, senior management and its business environment, and to induct them in their fiduciary duties and responsibilities.

18.2. It is mandatory for all directors to participate in periodic, relevant, professional continuing education programmes in order to update their knowledge and skills and keep them informed of new developments in the company's business and operating environment. The objective of the training is to assist the directors discharge fully and effectively their duties to the company. The training shall be at the company's expense.

4.10 Tenure and Re-election of Directors

19.1. Subject to satisfactory performance and the provisions of CAMA, all directors should be submitted for re-election at regular intervals of at least once every three (3) years. In order to guide the decision of shareholders, names and sufficient biographical details of directors nominated for re-election should be accompanied by performance evaluation results and any other relevant information.

19.2. Non-executive directors of public companies should serve for reasonable periods on the Board. However, it is necessary to reinforce the Board by continually injecting new energy, fresh ideas and perspectives. The Board should ensure the periodic appointment of new directors to replace existing non-executive directors.

4.11 The Audit Committee

30.1. Every public company is required under Section 359 (3) and (4) of the CAMA to establish an audit committee. It is the responsibility of the Board to ensure that the committee is constituted in the manner stipulated and is able to discharge its statutory duties and responsibilities effectively. At least one board member of the committee should be financially literate.

30.2. Members of the committee should have basic financial literacy and should be able to read financial statements. At least one member should have knowledge of accounting or financial management.

30.3. Whenever necessary, the committee may obtain external professional advice.

30.4. In addition to its statutory functions, the audit committee should have the following additional responsibilities:

(a) Assist in the oversight of the integrity of the company's financial statements, compliance with legal and other regulatory requirements, assessment of qualifications and independence of external auditor, and performance of the company's internal audit function as well as that of external auditors;

(b) Establish an internal audit function and ensure there are other means of obtaining sufficient assurance of regular review or appraisal of the system of internal controls in the company;

(c) Ensure the development of a comprehensive internal control framework for the company, obtain assurance and report annually in the financial report, on the operating effectiveness of the company's internal control framework.

(d) Oversee management's process for the identification of significant fraud risks across the company and ensure that adequate prevention, detection and reporting mechanisms are in place;

(e) At least on an annual basis, obtain and review a report by the internal auditor describing the strength and quality of internal controls including any issues or recommendations for improvement, raised by the most recent internal control review of the company;

(f) Discuss the annual audited financial statements and half yearly unaudited statements with management and external auditors;

(g) Discuss policies and strategies with respect to risk assessment and management;

(h) Meet separately and periodically with management, internal auditors and external auditors;

(i) Review and ensure that adequate whistle-blowing procedures are in place and that a summary of issues reported are highlighted to the Chairman;

(j) Review, with the external auditor, any audit scope limitations or problems encountered and management's responses to same;

(k) Review the independence of the external auditors and ensure that where non-audit services are provided by the external auditors, there is no conflict of interest;

(I) Preserve auditor independence, by setting clear hiring policies for employees or former employees of independent auditors;

(m) Consider any related party transactions that may arise within the company or group;

(n) Invoke its authority to investigate any matter within its terms of reference for which purpose the company must make available the resources to the internal auditors with which to carry out this function, including access to external advice where necessary; and

(0) Report regularly to the Board.

4.11.1 Internal Audit Function

1. All companies should have an effective risk-based internal audit function. Where the Board decides not to establish such a function, sufficient reasons must be disclosed in the company's annual report with an explanation as to how assurance of effective internal processes and systems such as risk management, internal control and the like will be obtained.

2. The purpose, authority and responsibility of the internal auditing activity should be clearly and formally defined in an audit charter approved by the Board through the audit committee. This should be consistent with the definition of internal auditing by the Institute of Internal Auditors (IIA).

3. The internal audit unit should be headed by a senior member of staff. The unit should be adequately resourced and have appropriate budget to enable it effectively discharge its responsibilities.

4. The internal audit unit should report directly to the Audit Committee while having a line of communication with the CEO/MD. The Audit Unit should have unrestricted access to the Chairman of the Audit Committee as well as the Chairman of the Board.

5. Internal audit should report at least once every quarter, at Audit Committee meetings, on the adequacy and effectiveness of management's governance, risk and control environment, deficiencies observed and management's mitigation plans.

6. The internal audit function should assist the directors and management to maintain effective controls through periodic evaluation to determine the effectiveness and efficiency of the company's internal control systems and make recommendations for enhancement or improvement.

7. The evaluation of controls by the internal audit function should encompass the following:

(a) The information systems environment;

(b) The reliability and integrity of financial and operational information;

(c) The effectiveness and efficiency of operations;

(d) Safeguarding of assets and

(e) Compliance with laws and regulations.

8. The internal audit function should establish a risk-based internal audit methodology that provides a consistent basis for the provision of internal audit services and highlights the key steps and activities to be performed from the planning stage through to the reporting phase of the audit.

9. The internal audit function should develop an annual risk-based internal audit plan in line with the risk-based internal audit methodology and should be approved by the audit committee.

10. The annual risk-based internal audit plan should:

(a) Address the broad range of risks facing the company linking this to risk management framework;

(b) Identify audit priority areas and areas of greatest threat to the company;

(c) Indicate how assurance will be provided on the company's risk management process; and

(d) Indicate the resources and skills available or required to achieve the plan.

11. The internal audit plan should be based on the result of the assessment of the risks faced by the company in line with the risk management framework and should be approved by the Board. The plan should identify audit priority areas and determine the frequency of audits as well as the required resources and skills. The risk assessment process should be of a continuous nature so as to identify emerging, as well as residual or existing risks and should be conducted at least annually, but more often in companies with complex operations.

12. Internal audit should provide independent assurance on the robustness and effectiveness of the company's risk management process.

13. The internal audit function should co-ordinate with other internal and external providers of assurances in order to ensure proper coverage and to minimize duplication of effort.

1 4. There should be an external assessment of the effectiveness of the internal audit function at least once every three years by a qualified independent reviewer, as defined by the Institute of Internal Auditors, or by an external review team.

4.12 Whistle-blowing Policy

1. Companies should have a whistle-blowing policy which should be known to employees, stakeholders such as contractors, shareholders, job applicants and the general public. It is the responsibility of the Board to implement such a policy and to establish a whistle-blowing mechanism for reporting any illegal or substantial unethical behaviour.

2. The whistle-blowing mechanism should be accorded priority and the Board should also reaffirm continually its support for and commitment to the company's whistle-blower protection mechanism.

3. The whistle-blowing mechanism should include a dedicated "hot-line" or e-mail system which could be used anonymously to report unethical practices. A designated senior level officer should review the reported cases and initiate appropriate action, if necessary, at the level of the Board or CEO/MD to redress situation.

4. The designated senior level officer assigned to review reported cases should provide the Chairman of the audit committee with a summary of reported cases, cases investigated, the process of investigation and the result of the investigation.

4.13 Rotation of External Auditors

1. In order to safeguard the integrity of the external audit process and guarantee the independence of the external auditors, companies should rotate both the audit firms and audit partners.

2. Companies should require external audit firms to rotate audit partners assigned to undertake the external audit of the company from time to time to guarantee independence. Audit personnel should be regularly changed without compromising continuity of the external audit process. External audit firms should be retained for no longer than ten (10) years continuously. External audit firms disengaged after continuous service to a company for ten (10) years may be re-appointed seven (7) years after their disengagement.

4.14 The need for reliable financial reporting: true and fair view

True and Fair View

True and Fair is the term using in the audit of financial statement to express the condition that financial statements are truly prepared and fairly presented in accordance with the prescribed accounting standards.

True suggests that the financial statements are factually correct and have been prepared according to applicable reporting framework such as the IFRS and they do not contain any material misstatements that may mislead the users. Misstatements may result from material errors or omissions of transactions and balances in the financial statements.

Fair implies that the financial statements present the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form.

Classification of True and Fair View

The meaning of true and fair view can be classified by associating them with three basic ideas:

1. *true and fair view can be characterized as a legal residual clause, which means it can be considered the sort of clause which often is added to statutes, contracts and other legal documents, to cover circumstances other than those specifically foreseen in other clauses in the document ... in effect, this kind of clause operates as a safety net put in by the creator of the contract to catch any eventuality not specifically foreseen in the other clauses and is not generally expected to be invoked except in unusual circumstances;*
2. *true and fair view can be considered an independent concept, meaning that it constitutes a supreme objective. . . as such, it can be defined independently by the accounting rules;*
3. *true and fair view can be used as a code for the representation of generally accepted accounting principles, in which case it is based on the notion that accounting principles do not represent a coherent, rationally consistent set of principles but rather a set of pragmatic responses to measurement problems.*

On 4 June 2014, the FRC of UK confirms that in the majority of cases a true and fair view will be achieved by compliance with accounting standards and by additional disclosure to fully explain an issue. However, where compliance with an accounting standard would result in accounts being so misleading that they would conflict with the objectives of financial statements, the standard should be overridden.

4.15 The nature of going concern statement and its relevance for governance

The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, unless the going concern assumption is inappropriate in the circumstances of the entity, assets and liabilities are recorded on the basis that the entity will be able to realize its assets, discharge its liabilities, and obtain refinancing (if necessary) in the normal course of business.

A

ISA 570 requires the auditor to consider whether they affect the auditor's assessment of the risks of material misstatement and to:

i. Review management's plans for future actions based on its going concern assessment;

ii. Gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists through carrying out audit procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and

iii. Seek written representations from management regarding its plans for future action.

4.15.1Management's Assessment of the Entity's Ability to Continue as a Going Concern

In management assessment of going concern the following factors are relevant:

i. In general terms, the degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future a judgment is being made about the outcome of an event or condition. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.
ii. Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events can contradict a judgment which was reasonable at the time it was made.
iii. The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors all affect the judgment regarding the outcome of events or conditions.

4.16 Directors' responsibility for the financial statement

Accounting Standard requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'.

In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. Directors are also required to:

i. properly select and apply accounting policies;
ii. present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
iii. provide additional disclosures, when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
iv. make an assessment of the Company's ability to continue as a going concern.

4.16.1 Responsibility of Directors to Financial Statement

The directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with International Financial Reporting Standards (IFRS), the interpretations adopted by the International Accounting Standards Board.

i. The directors' responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of these financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.
ii. The directors' responsibility also includes maintaining adequate accounting records and an effective system of risk management.

iii. The directors have the responsibility to make assessment of the Group's and Company's ability to continue as a going concern and state whether not there is any reason to believe that the Group and Company will not be going concerns in the year ahead.

4.17 Responsibility of the external auditors and their Responsibility for the discovery of fraud

An external auditor is appointed to provide an independent opinion on the true and fair view of the financial statements of the Company to give assurance to stakeholders on the reliability of the financial statements

The following are the responsibility of the External Auditor to financial statement

a. **Risk Assessment and Mitigation Planning:** External auditors help promote corporate governance by conducting period risk assessment. Auditors review the security measures that a company has in place against corporate fraud or corruption

b. **Crisis Management:** External auditors can help ensure development of efficient crisis-management plans to be used in the event of allegations of fraud or corruption. The plan typically involves assigning responsibilities to different administrative officials.

c. **Promote Accountability:** External auditors may introduce measures and policies designed to compel accountability in the workplace. For instance, auditors could recommend penalties for officers who manipulate financial statements by inflating figures or cooking accounting numbers.

d. **Represent Interest of Shareholders:** One of the primary roles of external auditors in corporate governance is protecting the interests of shareholders.

This is possible because external audition reports are conducted independent of the company’s influence. External auditors report the state of a company's finance and attest to the validity of financial reports that may have been released.

e. **Maintain Strong Relationship with Regulators:** The efforts of an external auditor help foster a good relationship with regulators. Most regulators are supportive of companies and agencies that appear to have transparent operations. External auditors evaluate the organization of a company for compliance with regulations. Regulators are also more likely to trust company disclosures after an auditor attest to them.

Due care generally implies four things:

1. The auditor must possess the requisite skills to evaluate accounting entries
2. The auditor has a duty to employ such skill with reasonable care and diligence
3. The auditor undertakes his task(s) with good faith and integrity but is not infallible
4. The auditor may be liable for negligence, bad faith, or dishonesty, but not for mere errors in judgment

MODULE 5

5.0 ROLE OF THE AUDIT COMMITTEE

5.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. The audit committee and external auditors
ii. Internal Audit Function
iii. External Auditors

5.2 The audit committee and external auditors

Every public company is required under Section 359 (3) and (4) of the CAMA to establish an audit committee. It is the responsibility of the Board to ensure that the committee is constituted in the manner stipulated and is able to discharge its statutory duties and responsibilities effectively. At least one board member of the committee should be financially literate.

Members of the committee should have basic financial literacy and should be able to read financial statements. At least one member should have knowledge of accounting or financial management.

Whenever necessary, the committee may obtain external professional advice.

Responsibilities of Audit Committee

In addition to its statutory functions, the audit committee should have the following additional responsibilities:

(a) Assist in the oversight of the integrity of the company's financial statements, compliance with legal and other regulatory requirements, assessment of qualifications and independence of external auditor, and performance of the company's internal audit function as well as that of external auditors;

(b) Establish an internal audit function and ensure there are other means of obtaining sufficient assurance of regular review or appraisal of the system of internal controls in the company;

(c) Ensure the development of a comprehensive internal control framework for the company, obtain assurance and report annually in the financial report, on the operating effectiveness of the company's internal control framework.

(d) Oversee management's process for the identification of significant fraud risks across the company and ensure that adequate prevention, detection and reporting mechanisms are in place;

(e) At least on an annual basis, obtain and review a report by the internal auditor describing the strength and quality of internal controls including any issues or recommendations for improvement, raised by the most recent internal control review of the company;

(f) Discuss the annual audited financial statements and half yearly unaudited statements with management and external auditors;

(g) Discuss policies and strategies with respect to risk assessment and management;

(h) Meet separately and periodically with management, internal auditors and external auditors;

(i) Review and ensure that adequate whistle-blowing procedures are in place and that a summary of issues reported are highlighted to the Chairman;

(j) Review, with the external auditor, any audit scope limitations or problems encountered and management's responses to same;

(k) Review the independence of the external auditors and ensure that where non-audit services are provided by the external auditors, there is no conflict of interest;

(l) Preserve auditor independence, by setting clear hiring policies for employees or former employees of independent auditors;

(m) Consider any related party transactions that may arise within the company or group;

(n) Invoke its authority to investigate any matter within its terms of reference for which purpose the company must make available the resources to the internal auditors with which to carry out this function, including access to external advice where necessary; and

(0) Report regularly to the Board.

5.3 Internal Audit Function

An effective internal audit function provides assurance to the Board on the effectiveness of the governance, risk management and internal control systems.

- The purpose, authority and responsibility of the internal audit function should be clearly and formally defined in an internal audit charter approved by the Board.

- Where the Board decides not to establish such a function, internally or outsourced, sufficient reasons should be disclosed in the Company's annual report with an explanation as to how the Board has obtained adequate assurance on the effectiveness of the internal processes and systems such as risk management and internal control.
- The internal audit function should be headed by a member of senior management, who is a professional with relevant qualifications, competence, objectivity and experience; and is registered with a recognised professional body.
- The Board should ensure that the internal audit function is sufficiently skilled and resourced to address the complexity and volume of risk faced by the organisation.
- The head of the internal audit function should:
- Report directly to the committee responsible for audit while having a line of communication with the MD/CEO.
- Have unrestricted access to the Chairman of the committee responsible for audit as well as the Chairman of the Board.
- Report at least once every quarter, to the committee responsible for audit, on the adequacy and effectiveness of management, governance, risk and control environment, deficiencies observed and management mitigation plans.
- Provide assurance to the Board by conducting periodic evaluations to determine the effectiveness and efficiency of the Company's internal control systems and make recommendations for enhancement or improvement.

- Develop an annual risk-based internal audit plan which should be approved by the committee responsible for audit.
- Liaise with other internal and external providers of assurance in order to ensure proper coverage and to minimise duplication of efforts.
- There should be an external assessment of the effectiveness of the internal audit function at least once every three years by a qualified independent reviewer to be appointed by the Board.
- The evaluation of the head of the internal audit function should be performed by the committee responsible for audit, and he may only be removed by the Board on the recommendation of the committee responsible for audit.

5.4 External Auditors

An external auditor is appointed to provide an independent opinion on the true and fair view of the financial statements of the Company to give assurance to stakeholders on the reliability of the financial statements.

- Subject to the provisions of any extant laws, the recommendation for the appointment, re-appointment or removal of an external auditor should be made by the committee responsible for audit to the Board.
- External audit firms may be retained for no longer than ten years continuously. External audit firms disengaged after ten years continuous service may not be considered for reappointment until seven years after their disengagement. Where an external auditor's aggregate or cumulative tenure has already exceeded ten years at the date of commencement of this Code, such auditor should cease to hold office as an auditor of the

Company at the Annual General Meeting to be held immediately after this Code comes into effect.

- An external auditor may provide to the Company only such other services as are approved by the Board on the recommendation of the committee responsible for audit and such as does not create a self-review threat in line with the provisions of international auditing standards.
- In order to preserve independence, there should be a rotation of the audit engagement partner every five years.
- In order to preserve independence, there should be an appropriate cooling off period spanning at least five years between the retirement of a partner from an audit firm and his appointment to the Board of an audit client. Similarly, there should be a cooling off period before a Company can engage any member of the audit team as a staff member in the financial reporting function.
- In order to ensure quality audit outcomes, the engagement partner and audit team should possess the knowledge, relevant skills and experience. Additionally, they should demonstrate a good understanding of the Company's business, be independent of the Company and approach their work with a high level of objectivity and professionalism – including applying internationally accepted audit standards in their work.
- Where the Board is satisfied that the external auditor has abused its office, acted in a fraudulent manner or colluded in any fraud or for any other reason, it may recommend the removal of such external auditor in accordance with the provisions of extant laws. Where a Regulator is satisfied that the external auditor of a Company has abused its office as

auditor, it may request the Company to remove such external auditor in line with the provisions of extant laws.

- Where external auditors discover or acquire information during an audit that leads them to believe that the Company or anyone associated with it has committed an indictable offence under any law, they should report this to the Regulator, whether or not such matter is or will be included in the Management Letter issued to the Committee responsible for audit and/or the Board.

MODULE 6

6.0 INDEPENDENCE OF THE EXTERNAL AUDITORS

6.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. Description and determination of Independence of External Auditors
ii. significance of auditor's independence
iii. Threats to Auditors Independence
iv. Auditors and non-audit Services/work.
v. Principles of reporting requirements for good governance

6.2 Introduction

Auditor independence is the cornerstone of the audit function. The independence of the external auditor is imperative for the opinion of the auditor to be relied upon by the users of the financial information. As such, auditor independence gives the public assurance that the audited financial statements are reliable and trustworthy. Independence of an auditor inform the level of objectivity that will be applied in the audit process and expression of opinion by the auditor.

Subject to the provisions of any extant laws, the recommendation for the appointment, re-appointment or removal of an external auditor should be made by the committee responsible for audit to the Board. External audit firms may be retained for no longer than ten years continuously. External audit firms disengaged after ten years continuous service may not be considered for reappointment until seven years after their disengagement. Where an external auditor’s aggregate or cumulative tenure has already exceeded ten years at the date of commencement of this Code, such auditor should cease to hold office as an auditor of the Company at the Annual General Meeting to be held immediately after this Code comes into effect. An external auditor may provide to the Company only such other services as are approved by the Board on the recommendation of the committee responsible for audit and such as does not create a self-review threat in line with the provisions of international auditing standards.

In order to preserve independence, there should be a rotation of the audit engagement partner every five years. In order to preserve independence, there should be an appropriate cooling off period spanning at least five years between the retirement of a partner from an audit firm and his appointment to the Board of an audit client. Similarly, there should be a cooling off period before a Company can engage any member of the audit team as a staff member in the financial reporting function. In order to ensure quality audit outcomes, the engagement partner and audit team should possess the knowledge, relevant skills and experience. Additionally, they should demonstrate a good understanding of the Company’s business, be independent of the Company and approach their work with a high level of objectivity and professionalism – including applying internationally accepted audit standards in their work.

Where the Board is satisfied that the external auditor has abused its office, acted in a fraudulent manner or colluded in any fraud or for any other reason, it may recommend the removal of such external auditor in accordance with the provisions of extant laws. Where a Regulator is satisfied that the external auditor of a Company has abused its office as auditor, it may request the Company to remove such external auditor in line with the provisions of extant laws.

Where external auditors discover or acquire information during an audit that leads them to believe that the Company or anyone associated with it has committed an indictable offence under any law, they should report this to the Regulator, whether or not such matter is or will be included in the Management Letter issued to the Committee responsible for audit and/or the Board.

6.3 Determination of Independence of External Auditors

The European Commission provides guidelines to measure auditors' independence; the auditor shall not participate in decision-making nor be a member of the governing body. Neither should the auditor, in the course of the three previous years have carried out audits, held voting rights within the audit client, been a member of any decision-making board within the audit client or been a partner, employee or somehow contracted by the firm (European Parliament & the Council, 2014).

According to the United Kingdom (UK) Financial Reporting Council's (FRC's) Auditor Practices Board (APB) Ethical Standard 1 (2011, p 4*), "Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired".* In other words, auditor's independence should not be tested on the auditor's reflection on his or her objectivity, but rather if a rational third party would determine the auditor's independence is or can be impaired.

6.4 The significance of auditor's independence: threats to the auditor independence

a. Subject to the provisions of any extant laws, the recommendation for the appointment, re-appointment or removal of an external auditor should be made by the committee responsible for audit to the Board.

b. External audit firms may be retained for no longer than ten years continuously. External audit firms disengaged after ten years continuous service may not be considered for reappointment until seven years after their disengagement. Where an external auditor's aggregate or cumulative tenure has already exceeded ten years at the date of commencement of this Code, such auditor should cease to hold office as an auditor of the Company at the Annual General Meeting to be held immediately after this Code comes into effect.

c. An external auditor may provide to the Company only such other services as are approved by the Board on the recommendation of the committee responsible for audit and such as does not create a self-review threat in line with the provisions of international auditing standards.

d. In order to preserve independence, there should be a rotation of the audit engagement partner every five years.

e. In order to preserve independence, there should be an appropriate cooling off period spanning at least five years between the retirement of a partner from an audit firm and his appointment to the Board of an audit client. Similarly, there should be a cooling off period before a Company can engage any member of the audit team as a staff member in the financial reporting function.

f. In order to ensure quality audit outcomes, the engagement partner and audit team should possess the knowledge, relevant skills and experience. Additionally, they should demonstrate a good understanding of the Company's business, be independent of the Company and approach their work with a high level of objectivity and professionalism – including applying internationally accepted audit standards in their work.

g. Where the Board is satisfied that the external auditor has abused its office, acted in a fraudulent manner or colluded in any fraud or for any other reason, it may recommend the removal of such external auditor in accordance with the provisions of extant laws. Where a Regulator is satisfied that the external auditor of a Company has abused its office as auditor, it may request the Company to remove such external auditor in line with the provisions of extant laws.

h. Where external auditors discover or acquire information during an audit that leads them to believe that the Company or anyone associated with it has committed an indictable offence under any law, they should report this to the Regulator, whether or not such matter is or will be included in the Management Letter issued to the Committee responsible for audit and/or the Board.

6.5 Threats to Auditors Independence

The threats the independence of an auditor can be categorized as follows: self-interest; self-review; advocacy, familiarity, and intimidation. A brief outline of the five types of threats which may occur as a result of Non-audit services are:

The Self-interest Threat**:** An auditor's independence may be threatened if a firm or a member of the audit team benefits from a financial interest in an audit client.

This could arise, for example, from a direct or indirect interest in a client; or from a fear of losing the client. In other words, all works that create a financial relationship between the auditor and the audit client may create a self-interest threat. The perceived threat to independence grows with the amount/size of the ensuing fee payable, and the self-interest caveat is thus increased further by providing Non-audit services to the audit client. But the most significant dimension of any threat, real or perceived, is likely to be the size of the total fees earned from a client in relation to the whole fees of the auditing firm.

The Self-Review Threat: This relates to the difficulty of maintaining objectivity when conducting a self-review procedure. This can arise when any product or judgment from a previous audit (or non-audit) assignment needs to be challenged, or re-evaluated in reaching the current audit conclusions; or when a member of the audit team has previously been a director or officer of the audit client, or was employed in any position likely to affect the subject matter of the audit engagement. Therefore, an auditor should give careful consideration to every issue bearing on the self-review threats. This includes the materiality of the amounts involved (in relation to the financial statements) and the degree of subjectivity inherent in any judgment of the elements concerned.

The Advocacy Threat: This occurs when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised. For instance, advocacy in any sharpened form is likely to threaten an auditor's independence, and appears to be incompatible with the particular objectivity required by the audit-reporting role. This separation of roles is vital to auditor's credibility. Therefore, if a firm, or a member of the audit team, becomes an advocate for (or against) the audit client's position in any adversarial proceedings (or situations) there may be serious ethical compromise. Examples of this confusion of roles may occur when acting as an advocate on behalf of the client in litigation; or when the client litigates against the auditor; when Business and dealing in or promoting shares (or securities) issued by the client. These activities are obviously considered likely to impair or compromise auditor independence.

The Familiarity to Trust Threat: By virtue of the close relationship with an audit client, its directors, officers and employees, there is a risk that the auditor may be influenced by the client's business ambience. This caution against over-familiarity must also include the influence of a client's personality and other personal qualities. There is the danger that these factors may subsequently contribute to excessive trust in that client. In this situation the auditor runs the risk of becoming too sympathetic to the client's representations and claims may be insufficient. An auditor should be extremely careful not to go beyond the advisory role and not drift into influencing the management sphere. Such a drift is potentially damaging to both parties. For example, too long and too close relationships with client personnel may result in excessive trust in the client and insufficient objective testing of his representation.

Intimidation Threats: This occurs when auditors are deterred from accounting objectively with an adequate degree of professional skepticism because of threats of replacement. According to CIMA (2002), independence may be compromised when preparing accounting records and financial statements. There is an obvious self-review threat and auditors must not make 'management decisions'. For audit clients that are not listed entities, the firm may provide an audit client with accounting and book-keeping services of a 'routine or mechanical nature'. Doing so for a listed company is not generally acceptable other than if immaterial or in emergencies with appropriate safeguards.

6.6 Auditors and non-audit Services/work.

non-audit Service/Work

Non-audit services are services provided by an auditor that are not considered as an audit, for example, Management Advisory Services (MAS), tax matters and other accounting services which could be provided by the incumbent audit firm or another audit firm. Non-audit services constitute the source of non-audit income. It may be described as any other services rendered to an audit client different from the examination of financial statements and expression of a professional opinion thereof.

Non-audit services is defined by the Financial Reporting Council (FRC) as ”Any engagement in which an audit firm provides professional services to an audited entity, its affiliates or another entity in respect of the audited entity, other than the audit of financial statements”

The provision of such services may be a threat for auditors' independence that can increase the risk of conflicts for statutory auditors and audit firms. According to Ye Carson and Simnett, (2006, the economic dependence of auditors on non-audit services, lengthy audit tenure and personal relationships built through alumni employees have contributed to the erosion of auditor independence.

Categories of Non-Audit Services

Non-audit services provided by auditors to their clients fall into three categories:

1. Services required by legislation or contract to be undertaken by the auditors of the business. These include:

    a. regulatory returns e.g. to the Prudential Regulation Authority
    b. legal requirements to report on matters such as share issues for non-cash consideration, expenditure for grant application purposes, etc
    c. contractual requirements, for example to report to lenders or vendors on net assets, covenant requirements, etc.

2. Services that are most efficient for the auditors to provide because of their existing knowledge of the business, or because the information required is a by-product of the audit process. These include:

    a. services such as those listed in category (1) above that the auditors are not required by law to undertake, but where the information largely derives from the audited financial records
    b. tax compliance, where much of the information derives from the audited financial records
    c. 'short form' or other reports in acquisition or reorganisation situations where completion is necessary in a very short time.

3. Services that could be provided by a number of firms. In this case, the fact that the firm is the auditor is incidental and it would generally only be chosen because, for example, it had won a tender process. Examples of such services include:

    a. management consultancy
    b. tax advice
    c. human resources consultancy.

The Argument for General Prohibition Non-Audit Services

When a company fails, the quality of the audit is often called into question. Typically, the accusation is made that the auditors have allowed inappropriate accounting treatments because their independence has been compromised, either because they have become too close to the company they are auditing (the "familiarity" threat) or, more directly, because their objectivity is challenged by over-reliance on income from a single source. Those who hold that view believe that the only solution is for auditors to be prohibited from providing any services other than audit, to their audit clients.

How the existing arrangements provide safeguards against the provision of non-audit services compromising independence.

First, ethical code forbids auditors to provide non-audit services to audit clients if that would present a threat to independence for which no adequate safeguards are available. In such circumstances, the firm must either resign as auditor or refuse to supply the non-audit services. The code includes examples of specific activities where no acceptable safeguards are available - for example the promotion of the shares of audit clients - which are therefore effectively prohibited.

Second, under the provisions of the Code of corporate governance, the audit committee, as representative of the shareholders, is required to oversee the relationship with the auditors and keep the nature and extent of non-audit services under review. The audit committee must satisfy itself that the independence and objectivity of the auditor are not compromised. This important task is underpinned by Auditing Standards, which specifically require that, for listed companies, audit engagement partners in the firm who are responsible for a company's audit must:

a. disclose in writing to the audit committee all relationships between the audit firm and the client that may reasonably be thought to bear on the firm's independence and the objectivity of the audit engagement partner and staff (including arrangements for ensuring that independence remains when non-audit services are commissioned) and the related safeguards that are in place; and
b. confirm that, in their professional judgement, the firm is independent and the objectivity of the audit engagement partner and audit staff is not impaired.

Third, it is believed that the distinction between the value of income from different sources is artificial. The ethical code specifies that an audit appointment should not be accepted if the client provides, for whatever work, an unduly large proportion of a firm's gross practice income. That approach limits undue financial dependency on any client without irrelevant restrictions on the balance between different types of income. In practice, auditors of listed companies are well within this limit.

Fourth, shareholders themselves are able to assess the extent of non-audit services provided by auditors.

At a more fundamental level, an examination of past cases of audit failure has shown that the provision of non-audit services was not a direct cause of the audit failure, nor did it arise from undue dependency on non-audit fees. The "problem" as stated is not supported by evidence and appears to be founded on subjective impressions of difficulties that might arise rather than fact.

The Argument Against General Prohibition

We believe that unnecessarily restricting the provision of non-audit services would have an unintended, adverse effect on the underlying quality of the audit through restrictions in knowledge and skills:

Knowledge: The cumulative knowledge on which auditors depend would be greatly reduced, actually resulting in a poorer understanding of the business and a lower likelihood of key issues being identified. When they are less familiar with the business of a company, auditors would be likely to find out about such issues only later in the process, resulting in an increased likelihood of undetected misstatements.

Skills: An effective audit often requires experience far beyond the traditional auditing skill set. Auditors need to be able to draw on the knowledge and experience of colleagues who are expert in key risk areas: taxation, treasury operations, information systems, regulatory compliance, financial management, due diligence, actuarial assessments, fraud and business processes. By inhibiting such exchanges within a firm, a rigorous separation of audit and non-audit services would be likely to lead to a deterioration in audit quality.

Quality of recruits: Ultimately, there would be no reason for specialist divisions within an audit firm to accept the constraint of being unable to accept work from clients of their auditor colleagues. It follows that there would be a gradual move to establish themselves as entirely separate entities. The remaining audit-only firms would not attract the brightest graduates who enter a profession they perceive as opening the door to a broad range of subsequent careers. The quality of audit judgements would do down and more frauds would go undetected as the brightest and the best are needed to detect the fraudsters who are becoming cleverer and more determined.

Dependence on client: As noted above, non-audit service prohibitions would make firms smaller. This, perversely, would mean that bigger clients would actually create a proportionately bigger intimidation threat because they would form a larger part of the firm's income.

Quality of business' own systems: The general quality of IT and accounting systems, which business depends on to deliver the information that management base decisions on, would suffer as a company's auditors are often in the best position to advise clients on systems. Business would thus be increasingly denied a vital source of people with the relevant wider skills which a multi functional audit firm develops.

Speed of reporting: Reliable financial information on which the markets rely would be subject to delay where external advisers had to be consulted by the auditors. This would mean that current attempts by certain regulators to reduce filing periods would be frustrated as two professional firms would need to be involved at the same time which in many cases would be unrealistic.

Cost: Non audit service prohibition would result in an increase in of professional costs in key areas: as regards the non-audit services, such services can usually be provided at far less cost by auditors who have the benefit of their cumulative audit knowledge; as regards the audit service, the need for one firm to advise on and another to audit key issues would inevitably increase costs. We believe this would impact particularly on businesses which are medium and small sized.

6.7 Principles of reporting requirements for good governance

The principles of reporting requirement for good governance as contained in the The Wates Principles of the UK Reporting Regulations 2019 essentially set out four matters that large private limited companies must report on annually:

1. Employee Engagement

Where this Reporting Requirement applies then the Directors Report must include a statement which describes "the action that has been taken during the financial year to introduce, maintain or develop arrangements aimed at:

1. providing employees systematically with information on matters of concern to them as employees;
2. consulting employees or their representatives on a regular basis so that the views of employees can be taken into account in making decisions which are likely to affect their interest;
3. encouraging the involvement of employees in the company's performance through an employee share scheme or by some other means; and
4. achieving a common awareness on the part of the employees of the financial and economic factors affecting the performance of the company."

The report must summarise "how the directors have engaged with employees and how the directors have had regard to employees interests and the effect of that regard including on the principal decisions taken by the company during the financial year."

2. Engagement with other Stakeholders

Where the Qualifying Conditions are met the Directors Report must set out "how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principle decisions taken by the company during the financial year."

3. Report on Directors Good Faith

Companies who meet the Qualifying Conditions must provide a statement in their Strategic Report describing how directors have had regard to the matters set out in section 172.

For ease of reference section 172 states that: "a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

1. the likely consequences of any decision in the long term;
2. the interests of the company's employees;
3. the need to foster the company's business relationships with suppliers, customers and others;
4. the impact of the company's operations on the community and the environment;
5. the desirability of the company maintaining a reputation for high standards of business conduct; and
6. the need to act fairly as between members of the company."

Note that if a parent company and its subsidiaries do not meet the Qualifying Conditions separately but the parent meets the threshold on a consolidated basis then, the parent company must prepare a section 172 (1) Statement.

4. Corporate Governance Statement

Where the Qualifying Conditions are met, the Directors' Report must include a statement on its corporate governance arrangements which should confirm:

- which corporate governance code, if any, the company applied in the financial year;
- how the company applied that code; and
- if the company departed from such code, the respects in which it did so, and its reasons for so departing.

Corporate governance is defined as:

- the nature, constitution or functions of the organs of the company;
- the manner in which organs of the company conduct themselves,
- the requirements imposed on organs of the company;
- the relationship between different organs of the company; and
- the relationship between the organs of the company and the members of the company.

If a company meeting the Qualifying Conditions has not applied any corporate governance code for a financial year, the statement of corporate governance arrangements must explain the reasons for that decision, and explain what arrangements for corporate governance were applied for that year. This is in line with the Reporting Regulations 'comply or explain' approach.

MODULE 7

7.0 RIGHTS AND POWERS OF SHAREHOLDERS

7.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. The Right and Powers of the Shareholders
ii. Dialogue with shareholders.
iii. Relationship with Shareholders

7.3 Dialogue and communications with institutional shareholders (companies) or major shareholders.

General Meetings

General Meetings are important platforms for the Board to engage shareholders to facilitate greater understanding of the Company's business, governance and performance. They provide shareholders with an opportunity to exercise their ownership rights and express their views to the Board on any areas of concern.

- ➢ General Meetings should be conducted in an open manner allowing for free discussions on all issues on the agenda. Sufficient time should be allocated to shareholders, particularly minorities, to participate fully and contribute effectively at the meetings.
- ➢ The Chairmen of all Board committees and of the Statutory Audit Committee should be present at General Meetings of the Company to respond to shareholders' queries and questions.

- The venue of a General Meeting should be accessible to shareholders, to ensure that shareholders are not disenfranchised on account of the choice of venue.
- Notices of General Meetings shall be at least 21 days from the date on which the meeting will be held. Copies of the annual reports, audited financial statements and all other information pertaining to any resolution to be voted upon – including voting or proxy instructions and relevant papers – or that will enable members prepare adequately for the meeting should be despatched along with the notice.
- The Board should ensure that unrelated issues for consideration are not lumped together at General Meetings. Statutory business should be clearly and separately set out. Separate resolutions should be proposed and voted on for each substantial issue.
- The Board should ensure that decisions reached at General Meetings are properly and fully implemented as governance directives.

7.3 Relationship with Shareholders

Shareholder Engagement

The establishment of a system of constant dialogue with shareholders balances their needs, interests and expectations with the objectives of the Company.

- The Board should develop a policy that ensures appropriate engagement with shareholders. The policy should be hosted on the website of the company.
- The Chairman of the Board, or other designated persons as specified in the policy referred to in section 17.1, may interact with shareholders in order to help develop a balanced understanding of shareholder issues and ensure that their views are communicated to the Board.

- The Board should encourage institutional investors to:
  - Positively influence the standard of corporate governance and promote value creation in the companies in which they invest.
  - Monitor conformance with the provisions of this Code and raise concerns as appropriate.
- The Board should ensure that dealings of the Company with shareholder associations are always transparent and in the best interest of the Company.

Protection of Shareholder Rights

Equitable treatment of shareholders and the protection of their statutory and general rights, particularly the interest of minority shareholders, promote good governance.

d. The Board should ensure that:

i. shareholders at annual general meetings preserve their effective powers to appoint and remove Directors of the Company;

ii. all shareholders are treated fairly and equitably. No shareholder, however large his shareholding or whether institutional or otherwise, should be given preferential treatment or superior access to information or other materials;

iii. minority shareholders are adequately protected from abusive actions by controlling shareholders;

iv. the Company promptly renders to shareholders documentary evidence of ownership interest in the Company and related instruments. Where these are rendered electronically, the Board should ensure that they are rendered to shareholders promptly and in a secure manner; and

v. all shareholders understand the ownership structure of the Company, and support them in this by making available, current information on the ultimate beneficial owners of the major shareholdings or any shareholders owning, controlling or influencing 5% or more of the company's shares.

e. Directors, at all times, should act in good faith and with integrity in the best interests of all shareholders, and provide adequate information to shareholders to facilitate their investment decisions.

Role of institutional investor organisations (or major stakeholders)

- ➢ The Board should encourage institutional investors to:
  - ▪ Positively influence the standard of corporate governance and promote value creation in the companies in which they invest.
  - ▪ Monitor conformance with the provisions of this Code and raise concerns as appropriate.
- ➢ The Board should ensure that dealings of the Company with shareholder associations are always transparent and in the best interest of the Company.

The rights of minority shareholders

- ➢ The Board should ensure that:
- ▪ shareholders at annual general meetings preserve their effective powers to appoint and remove Directors of the Company;
- ▪ all shareholders are treated fairly and equitably. No shareholder, however large his shareholding or whether institutional or otherwise, should be given preferential treatment or superior access to information or other materials;
- ▪ minority shareholders are adequately protected from abusive actions by controlling shareholders;

- the Company promptly renders to shareholders documentary evidence of ownership interest in the Company and related instruments. Where these are rendered electronically, the Board should ensure that they are rendered to shareholders promptly and in a secure manner; and
- all shareholders understand the ownership structure of the Company, and support them in this by making available, current information on the ultimate beneficial owners of the major shareholdings or any shareholders owning, controlling or influencing 5% or more of the company's shares.

- Directors, at all times, should act in good faith and with integrity in the best interests of all shareholders, and provide adequate information to shareholders to facilitate their investment decisions.

MODULE 8

8.0 CORPORATE SOCIAL RESPONSIBILITY

8.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. The nature of corporate responsibility (CSR)
ii. Components of CSR
iii. Benefits and Implications of CSR
iv. Approaches to corporate social responsiveness
v. Corporate responsibility and stakeholders
vi. Internal and external stakeholders
vii. Responsibility to and interest of various stakeholder group
viii. Elements of corporate social responsibility

8.2 The nature of corporate responsibility and corporate citizenship

The broadest definition of corporate social responsibility is concerned with what is or should be the relationship between global corporations, governments of countries and individual citizens. More locally the definition is concerned with relationship between a corporation and the local society in which it resides or operates. Another definition is concerned with the relationship between a corporation and its stakeholders.

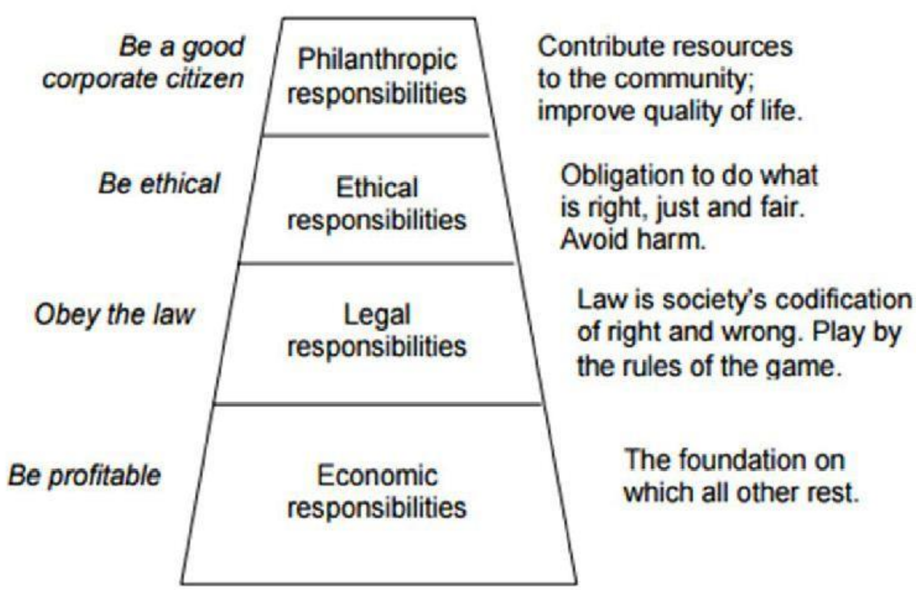
According to the EU Commission (2002)

"… CSR is a concept whereby companies integrate social and environmental concern in their business operations and in their interaction with their stakeholders on a voluntary basis."

Corporate social responsibility is defined as achieving commercial success in ways that honour ethical values and respect people, societies, and the environment (Toutsoura, 2004).

8.3 Components of CSR

Carroll (1991) opined that firm CSR should be characterized in a way that should be useful to business managers to reconcile their obligations to their shareholders with those of other competing groups claiming legitimacy. The categorization reflects the interest of all stakeholders in a firm. For CSR to be accepted by business managers, it should embrace the entire range of business responsibilities. Thus, Carroll (1991) suggested four (4) components of social responsibilities which includes, Economic Responsibility, Legal responsibility, ethical responsibility and Philanthropic responsibility.



The Pyramid of Corporate Social Responsibility: Carroll (1991).

The profit motive is the primary motive for a business establishment which also serves as an incentive to investors. Before anything else, firms are economic units in our society. Hence, its primary role is to satisfy consumers' needs and to ensure return on investment in the process also referred to as economic responsibility.

Firms are to comply with the laws and regulations promulgated by the society in which the businesses operate. As the part social contract between the firm and the society, the firm is expected to achieve is its economic mission within the framework of the law and regulations of the society. Legal responsibility is reflected in the way a firm's lawful operation in its effort to achieve or meet its economic responsibility.

Firm ethical responsibilities are those actions and practices that are expected or prohibited by a society which are not codified into law. Otherwise those cultural and social norms or expectations that reflect what the consumers, employees, shareholders, and the community regard as fair and just and to protect the stakeholders' moral rights.

Philanthropy responsibility is response or action to expectations of the society that firms should be good corporate citizens. This covers engaging programs that promote the welfare and goodwill of the society. This includes contributions to healthcare, education, roads and other forms of community development programmes.

8.4 Benefits and Implications of CSR

Many factors have led to increasing attention being devoted to the role of CSR. Ketocho (2015) suggested the following to be the benefits of Corporate Social Responsibility:

a) **Sustainable Development:** The United Nations (UN) studies underlined the fact that humankind is using natural resources at a faster rate than they are being replaced. If this continues, future generations will not have the resources they need for their development. In this sense, much of the current development is unsustainable; it cannot be continued for both practical and moral reasons. Related issues include the need for greater attention to poverty alleviation and respect for human rights need to be considered. CSR is an entry point for understanding sustainable development issues and responding to them in firms; business strategy (Freeman & Evan, 1990).

b) **Globalization:** With the attendant focus on cross-border trade, multinational enterprises and global supply chains, economic globalization is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety among other things (Bowen 2013). CSR can play a vital role in detecting how business impacts labour conditions, local communities and economies and in the steps that can be taken to ensure business helps to maintain and build the public good. This can be especially important for export-oriented firms in emerging economies.

c) **Governance:** Governments and intergovernmental bodies, such as the UN, the Organization for Economic Co-operation and Development (OECD) and the International Labour Organization (ILO) have developed various compacts, declarations, guidelines, principles and other instruments that outline norms for what they consider to be acceptable business conduct (Duncan 2008). CSR instruments often reflect internationally-agreed goals and laws regarding human rights, the environment and anti-corruption.

d) **Corporate Sector Impact:** The size and number of corporations, and their potential to impact political, social and environmental systems relative to governments and civil society, raise questions about influence and accountability (Evans 2011). Even small and medium-sized enterprises (SMEs), which collectively represent the largest single employer, have a significant impact. Companies are global ambassadors of change and values. How they behave is becoming a matter of increasing interest and importance.

e) **Communications:** Advances in communications technology, such as the Internet and mobile phones, are making it easier to track and discuss corporate activities. Internally, this can facilitate the management, reporting and change. Externally, NGOs, the media and others can quickly assess and profile business practices they view as either problematic or exemplary. In the CSR context, modern communications technology offers opportunities to improve dialogue and partnerships.

f) **Finance:** Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues. A sound CSR approach can help build share value, lower the cost of capital, and ensure better responsiveness to markets.

g) **Ethics:** A number of serious and high-profile breaches of corporate ethics resulting in damage to employees, shareholders, communities or the environment as well as share price have contributed to elevated public mistrust of corporations. A CSR approach can help improve corporate governance, transparency, accountability and ethical standards.

h) **Consistency and Community:** Citizens in many countries are making it clear that corporations should meet the same high standards of social and environmental care, no matter where they operate (Stigritz 2007). In the CSR context, firms can help build a sense of community and shared approach to common problems.

i) **Leadership:** There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that CSR address. CSR can offer the flexibility and incentive for firms to act in advance of regulations, or in areas where regulations seem unlikely (Duncan 2008).

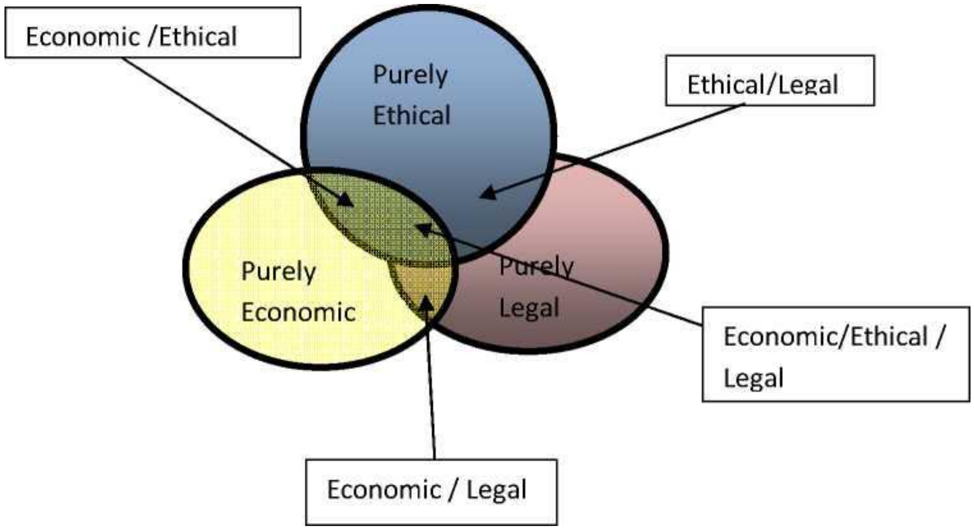
j) **Business Tool**: Businesses are recognizing that adopting an effective approach to CSR can reduce the risk of business disruptions, open up new opportunities, drive innovation, enhance brand and company reputation and even improve efficiency (Hohnen 2007).

k) **Improved Reputation of Management:** Organizations that perform well with regard to CSR can build their reputation, while those that perform poorly can damage brand and company value when exposed. Reputation, or brand equity, is founded on values such as trust, credibility, reliability, quality and consistency. Even for firms that do not have direct retail exposure through brands, their reputation for addressing CSR issues as a supply chain partner both good and bad can be crucial commercially.

l) **Improved Relationship with Regulators:** In a number of jurisdictions, governments have expedited approval processes for firms that have undertaken social and environmental activities beyond those required by regulation. In some countries, governments use (or are considering using) CSR indicators in deciding on procurement or export assistance contracts. This is being done because governments recognize that without an increase in business sector engagement, government sustainability goals cannot be attained (Hohnen 2007).

8.5 Three-domain model of corporate social responsibility

Later, Carroll and Schwartz developed a Venn diagram which clearly shows that there is an overlap among the CSR categories. The diagram below has an interesting difference from the CSR pyramid proposed earlier. In figure 3 the discretionary/philanthropy category is missing. Carroll and Schwartz (2003) argue that it is possibly quite incorrect to label these as 'responsibilities' because they are primarily guided by business requirements. This is different from the obligatory conformance with legal, economic and ethical dimensions of CSR (Godfrey, 2005).



The three-domain Model of Corporate Social Responsibility: Schwartz and Carroll (2003)

It is generally argued that business entities are established for economic purposes. That is to bring the highest level of return on investment. This argument was further extended by (Lantos, 2001) who believed that philanthropy is not a legitimate concern of the business. This was supported by Peter Drucker (1989) who shares a similar sentiment when he says that an organization acts irresponsibly if it goes beyond what is necessary to do its job. Friedman (1970), corporate spending on social and philanthropic activities is not only illegal but can be construed as theft of shareholders' funds.

8.6 Approaches to corporate social responsiveness

Three main approaches of corporate social responsiveness corresponding with three different periods of time (the late 1970s, early 1990s and 2000s) are presented in order to emphasize the evolution and evaluation of business response to social responsibility and social issues.

The first approach was introduced in the 1970s which emphasized how business can put corporate social responsibility into practice. There are four possible business responses to social pressure, categorized by Carroll (1979) as the philosophy of corporate social responsiveness.

a. Reaction (Fight all the way): This type of business response mainly reflects pragmatic, economic priorities, meanwhile the social responsibilities are completely ignored. A company that adheres to this strategy usually denies social complaints against its illegal or immoral actions.

b. Defence (Do only what is required): The business organization that adopts this response strategy only complies with the minimum legal requirements in order to protect the company and satisfies the social expectations. When it is criticized for the damages incurred at the societal level, a business organization in this stage generally tries to demonstrate its innocence and annihilate the charges against it.

c. Accommodation (Be progressive): This type of response is found in business organizations that accept their social responsibilities and try to comply with economic, legal and ethical requirements. At this level, the organizational behaviour is in line with social norms, values and relevant perspectives, but the external pressures are generally the main driver behind these responsible actions.

d. Proactive (Lead the industry): The most comprehensive type of business response to social pressures, it complies with all social performance criteria, including the discretionary one. A proactive company is the one that always leads the social initiatives, prevents the social negative impact of its activities, and anticipates social problems and solutions.

The second approach was in the 1990s. The emphasis of the second approach was on corporate moral development. Reidenbach and Robin 1991 in Iamandi

(2007) identified five stages of corporate moral development associated with five types of business responses to social pressures to include:

i. *Amoral organization:* Making a profit at all cost, it is driven by greed and short-term orientation; its approach to ethics is it's ethical as long as we will not get caught and ethical violations, when caught, are considered to be a cost of doing business. A company in this stage of moral development has no meaningful code of ethics or other documentation.

ii. *Legalistic organization:* they are law-abiding and are driven by concern for economic performance and it uses damage control through public relations when social problems occur. An organization in a legalistic stage has a reactive approach to ethics that could be synthesized in if it's legal, it's OK and it avoids writing codes of ethics, as this can create legal problems later on; however, if a code of ethics exists, this is an internal document.

iii. *Responsive organization:* such entity is characterized by a growing concern for balance between profits and ethics, taking also into account corporate stakeholders other than owners. In this stage of corporate moral development, the management of a company understands the value of not acting solely on a legal basis, although its approach to ethics is a pretty cynical one, based on the profits that ethics may incur. Codes of ethics are more externally oriented and reflect a concern for other publics.

iv. *Emerging ethical organization:* demonstrates an active concern for ethical outcomes, providing support and measures of ethical behaviour, although it lacks organization and long-term planning. In this stage, shared ethical values provide corporate guidance in some situations and corporate culture is less reactive and more proactive to social problems when they occur. Codes of ethics become action documents.

v. *Ethical organization:* thoroughly integrates questions of ethical behaviour with developing strategy and mission, thereby addressing the fundamental issue of organizational integrity. This type of company has a totally ethical profile, with carefully selected core values, meanwhile, the corporate culture is planned and managed to be ethical. The corporate codes focus on the ethical profile and core values.

The third approach is focused on value systems. This view emphasizes the existence of multiple forms or levels of corporate social responsibility, each linked to specific societal circumstances and related value systems, which match the development stages, awareness and ambition levels of different types of organizations. There are six aspects identified by which each organization should choose based on its own specific ambition and approach regarding corporate responsiveness.

i. *Pre-CSR – Red (Energy and power):* At this level, there is basically no ambition for CSR; however, steps labelled as CSR might be initiated when there is a pressure from the outside. The internal driver behind the manifestation of such a CSR form is the awareness that it could increase personal power; at the same time, the criteria for the decision making is based specifically on the impact of the decision on personal power. As an external driver for CSR, an outside force is needed. In this stage, the main role of the government is to implement traditional public tasks. The organization society relationship is based on distrust the organization might act in a very unsocial and unsustainable way when not properly controlled. Close monitoring and constant reinforcement will be required.

ii. *Compliance-driven CSR – Blue (Order):* CSR at the second level consists of providing welfare to society, within the limits of regulations from the rightful authorities. In addition, organizations might respond to charity and stewardship considerations. The internal motivation for CSR is that it is perceived as a moral duty and obligation, or correct behaviour. In this development, stage decisions should be taken by the correct authority, according to the proper procedures and in line with the basic purpose of the business activity. Instructions from higher authorities represent external drivers behind CSR and the government should enforce effective and visible legislation, with a clear division of tasks and responsibilities. Organization, stakeholders and society are independent of each other and apart from legal compliance, the organization has no other obligation because social welfare is the responsibility of the state.

iii. *Profit-driven CSR – Orange (Success):* At this third level, CSR consists of the integration of social, ethical and ecological aspects into business operations and decision-making, provided it contributes to personal success and financial bottom line. The clear and only motivation for CSR is the awareness of the business case: CSR is promoted if profitable, for example, because of an improved reputation in various markets. The financial criterion (highest expected profit, return on investment or shareholder value) is the most important when taking a decision. As external drivers for CSR, a proof that it improves profitability or pressure from various markets is necessary. The government should create and maintain a level playing field, offering financial stimuli for companies to engage in CSR. Considering the relationship organization-stakeholders-society, shareholders normally come first; taking account of the interests of other stakeholders is often expensive and preferably avoided.

iv. *Caring CSR – Green (Community):* CSR consists of balancing economic, social and ecological concerns, which are all important in themselves. CSR initiatives go beyond legal compliance and beyond profit considerations. The internal motivation for CSR is that human potential, social responsibility and care for the planet are as such important. For taking a decision, a consensus is needed or at least the consent of all relevant stakeholders, meanwhile, the decision criteria are People, Planet, and maybe Profit. The requests from employees and other stakeholders for social and environmental care usually represent external drivers for CSR in this stage. The preferred role for the government is to support international governance structures and national policies on poverty, environments, equity, ethical codes, as well as to stimulate the formation of participative CSR discussion groups. The relationship organization-stakeholders-society is characterized by a continuous dialogue.

v. *Synergistic CSR – Yellow (Synergy):* This manifestation of CSR consists of a search for well-balanced, functional solutions creating value in the economic, social and ecological realms of corporate performance, in a synergistic, win-together approach with all relevant stakeholders. The motivation for CSR is that sustainability is important in itself, especially because it is recognized as being the inevitable direction progress takes. When making a decision at this stage, this will be a balanced and functional long-term one, taking into account all available expertise and considerations. Information from any source regarding the consequences of organizational actions – unexpected negative externalities or unused improvement opportunities – are the external drivers behind CSR. The government is thought to have a coordination role: it has to stimulate a network of experts in order to further develop and implement expertise regarding CSR in the most effective way, to coordinate overlapping responsibilities, to consolidate the triple–bottom line in different projects and to promote rules supporting socially responsible investments and transparency. As a guiding relationship between organization, stakeholders and society, taking interests of all relevant stakeholders into account is integrated into the core business.

vi. *Holistic CSR – Turquoise (Holistic life system):* In the last stage, CSR is fully integrated and embedded in every aspect of the organization, aimed at contributing to the quality and continuation of the life of every being as an entity, now and in the future. The internal motivation for CSR here is that sustainability is the only alternative since all beings and phenomena are mutually interdependent. This is why each person or organization has a universal responsibility towards all other beings. At this last level, decisions are taken in line with and in favour of holistic interests for the survival of life on the planet. Concentration in performing societal issues is the preferred role for the government.

8.7 Corporate responsibility and stakeholders

The uncertainty surrounding the nature of CSR activity makes it is difficult to define CSR and to be certain about any such activity. It is therefore imperative to be able to identify such activity and we take the view that there are three basic principles which together comprise all CSR activity. These are:

- Sustainability
- Accountability
- Transparency

Sustainability will be considered in detail in terms of action in future while accountability and transparency will be considered in terms of responsibility to give efforts to action.

Sustainability

This is concerned with the effect of action taken in the present upon the options available in the future. If resources are utilized in the present are no longer available for use in the future, and this is of particular concern if the resources are not renewable. Sustainability therefore implies that society must use no more of a resource than can be regenerated

Viewing an organization as part of a wider social and economic system implies that these effects must be taken into account, not just for the measurement of costs and value created in the present but also for the future of business itself.

Accountability

This is concerned with an organization recognizing that it actions affect the external environment, and therefore assuming responsibility for the effects of its actions. This concept therefore implies a qualification of the effects of actions taken, both internal to organization and externally. More specifically the concept implies a reporting of those qualifications to all parties affected by those actions. This implies a reporting to external stakeholders of the effects of actions taken by the organization and how they are affecting those stakeholders.

Transparency

Transparency, as a principle, means that the external impact of the actions of the organization can be ascertained from that organisation's reporting and pertinent facts are not disguised within that reporting. Thus, all the effects of actions of organizations, including external impacts, should be apparent to all from using the information provided by the organization's reporting mechanisms.

8.8 Internal and external stakeholders

There exist various groups of individuals that play important roles as well as have an impact on corporate governance. These groups of individuals are referred to as internal and external stakeholders to the organization. The internal groups of individuals include:

a. Employees: These are individuals that make up the workforce of an organization. They are the manpower resources that an organization engages in its effort to achieve its goals and objectives.

b. Shareholders: These are the owners of the firm whose primary concern is that their investment in the firm yields maximum returns.

c. Board of directors: These are representatives appointed by the shareholders to pilot the affairs of the organization

d. Management: These are those tasked with the responsibility of running the day-to-day affairs of the organization.

The external groups of individuals include:

1. Supplier: This refers to those who make available various inputs required by the organization to ensure its smooth running.
2. Host community: This refers to the people and area where the corporation is situated i.e. the geographical location of the organization.

3. Government regulatory authorities: These are group of individuals with delegated authority from government to formulate laws and codes and also to monitor and control activities of business organizations.
4. Creditors: They make available finance which the organization utilizes for growth and expansion.
5. Customers: These are the categories of persons who represent the reason for the existence of the business. They are those whose needs the business seeks to profitably meet.
6. Potential Investors: These are individuals or group of individuals having capacity to invest resources in an organization. These resources could be financial, technical, manpower etc.

Differences Between Internal and External Stakeholders

The following are the major differences between internal and external stakeholders:

1. The individual or group that works for the organisation and they actively participate in the management of the company are known as Internal Stakeholders. External Stakeholders, on the other hand, are the individual or group that is not employed by the organisation but they get affected by its activities.
2. Internal Stakeholders serves the organisation, but External Stakeholders deals with the company externally.
3. Internal Stakeholders are directly influenced by the company's activities because they are the part of the organisation which is just opposite in the case of External Stakeholders.
4. Internal Stakeholders are employed by the company, but external stakeholders are not.

5. Internal matters of the company are known to internal stakeholders. However, external stakeholders are not known about such matters.
6. Internal Stakeholders are the primary stakeholders whereas External stakeholders are the secondary stakeholders.

8.9 Responsibility to and interest of various stakeholder group

Responsibility to Employees: An organization's first responsibility is to provide a job to employees. Keeping people employed and letting them have time to enjoy the fruits of their labor is the finest thing business can do for society. Beyond this fundamental responsibility, employers must provide a clean, safe working environment that is free from all forms of discrimination. Companies should also strive to provide job security whenever possible.

Responsibility to Customers: To be successful in today's business environment, a company must satisfy its customers. A firm must deliver what it promises, as well as be honest and forthright in everyday interactions with customers, suppliers, and others. Recent research suggests that many consumers, particularly millennials, prefer to do business with companies and brands that communicate socially responsible messages, utilize sustainable manufacturing processes, and practice ethical business standards.

Responsibility to Society: A business must also be responsible to society. A business provides a community with jobs, goods, and services. It also pays taxes that go to support schools, hospitals, and better roads. Some companies have taken an additional step to demonstrate their commitment to stakeholders and society as a whole by becoming Certified Benefit Corporations.

Environmental Protection: Business is also responsible for protecting and improving the world's fragile environment. The world's forests are being destroyed fast. Every second, an area the size of a football field is laid bare. Plant and animal species are becoming extinct at the rate of 17 per hour. A continent-size hole is opening up in the earth's protective ozone shield. Each year we throw out 80 percent more refuse than we did in 1960; as a result, more than half of the nation's landfills are filled to capacity. To slow the erosion of the world's natural resources, many companies have become more environmentally responsible.

Corporate Philanthropy: Companies also display their social responsibility through corporate philanthropy. Corporate philanthropy includes cash contributions, donations of equipment and products, and support for the volunteer efforts of company employees.

Responsibilities to Investors: Companies' relationships with investors also entail social responsibility. Although a company's economic responsibility to make a profit might seem to be its main obligation to its shareholders, some investors increasingly are putting more emphasis on other aspects of social responsibility.

Some investors are limiting their investments to securities (e.g., stocks and bonds) that coincide with their beliefs about ethical and social responsibility. This is called social investing. For example, a social investment fund might eliminate from consideration the securities of all companies that make tobacco products or liquor, manufacture weapons, or have a history of being environmentally irresponsible. Not all social investment strategies are alike. Some ethical mutual funds will not invest in government securities because they help to fund the military; others freely buy government securities, with managers noting that federal funds also support the arts

MODULE 9

9.0 THE NATURE OF SUSTAINABILITY

9.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. The nature and Pillars of Sustainability
ii. Evolution of Sustainability Development
iii. The Benefits of Corporate Sustainability and Governance
iv. Governance aspect of Corporate sustainability
v. Sustainability Implementation Strategy

9.2 Introduction

In today's business world there is a growing number of companies that voluntarily adopt and implement a broad range of sustainability practices as a response to emerging challenges and stakeholder expectations across the environmental, social and governance (ESG) domains. In doing so, they try to integrate sustainability into their strategy, business models, and organizational processes and structures (Eccles, Ioannou and Serafeim, 2014).

According to the Chartered Institute of Personnel and Development (CIPD, 2012), the essence of sustainability in an organizational context is "the principle of enhancing the societal, environmental and economic systems within which a business operates". This introduces the concept of a three-way focus for organizations striving for sustainability. This is reflected also by Colbert and

Kurucz (2007), who state that sustainability "implies a simultaneous focus on economic, social, and environmental performance".

Eccles et al (2011) note that organizations are developing sustainability policies, but they highlight that these policies are aimed at developing an underlying "culture of sustainability", through policies highlighting the importance of the environmental and social as well as financial performance. These policies seek to develop a culture of sustainability by articulating the values and beliefs that underpin the organization‟s objectives.

The Chartered Institute of Personnel and Development (CIPD, 2012), also emphasizes the importance of organizational culture in seeking to understand organizational sustainability, referring to "the creation of meaningful values that shape strategic decision-making and building a culture that reinforces desirable behaviour".

9.3 What is Sustainability?

Sustainable growth encompasses a business model that creates value consistent with the long-term preservation and enhancement of financial, environmental and social capital.

Organizational sustainability can be defines as "the ability to meet the needs of present customers while taking into account the needs of future generations" (Ford, 2012).

The United Nation's 1987 World Commission on Environmental and Development: Our Common Future, defines Sustainable as "development which meets the needs of the present without compromising the ability of future generations to meet their needs".

The concept continues to expand in scope. In 2000, the Earth Charter broadened the definition of sustainability to include the idea of a global society “founded on respect for nature, universal human rights, economic justice, and a culture of peace.”

By the definition Corporate sustainability suggested that a company’s responsibility does not simply only involve maximizing profits for shareholders but also carrying out its activities ethically in its dealings with all stakeholders and in relation to the eco-systems in which it operates.

Corporate sustainability is the ability of companies, through its governance practices and market presence, to positively influence ecosystems (improving natural resources, reducing pollution levels, etc), society (supporting local populations, creating employment etc.) and economic development (distributing wealth through dividends, paying fair salaries, respecting supplier payment obligations etc.). Companies with sustainability practices will be more likely to operate in harmony with the societies in which they operate, maintain their market presence and help maintain and increase profitability levels.

Managers must accept that businesses are a societal construction and that managers have an obligation to create benefits for members of their society (Carroll, 1984). Corporations that are managed selfishly to benefit a limited number of individuals may become illegitimate institutions in the emerging 21st Century environment. Corporations exist only because society has given them the right to do so. That right could be revoked. Some managers (and academics and students), who have their visions fixed on short-term financial profitability, do not appreciate that corporations’ rights to exist are determined by society (Galbraeth, 2006). Corporations must be responsive to society’s expectations over the long-term if they are to survive in their present form: The corporation cannot – and should not survive if it does not take responsibility for the welfare of all of its constituents, and for the well-being of the larger society within which it operates. The contractual agreements and government regulations it must follow are not always enough (Post, Lee and Sybille, 2002).

There are therefore four aspects of sustainability which need to be recognised and analysed, namely. These four must be considered as the key dimensions of sustainability, all of which are equally important. They include:

a. ***societal influence,*** which we define as a measure of the impact that society makes upon the corporation in terms of the social contract and stakeholder influence;
b. ***environmental impact,*** which we define as the effect of the actions of the corporation upon its geophysical environment;
c. ***organizational culture,*** which we define as the relationship between the corporation and its internal stakeholders, particularly employees, and all aspects of that relationship; and
d. ***finance,*** which we define in terms of an adequate return for the level of risk undertaken.

9.4 The Pillars of Sustainability

In 2005, the World Summit on Social Development identified three core areas that contribute to the philosophy and social science of sustainable development.

Economic Development

Economic development is about giving people what they want without compromising quality of life, especially in the developing world, and reducing the financial burden and "red tape" of doing the right thing.

It is also about providing incentives for businesses and other organisations to adhere to sustainability guidelines beyond their normal legislative requirements. Also, to encourage and foster incentives for the average person to do their bit where and when they can; one person can rarely achieve much, but taken as a group, effects in some areas are cumulative. The supply and demand market is consumerist in nature and modern life requires a lot of resources every single day, for the sake of the environment, getting what we consume under control is the paramount issue.

Social Development

There are many facets to this pillar. Most importantly is awareness of and legislation protection of the health of people from pollution and other harmful activities of business and other organisations. It is also about maintaining access to basic resources without compromising the quality of life.

The biggest hot topic for many people right now is sustainable housing and how we can better build the homes we live in from sustainable material. The final element is education - encouraging people to participate in environmental sustainability and teaching them about the effects of environmental protection as well as warning of the dangers if we cannot achieve our goals.

Environmental Protection

The primary concern is on the future of humanity. It defines how we should study and protect ecosystems, air quality, integrity and sustainability of our resources and focusing on the elements that place stress on the environment. Businesses are regulated to prevent pollution and to keep their own carbon emissions low.

It also concerns how technology will drive our greener future; the EPA recognized that developing technology and biotechnology is key to this sustainability, and protecting the environment of the future from potential damage that technological advances could potentially bring.

9.5 Evolution of Sustainability Development

The evolution of the concept of sustainable development can be divided into three periods. The first period is the so-called "Pre-Stockholm" (1972) period, when religious beliefs and traditions in general played an important role. For example, in Judeo-Christian scripture, there is an allusion to the right of man to dominate the earth. Additionally, among the American indigenous people, there was a holistic view that emphasized the need to live in harmony with nature. The second period (1972-1987) commenced following the Stockholm Conference that was sponsored by the United Nations (UN) in 1972 and lasted until the World Commission on Environment and Development (WCED) in 1987, which marked the most important step in the configuration of the concept of sustainable development (Mebratu, 1998). The third period may be called the "Post-WCED" (1987) period and includes the UN Conference on Environment and Development in Rio de Janeiro, Brazil, in 1992, where the issue of ecological change was added to the agenda of world leaders (Dauvergne, 2012).

The Rio conference held in Brazil in 1992 was regarded at the time as the greatest implementation of sustainable development at the global level. According to Pierri, (2005) the implementation occurred through a series of international compromises that clearly identified time frames and material resources and was embodied in five documents:

1. the Rio Declaration on the Environment;
2. Agenda 21;
3. the United Nations Framework Convention on Climate Change;
4. the Convention on Biological Diversity; and
5. the Declaration of Principles on the Management, Conservation and Sustainable Development of All Types of Forests

9.6 The Primary Goals of Sustainability

It is agreed by many that sustainability is the way to ensure improved humanity while protecting the ecosystem. In 2015, the United Nations achieved international agreement for its 2030 Agenda on Sustainable Development, which outlines 17 Goals which are summarized into five key themes:

1. People – to ensure that all human beings can fulfil their potential in dignity and equality and in a healthy environment
2. Planet – to protect the planet through sustainable consumption and production, sustainably managing its natural resources and taking urgent action on climate change, so that it can support the needs of the present and future generations

3. Prosperity – to ensure that all human beings can enjoy prosperous and fulfilling lives and that economic, social and technological progress occurs in harmony with nature
4. Peace – to foster peaceful, just and inclusive societies which are free from fear and violence (There can be no sustainable development without peace and no peace without sustainable development)
5. Partnership – to mobilize the means required to implement this Agenda through the participation of all countries, all stakeholders and all people

9.7 The Benefits of Corporate Sustainability and Governance

The concept of corporate sustainability therefore provides the following benefits:

a. Efficient management of the social, environmental and economic factors that affect the company, its business activities, products and services, and their impact throughout the entire value chain;
b. The management of stakeholder expectations, balancing and managing the social, environmental and economic risks that have the potential to adversely affect relationships with stakeholders of the company;
c. Adoption of practices and behaviour, which are compatible with the values of society.
d. The ability to offer products and services that attach environmental, social and financial value to their levels of quality, perceived as such by customers and providing a clear license to operate (from all relevant stakeholders).

9.8 How to achieve corporate sustainability

Corporations, aiming at accountability to the societal actors in terms of their sustainability efforts, shall follow these principles:

a. assume societal leadership for responsibility;
b. identify clearly and specifically their social, environmental and economic values in accordance with the demands of their stakeholders;
c. Define their social, environmental and economic priority areas for action;
d. Adopt specific management practices to integrate these values into their operations and take measurable action;
e. Disclose comprehensive data on their social, environmental and economic impacts;
f. Involve in comprehensive review of their activities;
g. Strive for continuous learning.

9.9 Governance aspect of Corporate sustainability

Paying adequate attention to sustainability issues including environment, social, occupational and community health and safety will project the Company as a responsible corporate citizen contributing to economic development.

The Board should establish policies and practices regarding its social, ethical, safety, working conditions, health and environmental responsibilities as well as address corruption. The policies should include the following:

- the Company's business principles, practices and efforts towards achieving sustainability;
- the management of safety issues including workplace accidents, fatalities, occupational and safety incidents;

- plans and strategy for addressing and managing the impact of serious diseases on the Company's employees and their families;
- the most environmentally beneficial options particularly for companies operating in disadvantaged regions or in regions with delicate ecology, in order to minimize environmental impact of the Company's operations;
- the nature and extent of employment equity and diversity (gender and other issues);
- training initiatives, employee development and the associated financial investment;
- opportunities created for physically-challenged persons or disadvantaged individuals;
- the environmental social and governance principles and practices of the Company; and
- corruption and related issues

The Board should monitor the implementation of sustainability policies and report on the extent of compliance with the policies.

9.10 Sustainability Implementation Strategy

Just like with overall strategy there is no one right solution on sustainability. The best solution depends on the ambitions and stakes at each company. Here are a few useful actions for all management teams to improve sustainability practices.

Align strategy and sustainability: Management needs to make sure that the strategy of the company and the sustainability efforts are aligned. Often, we see divergence, which of course makes the sustainability efforts fragile, lacking real commitment and prioritization.

Compliance first, then competitive advantage: First and foremost, companies need to address compliance, which often relates to regulations in waste management, pollution and energy efficiency as well as human rights and labour responsibility.

Change form reactive to proactive: Many of today's leading companies in sustainability, like Nike, Coca-Cola, Telenor, IKEA, Siemens and Nestlé have stepped up largely as a consequence of a crisis. For example, Nike faced boycotts and public anger for abusive labour practices in places like Indonesia throughout the 90s, but turned the tide around. In 2005, it became a pioneer in establishing transparency by publishing a complete list of the factories it contracts with and a detailed 108-pages report revealing conditions and pay in its factories. It also acknowledged widespread issues, particularly in its south Asian factories. By recognizing the impact of sustainability in a crisis these companies have all developed more proactive sustainability strategies.

Quantify, including the business case: All companies struggle with quantifying the return on their sustainability investments. With regards to compliance this is a straight forward issue. With regards to areas of competitive advantage, however, companies need to link sustainability to a business case. But the ones that actually do form a relatively small group.

Transparency is a pre-condition for assessing and improving sustainability practices. You cannot judge without transparency. Transparency builds on the idea that an open environment in the company as well as with the community will improve performance. The only way for companies to accomplish transparency is through open communications with all key stakeholders built on high levels of information disclosure, clarity, and accuracy – as well as an openness to recognizing faults and improving practices.

Engage the Board: Boards are often critical in collaborations with key stakeholders such as NGOs, governments and international Organizations. Thus, engaging the board in sustainability activities ensures the achievement of high compliance.

Engage your ecosystem: We see that collaboration is critical for efficient sustainability practices, in particular in solving crises and in shaping broader solutions. Most management see sustainability as an area where collaboration is necessary to succeed.

Engage the organization broadly: One example of engagement is philanthropy program contributes to each employees' personal ability to engage with environmental organizations and initiatives that support local communities. Sustainability should be considered during every decision made at Nespresso.

MODULE 10

10.0 THE APPLICATION OF GOVERNANCE RULES AND PRINCIPLES

10.1 Learning outcome

On successful completion of this module, students/readers should be able to understand and explain the following:

i. The Board Role of the board and its governance responsibilities
ii. Unitary and two-tier boards
iii. Roles of the chairman and chief executive officer
iv. Board balance, independence, Independence non-executive directors
v. Functions of the independent non-executive directors

10.2 Introduction

Candidates will be required to discuss in detail statutory rules and the principles or provisions of governance codes (as issued by the financial reporting council of Nigeria), and apply them to specific situations or case studies. Candidates will also be expected to understand the role of the company secretary in providing support and advice regarding the application of best governance practice. Although the syllabus presents governance issues mainly from the perspective of companies, candidates may be required to apply similar principles to non-corporate entities. Such as government organisations and organisations in the voluntary sector.

10.3 The board of directors or governing board

The board of directors or the governing board as they are sometimes called are usually elected by shareholders during the annual general meeting (AGM) to govern the company's operation and protect the interest of the shareholders. The board is given the ultimate decision-making power and in general, is authorized by the shareholders to; set the company's policies, objectives and overall direction, hire, evaluate, monitor and fire the managing director and senior executive officers of the company; hire, remunerate and terminate the appointment of an auditor among other responsibilities.

10.4 Role of the board and its governance responsibilities

The board and its governance responsibilities are as follows:

i. exercising leadership, enterprise, integrity and judgment in its oversight and control of the Company so as to achieve the Company's continued survival and prosperity;
ii. ensuring that the Board and its committees act in the best interest of the Company at all times;
iii. ensuring compliance with the laws of the Federal Republic of Nigeria and other applicable regulations;
iv. considering and approving the long-term and short-term strategies for the business of the Company and monitoring their implementation by management;
v. ensuring the establishment and implementation of a succession plan, appointment process, training mechanism and remuneration structure for both the Board and senior management of the Company;
vi. being accountable to the Company as well as identifying and managing the relationship with shareholders and other stakeholders;

vii. establishing and maintaining the Company's values and standards (including an ethical culture) as well as modelling these values and standards;
viii. overseeing the internal audit function, approving the internal audit plan, and appointing and removing the head of the internal audit function on the recommendation of the committee responsible for audit;
ix. establishing the Company’s risk management framework and monitoring its effectiveness, setting the Company’s risk appetite, receiving and reviewing risk reports;
x. providing oversight over Information Technology governance;
xi. defining a formal schedule of matters specifically reserved for Board decision and matters delegated to Board committees and management;
xii. overseeing the effectiveness and adequacy of the internal control system;
xiii. overseeing the Company’s communication and information dissemination policy;
xiv. performing the appraisal of Board members and executive management;
xv. ensuring the integrity of annual reports and accounts and all material information provided to regulators and other stakeholders; and
xvi. ensuring that management systems are in place to identify and manage environmental and social risks and their impact.

10.5 Unitary and two-tier boards

Unitary board of directors

unitary board of directors also called the One-tier board of directors is a single body of directors that makes strategic decisions of a company. It includes both executive directors and non-executive directors.

Two-tier board of directors

Two-tier board of directors is a system in which a company is governed by two different boards of directors, that is a management board and a supervisory board. Management board is accountable to supervisory board and makes decisions related to operational and tactical direction of the company. The supervisory board makes decisions about long-term strategic direction of the business.

Difference between unitary and two-tier board of doctors:

The difference between one-tier and two-tier board of doctors are as follows:

1. **Composition:** The unitary board of directors is composed of executive directors and non-executive directors (independent external directors). Both these directors sit on a single board. In a two-tier system, the supervisory board is directly elected by the shareholders and includes senior board members and/or employee representatives. The supervisory is responsible for the hiring and firing of the management board.

2. **Segregation of roles:** In a one-tier or unitary board of management there is no clear separation of duties as both the executive and non-executive directors sit on the same board. While in a two-tier board, two different boards are present, with one clearly responsible for undertaking management roles and the other for the purposes of check and balance and policy making.

3. **Decision-making:** The process of decision-making in a unitary board is faster because all the decisions are made and approved by a single board. Whereas, decisions made by the management board in a two-tier system have to be approved by the supervisory board for implementation which, therefore, can take

time. This delay can prolong if the management and supervisory board disagree on a certain agenda.

4. **Stakeholder Indulgence:** The composition of unitary board of directors does not allow for different kinds of stakeholder representation. This is because a single board cannot accommodate a large number of directors and therefore non-executive directors are the only independent input in a unitary board. However, in a two-tier system, as the management board and supervisory boards are different, it provides a chance to add representatives of more stakeholders especially representatives of employees.

5. **Role of chairman and CEO:** In a one-tier board, the Chairman of board and the CEO sit on a single board. While in a two-tier board system, the supervisory board is led by the Chairman of the company and the management board is led by the CEO of the company.

6. Communication and supervision: In a unitary board, the executives and non-executives sit on a single board. Therefore, all the decisions have an ongoing input of both of these directors. In this way, the non-executive directors who are primarily responsible for the supervision of executive directors can actively seek their duty. In a two-tier system as the two boards meet separately, the supervisory board cannot actively hold management board accountable and only gets the information which management board disseminates to them.

10.6 Matters reserved for the board

A successful Company is headed by an effective Board which is responsible for providing entrepreneurial and strategic leadership as well as promoting ethical culture and responsible corporate citizenship. As a link between stakeholders and the Company, the Board is to exercise oversight and control to ensure that management acts in the best interest of the shareholders and other stakeholders while sustaining the prosperity of the Company.

10.7 Roles of the chairman and chief executive officer

The positions of the Chairman of the Board and the Managing Director/Chief Executive Officer (MD/CEO) of the Company should be separate such that no person can combine the two positions. The Chairman of the Board should not serve as chairman or member of any Board committee. The MD/CEO or an Executive Director should not serve as chairman of any Board committee. A person (or group of persons) who is not a serving Director of the Company should not exercise any influence or dominance over the Board and/or Management. Such a person or group of persons would be deemed a shadow director as defined by extant laws.

The Chairman's primary responsibility is to ensure the effective operation of the Board such that the Board works as a group towards achieving the Company's strategic objectives. He should also provide guidance to the MD/CEO and be available to him for regular communication.

The functions and responsibilities of the Chairman

The Chairman's functions should include the following:

i. presiding over meetings of the Board of Directors and general meetings of shareholders;
ii. agreeing an annual Board plan with the Board;
iii. ensuring that the agenda for Board meetings is set;

iv. ensuring that the Board and its committees are composed of individuals with relevant skills, competencies and desired experience;
v. ensuring that Board meetings are properly conducted;
vi. ensuring that the Board is effective and functions in a cohesive manner;
vii. ensuring that induction programmes are conducted for new Directors and a continuing education programme is in place for all Directors;
viii. ensuring effective communication and relations with the Company's shareholders and other stakeholders; and
ix. taking a lead role in the assessment, improvement and development of the Board.

The functions and responsibilities of the MD/CEO

The functions and responsibilities of the MD/CEO should include:

i. day-to-day management of the Company;
ii. proper implementation and achievement of the Company's strategic imperatives to ensure the sustainable development and growth of the Company;
iii. ensuring prudent management of the Company's finances and other resources;
iv. providing the Board with complete, accurate and timely information and documentation to enable it make sound decisions;
v. promoting and protecting the interests of the Company; and
vi. being the Company's leading representative in its dealings with its stakeholders.

10.8 Size, structure and composition of the board; board balance, independence, Independence non-executive directors

Structure, composition and Size of the board

Board Structure and Composition Principle: The effective discharge of the responsibilities of the Board and its committees is assured by an appropriate balance of skills and diversity (including experience and gender) without compromising competence, independence and integrity.

Board Size: The Board should consider the following factors in determining the requisite number of its members: (a) appropriate mix of knowledge, skills and experience, including the business, commercial and industry experience needed to govern the Company; (b) appropriate mix of Executive, Non-Executive and Independent Non-Executive members such that majority of the Board are Non-Executive Directors. It is desirable that most of the Non-Executive Directors are independent; (c) need for a sufficient number of members that qualify to serve on the committees of the Board; (d) need to secure quorum at meetings; and (e) diversity targets relating to the composition of the Board.

The Board should promote diversity in its membership across a variety of attributes relevant for promoting better decision-making and effective governance. These attributes include field of knowledge, skills and experience as well as age, culture and gender. The Board should have a policy to govern this process and establish measurable objectives for achieving diversity in gender and other areas.

10.9 Functions of the independent non-executive directors

Independent Non-Executive Directors bring a high degree of objectivity to the Board for sustaining stakeholder trust and confidence. An Independent Non-Executive Director (INED) should represent a strong independent voice on the Board, be independent in character and judgment and accordingly be free from such relationships or circumstances with the Company, its management, or substantial shareholders as may, or appear to, impair his ability to make independent judgment.

The relevance of the regulatory role of top management has simultaneously implied greater relevance for the role of Non-Executive Independent Board Directors, since the responsibility for the supervision of executive managers of companies falls mainly to them. By definition, the role of non-executive directors is the supervision of executive directors, in the name of and representing all shareholders of the company, to ensure that executives are acting in the best interests of the company and its stakeholders. With the increase in issues relating to supervision, the relevance of these directors is increasing, especially that of Non-Executive and Independent Directors, who are entirely free from commitments to executive management, shareholders and any stakeholder which is dependent on the company or on which the company is dependent. These are the Directors who ensure that Executive Directors are challenged, monitored and appropriately evaluated, according to the performance of the company.

REFERENCES

CIPD (2012). Responsible and Sustainable Business: HR leading the way – A collection of "thought pieces". London: CIPD.

Colbert, B. and Kurucz, E. (2007). Three conceptions of triple bottom line business sustainability and the role for HRM, Human Resource Planning 30.

Eccles, R.G., Ioannou, I. and Serafeim, G., (2014). The impact of corporate sustainability on organizational processes and performance. Management Science, 60(11), pp.2835-2857.

FRC. (2011). *APB ETHICAL STANDARD 1 (REVISED) INTEGRITY, OBJECTIVITY AND INDEPENDENCE.* Financial Reporting Council.

Galbraeth, J. 2006. Corporate social responsibility strategy: strategic options, global considerations, Corporate Governance, Vol. 6 (2), pp.175-87.

Post, E.J., Lee E.P. & Sybille, S. (2002). Redefining the corporation. Stanford University Press.

World Commission on Environment and Development (WCED). Our Common Future; Oxford University Press: New York, NY, USA, 1987. [**Google Scholar**]