SUGGESTED SOLUTION

CS PROFESSIONAL

Subject – Corporate Governance, Risk Management, Internal Control, Reporting and Compliances

Topic –Part-C & D Internal Control, Reporting And Ethics
Chapter 13 To 17

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.
Tel : (022) 26836666

Answer to Q1.A.

Corporate sustainability indicates new philosophy, as an alternative to the traditional growth and profit maximization model, under which sustainable development comprising of environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous growth of the corporate and profitability.

It is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.

Corporate sustainability encompasses strategies and practices that aim to meet the needs of the stakeholders today while seeking to protect, support and enhance the human and natural resources that will be the need of the future. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.

Concern towards social, environmental and economical issues, i.e., covering all the segments of the stakeholders, are now basic and fundamental issues which permit a corporate to operate in the long run sustainably.

<u>Following key drivers need to be garnered to ensure sustainability:</u>

Internal Capacity Building strength – In order to convert various risks into competitive advantages.

Social impact assessment – In order to become sensitive to various social factors, like changes in culture and living habits.

Repositioning capability through development and innovation: Crystallisation of all activities to ensure consistent growth.

Corporate sustainability is a business approach creating shareholder value in the long run.

These may be derived by converting risks arising out of economic, environmental and social activities of a corporate into business opportunities keeping in mind the principles of a sustainable development.

(5 marks)

Answer to Q1.B.

In a business entity the internal control should be adequate to cover all the key and sensitive areas of the organization. No one person should be allowed to complete one set of transactions. The control mechanism once established should be reviewed periodically in order to assess the lacunas and to remove the same. The password sharing should be strictly prohibited and stringent action should be taken against the erring staff. The efficacy of the internal control mechanism depends when the employees accepts this philosophy in the true letter and spirit.

<u>A good and efficient Internal control system can assist in the following ways:</u>

1. help an entity achieve its performance and profitability targets, and prevent loss of resources.

2. help ensure reliable financial reporting.

3. help ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences.

4. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.

<u>While internal control as such is inherently useful and help organisation in many ways yet it is not a panacea as it also has its limitations such as:</u>

1. Internal control cannot change an inherently poor manager into a good one.

2. Internal control cannot ensure success, or even survival in case of shifts in government policy or programs, competitors' actions or economic conditions, since these are beyond the management's control.

3. An internal control system, no matter how well conceived and operated, can provide only reasonable-- not absolute--assurance to management and the board regarding achievement of an entity's objectives.

4. The likelihood of achievement is affected by limitations inherent in all internal control systems.

5. Controls can be circumvented by the collusion of two or more people, and management has the ability to override the system.

6. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

(5 marks)

Answer to Q2.A.

IIRC has developed an International Integrated Reporting Framework to establish Guiding Principles and Content Elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them.

The Framework: • Identifies information to be included in an integrated report for use in assessing the organization's ability to create value; it does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance

• Is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and notfor-profit organizations.

The following Guiding Principles underpin the preparation of an integrated report, informing the content of the report and how information is presented:

• Strategic focus and future orientation : An integrated report should provide insight into the organization's strategy, and how it relates to the organization's ability to create value in the short, medium and long term, and to its use of and effects on the capitals

• Connectivity of information : An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time

• Stakeholder relationships : An integrated report should provide insight into the nature and quality of the organization’s relationships with its key stakeholders, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

• Materiality : An integrated report should disclose information about matters that substantively affect the organization’s ability to create value over the short, medium and long term

• Conciseness : An integrated report should be concise

• Reliability and completeness : An integrated report should include all material matters, both positive and negative, in a balanced way and without material error

• Consistency and comparability : The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) in a way that enables comparison with other organizations to the extent it is material to the organization’s own ability to create value over time.

(5 marks)

Answer to Q2.B.

Business ethics and corporate governance of an organization go hand in hand. The organization that follows ethical practices in all its activities will, in all probability, follow best corporate governance practices as well.

Corporate governance is meant to run companies ethically in a manner such that all stakeholders including creditors, distributors, customers, employees, the society at large, governments and even competitors are dealt with in a fair manner. Good corporate governance should look at all stakeholders and not just the shareholders alone.

Corporate governance is not something which regulators have to impose on a management, it should come from within. A business organization has to compete for a share in the global market on its own internal strength, in particular on the strength of its human resource, and on the goodwill of its other stakeholders. While its state-of-the-art technologies and high level managerial competencies could be of help in meeting the quality, cost, volume, speed and breakeven requirements of the highly competitive global market, it is the value-based management and ethics that the organization has to use in its governance. This would enable the organization to establish productive relationship with its internal customers and lasting business relationship with its external customers.

(5 marks)

Answer to Q.3.A.

The National Guidelines on Responsible Business Conduct comprises nine thematic pillars of business responsibility that are known Principles. These principles are interdependent, interrelated and non-divisible and all business are urged to address them holistically. It guides all companies on the adoption and implementation of the Principles.

The nine thematic pillars of business responsibility provided by the NGRBC are as under:

• Businesses should conduct and govern themselves with integrity in a manner that is Ethical, Transparent and Accountable.

• Businesses should provide goods and services in a manner that is sustainable and safe. • Businesses should respect and promote the well-being of all employees, including those in their value chains.

• Businesses should respect the interests of and be responsive to all their stakeholders.

• Businesses should respect and promote human rights.

• Businesses should respect and make efforts to protect and restore the environment. • Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent.

• Businesses should promote inclusive growth and equitable development.

• Businesses should engage with and provide value to their consumers in a responsible manner.

(5 marks)

Answer to Q3.B.

COSO is the abbreviation of The Committee of Sponsoring Organizations of the Treadway Commission (COSO). COSO's (original framework, which identified five components of internal control, became widely adopted for use in assessing the effectiveness of internal controls. Its more recently updated framework identifies 17 principles mapped to the original components.

These Principles are as under:

<u>Component 1: Control Environment</u>

1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability

<u>Component 2: Risk Assessment</u>

6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change

<u>Component 3 : Control Activities</u>

10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys control activities through policies and procedures

<u>Component 4 : Information & Communication</u>

13. Uses relevant information 14. Communicates internally 15. Communicates externally

<u>Component 5 : Monitoring Activities</u>

16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

(5 marks)

Answer to Q4.A.

(a) CSR and Philanthropy has been always misconstrued as synonymous. However, there is a significant difference between the two. Philanthropy means the act of donating money, goods, time or effort to support a charitable cause with reference to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate. It is the active effort to promote human welfare. Corporate Social Responsibility on the contrary goes beyond that. CSR is about making the core business functions of a company more sustainable. It is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/or planet issues. A CSR initiative of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies. A CSR program does not only benefit the community, but also the business in form of improved morale, increased staff retention, status as an employer of choice, attracting new business, and differentiation from competitors. This is because a CSR program requires involvement from all the stakeholders including employees as well as the community.

(b) The Dow Jones Sustainability Indices are the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide, it was launched in 1999. The Dow Jones Sustainability World Index (DJSI World) comprises more than 300 companies that represent the top 10% of the leading sustainability companies out of the biggest 2500 companies in the Dow Jones World Index. In addition to the composite DJSI World, there are six specialized subset indexes excluding alcohol, ex gambling, ex tobacco, ex armaments & firearms, ex alcohol, tobacco, gambling, armaments & firearms indexes, and ex alcohol, tobacco, gambling armaments & firearms, and adult entertainment.

(c) **(5 marks)**

Answer to Q4.B.

<u>Composition of Lokpal</u> : Lokpal is a statutory, multi-member body which has no constitutional backing. It consists of one Chairperson and a maximum of 8 members. • Chairperson : A person becomes eligible for the appointment as Chairperson of Lokpal if he is a former Chief Justice of India, a former member of Supreme Court or an eminent person with impeccable integrity and outstanding ability. Additionally, he should have adequate knowledge and 25 years of experience in the matters of the anti-corruption policy, finance, vigilance, law and management, and public administration.

• Members : Out of 8 permissible members, 50% are from the judiciary. Rest 50% of members are from OBC/SC/ST/women and minorities. Judicial members should either be a former Judge of Supreme Court or a former Chief Justice of a High Court. In the case of non-judicial members, they should be eminent persons with impeccable integrity and outstanding ability in their chosen professional areas. They should have at least of 25 years of experience in matters relating to anti-corruption policy, vigilance, public administration, vigilance, law, management, and finance.

<u>Powers of Lokpal</u>

Its inquiry wing has the power to search and seize objects both movable and immovable objects and make reports based on them. These reports would be taken up by the 3- member Lokpal benches for further scrutiny. The benches would give the opportunities for the allegedly corrupt officers to say in their defense. After this, the benches would undertake any of the following alternatives-

• If the officers are found guilty, the benches would grant their sanction to the prosecution wing or CBI to file charge sheets against them. The benches can also direct the concerned government departments to start proceedings against them.

• If the officers are found innocent, the benches would direct the filing of the closure of case reports before the Special Court.

(5 marks)

Answer to Q5.A.

a) Integrated reporting is an emerging and evolving trend in corporate reporting, which primarily aims to offer an organization's providers of financial capital with an integrated representation of the key factors that are material to its present and future value creation. Integrated reporters build on sustainability reporting foundations and disclosures in preparing their integrated report. Through the integrated report, an organization provides a concise communication about how its strategy, governance, performance and prospects lead to the creation of value over time. Conceptually, integrated reporting would build on the existing financial reporting model to present additional information about a company's strategy, governance, and performance. It is aimed at providing a complete picture of a company, including how it demonstrates stewardship and how it creates and sustains value.

Sustainability reporting is a process that assists organizations in setting goals, measuring performance and managing change towards a sustainable global economy one that combines long term profitability with social responsibility and environmental care. Sustainability is the key platform for communicating the organization's economic, environmental, social and governance performance, reflecting positive and negative impacts. The aspects that the organization deems to be material, in response to its stakeholders' expectations and interests, drive sustainability reporting.

b) In line with 'National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business' issued by MCA in 2011, Securities Exchange Board of India decided to mandate inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for listed entities.

As per updated Regulation 34(2)(f) of SEBI (LODR) Regulations, 2015, annual report of the top one thousand listed entities based on market capitalization (calculated as on March 31 of every financial year), shall include business responsibility report describing the initiatives taken by them from an environmental, social and governance perspective, in the format as specified by the Board from time to time: Provided that listed entities other than top five hundred listed companies based on market capitalization and listed entities which have listed their specified securities on SME Exchange, may include these business responsibility reports on a voluntary basis in the format as specified. Business Responsibility Report is a disclosure of adoption of responsible business practices by a listed company to all its stakeholders. SEBI had also prescribed a format for 'Business Responsibility Report'. It contains a standardized format for companies to report the actions undertaken by them towards adoption of responsible business practices.

(5 marks)

Answer to Q5.B.

A number of controls falling under operational controls can also be administrative controls. Examples of operational controls are: quality control, works standards, periodic reporting, policy appraisal etc.

Administrative controls are very wide in their scope. They include all other managerial controls concerned with decision-making process. They are concerned with the authorisation of transactions and include anything from plan of organisation to procedures, record keeping, distribution of authority and the process of decision-making.

They include controls such as time and motion studies, quality control through inspection, performance budgeting, responsibility accounting and performance evaluation etc.

Administrative controls have an indirect relationship with financial records and the auditor may evaluate only those administrative controls which have a bearing on the financial records.

Thus, administrative controls are those which help in improving the efficiency, productivity and not necessarily recorded under the accounting systems. Works standards, quality control, methods study and motion study are examples of administrative control.

(5 marks)