CORPORATE GOVERNANCE REPORTING (A CASE OF BEST PRACTICE)

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ICPAK

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PRESENTATION OUTLINE

1. Introduction, definition and background
2. Pillars of corporate Governance
3. Why the focus on corporate governance and other benefits
4. The Cadbury Committee, The Genesis of Best Reporting
5. Understanding Financial Reporting
   a. Components
   b. Compliance with IFRS
6. ILLUSTRATIONS

INTRODUCTION AND DEFINATION

Corporate Governance

The systems, processes, practice and procedures by which corporate entities are directed, controlled and held accountable.

It encompasses the authority, accountability, stewardship, leadership, direction and control exercised in corporations.

It’s the manner in which the power of a corporate entity is EXCERCISED in the stewardship of the entity’s total portfolio of assets and resources.

Key objective being SUSTAINING and increasing shareholder value with the satisfaction of other stakeholders within the framework of its corporate mission

BACKGROUND…

Corporate governance responsibility for the affairs of an organization rests with the Board of Directors whose duties include:

- setting the company's strategic aims
- providing the leadership to put them into effect
- supervising the management of the business
- reporting to shareholders on their stewardship.

The board’s action are subject to laws, regulations and shareholders in general meeting.

The shareholders role in governance is to appoint the directors and auditors and satisfy themselves that an appropriate governance structure is in place.

In essence, corporate governance begins and ends with the Board of Directors. However, in practice the Board of Directors of an entity is expected to delegate the day-to-day routine of conducting the entity's business to its Key Officers and employees headed by the CEO.

The Board cannot however delegate its responsibility for the consequences of unsound or imprudent policies and practices in protecting against internal Fraud, or any other operating activities

PILLARS OF CORPORATE GOVERNANCE.

1. Discipline

Commitment to adhere to behavior that is accepted and recognized universally to be correct and proper.

2. Transparency

Ease to obtain meaningful information to enable outsiders analyze the actions, economic fundamentals and non-financial aspects pertinent to the business of the entity and what happens inside the entity.

3. Accountability

process ensuring that those entrusted with power, assets and resources can be held to account.

4. Fairness

The extend to which the entity has put in place mechanisms to ensure that it acts fairly and justifiably and protects the interests of all stakeholders.

5. Responsibility & Responsiveness

Responsibility-Ensuring that the enterprise as a "good citizen" acts with utmost good care in regard to environment, societal and human rights issues and adheres to the highest ethical standards.

Ensuring that those entrusted with the direction, management and control of the Company are held collectively responsible and personally liable for their actions and that delegating the authority to others does not mitigate, dissipate or discharge them from their duties and responsibilities or remove their personal liability.

Responsiveness- Since the business operates in a society, it ought to be responsive to the needs, and improve the quality of life, of society by efficiently and effectively utilizing entrusted resources while adding value to the wealth producing capacity of the society

6. Efficiency and effectiveness

Ensuring maximizing economic use of available resources with minimum waste for the greatest benefit to Society.

PILLARS OF CORPORATE GOVERNANCE CONTINUED

In all fields of human endeavor, good governance is founded upon the attitudes, ethics, practices, and values of society regarding;

- Accountability of power
- Domestic values in respect of sharing power, representation and participation.
- The sense of right and wrong, what is fair and just, work ethics technology and continuing corporate social responsibility.

WHY FOCUS ON CORPORATE GOVERNANCE

The global corporate Governance forum notes in its mission that Corporate Governance has become an issue of world-wide importance.

The corporation has a vital role to play in promoting economic development and social progress. It is the engine of growth internally, and increasingly responsible for providing employment, public and private services/goods and infrastructure.

1. For the Enterprise/corporation

- ❖ Increase the firm value
- ❖ Lower cost of capital
- ❖ Enhance capital efficiency
- ❖ Promote corporate reputation and image
- ❖ Protect the interest of all stakeholders.

2. For the National Economy

- Revitalizing the market economy
- Promote respect for ‘’Righteous Wealth” based on hard work and not corruption
- Create wealth and savings for sustainable growth;
- Develop transparent capital markets;
- Enhance investor confidence; shareholders, financiers and suppliers sure of repayment
- Increase national competiveness through fair trade.

3. Society

- ❖ Enhanced efficient use of scarce national resources
- ❖ Clean and transparent society;
- ❖ Preventing corruption; Increasing social welfare,
- ❖ Enhancement of the rule of law; fair and orderly society.

WHY THE INTEREST IN GOOD GOVERNACE?

- Government-the engine of growth, increased tax revenues, jobs for many.
- The Society-increased production and creation of wealth for development and prosperity for all;
- The Investors, owner, and shareholder-sustainable stream of revenues and wealth;
- Suppliers and financiers-assured payment when due
- Employees-jobs now and assured pension in future,
- Customers-high quality and innovative goods and services
- The directors mangers –avoid increased liabilities based on clarity of roles.

OTHER BENEFITS OF GOOD GOVERNANCE.

The efficiency and accountability of the corporation is now a matter of both private and public interest, and governance has thereby come to be a priority of the international agenda.

Good Corporate governance Is necessary in order to;

- -Attract Investors-both local and foreign
- -Create Competitive and Efficient companies and business enterprises
- Enhance the accountability and performance of those entrusted with the management corporations.
- Promote Effective and Efficient use limited resources.

THE CADBURY COMMITTEE

- The Cadbury committee was set up by the City of London and the Accounting profession in 1991 to look at actions that might be taken to soothe public disquiet about how major companies were being run, especially in the light of the BCCI and Maxwell mirror group scandals of the immediately preceding years.
- The committee's purpose was to review those aspects of corporate governance that related to the financial reporting and accountability as follows;

CADBURY COMMITTEE CONTINUED…

- The responsibility of executive and non-executive directors for reviewing and reporting on performance to shareholders and other financially interested parties,
- The frequency, clarity and form in which information should be provided,
- The case for the audit committees of the Board, including their composition and role.
- The principal responsibility of the auditors and the extent and value of the audit.

CADBURY COMMITTEE CONTINUED…..

- The link between shareholders, boards and auditors
- Any other relevant matter. (Stephen Bloomfield,2013)

UNDERSTANDING FINANCIAL REPORTING

- ❑ Understanding Financial Statements
- ❑Budgeting
- ❑Assessing Company Performance

CORPORATE FINANCIAL REPORTS ARE PREPARED FOR 2 TYPES OF USERS

Internal users- day to day

- management,
- directors,
- senior staff
- operating staff

External Users – wide variety of needs

- Shareholders
- Company lenders
- Suppliers & Customers
- Unions & Government
- Share market

Directors need to recognize the 2 user groups and the different needs of each and summarize the results simply for external users.

COMPONENTS OF FINANCIAL STATEMENTS

- Profit & Loss Statement
- Balance Sheet
- Cash Flow Statements
- Other Internal Management Reports

ACCOUNTING STANDARDS ARE USED TO ENSURE CONSISTENCY AND ACCURATE REPORTING

MAJOR ACCOUNTING STANDARDS INCLUDE:

❖ **ENTITY STANDARD**- Reports for each business entity.

❖ **GOING CONCERN STANDARD**- Financial Statements Prepared on the basis that the entity will operate in the future.

❖ **CONSISTENCY STANDARD**- Figures consistent each period.

❖ **MATERIALITY STANDARD**- requires a range greater than 5-10% of the Total to be material.

❖ **MANY OTHER SPECIFIC STANDARD**- As prescribed by the Accounting Bodies in that country.

THE ACCURACY AND RELIABILITY OF FINANCIAL REPORTS DEPENDS ON:

- The accuracy of the company's financial accounting systems
- The adoption of the relevant accounting Standards
- Internal/external audit of the reports
- Internal supervision of the entire process
- Best practice- overview by the audit committee of the Board

CONTENT OF A BALANCE SHEET

ASSETS

NON CURRENT ASSETS- Are assets of a long term nature e.g. Land, buildings, plant, equipment and intangible assets.

CURRENT ASSETS – Are subject to continual change and are normally convertible into cash within 12 months e.g. stock, debtors and cash.

LIABILITIES

CURRENT LIABILITIES- are obligations due to be paid within 12 months and include creditors, provisions and short term debts

NON CURRENT LIABILITIES are normally due to be paid after 12 months and include long term loans, debentures and other commitments.

SHAREHOLDER’S FUNDS

The difference between assets and liabilities represent the shareholders’ equity in the business.

- Share Capital
- Accumulated Profits(Losses)
- Reserves.

CONTENTS OF A THE PROFIT & LOSS STATEMENT

INCOME: Gross revenue of the period.

EXPENDITURE: Total cost of the period, normally reported by type of expenditure e.g. salaries and wages, interest, purchases and deprecation

NET PROFIT/LOSS before tax, and abnormal/extraordinary items: The difference between normal income and expenditure

- NET PROFIT/LOSS after tax subdivided between:
  - Net profit/loss after tax for normal operations.
  - Net profit/loss after tax for abnormal/extraordinary items.
- Dividends paid to shareholders

- Balance representing profit after dividends, transferred to Shareholders equity.

CONTENT OF A CASH FLOW STATEMENT

- This statement reconciles the cash expenditure and receipts of the business through its cash accounts for the reporting period.

- Normally Reported as follows:
  - ✓ Cash Provided/expended through normal trading operations e.g. buying materials, selling products, paying wages.
  - ✓ Cash invested in the business e.g. purchase of plant.
  - ✓ Cash supplied by financing e.g. borrowing money from banks.
  - ✓ Reconciliation of opening and closing bank balances

COURSE RECAP

- Q1. Which government department might be users of a company's Annual Financial Statements?
- Q3. What factors determine the accuracy of the financial reports produces by a business?
- Q4. Give some examples on Non Current Assets and Non Current Liabilities.
- Q5. What is the major factor which increases Shareholders Equity?

CASE: CHAMGIWADWA OUTGROWERS CO. LTD

	Profit & Loss for the year 1999 & 2000				
			This Yr2		Last Yr 1
			Ksh ‘000		Ksh ‘000
Sales			4500		4000
Less Cost of sales		1000		900	
Direct labor		300		250	
Overheads		1700	3000	1650	2800
Gross Margin			1500		1200
Less Expenses					
Selling		600		500	
Cane Development		150		200	
Administration		350	1100	200	900
Net Profit before tax			400		300

What questions would you ask a director of this company?

Balance Sheet as at 30th JUNE 2000		
	This Yr Ksh '000	Last Yr Ksh '000
NON CURRENT ASSETS		
Land and Buildings	60	70
Plant & Equipment	700	650
Office Equipment	80	50
Goodwill	100	100
CURRENT ASSETS		
Inventory	700	600
Debtors	600	560
TOTAL ASSETS	2240	2030
NON CURRENT LIABILITIES		
Term Loan	550	450
CURRENT LIABILITITES		
ACCOUNTS PAYABLE	500	500
Bank overdraft	300	320
TOTAL LIABILITIES	1350	1270
SHAREHOLDERS EQUITY	890	760

What question would you ask the Director of the company?

CASE STUDY

CHAMGIWADWA OUTGROWER COMPANY LTD

CASE STUDY

- You have approached to join the CHAGIWADWA Company Ltd as a non- executive director.

- Please Review the attached accounts and summarize any questions/ concerns you may have.

ACCOUNTS

		This Yr 3 Ksh ‘000		Last Yr 2 Ksh ‘ 000
Sales		5000		4500
Less Cost of Sales			1000	
Direct labor, cane cutter			1000	
Over-heads			300	
Material Usage	3400	6000	1700	
Gross Margin		(1000)		**1500**

ACCOUNTS CONT…

Less Expenses				
Selling	800		600	
Cane Dev. Costs	400		150	
Administration	700	1900	350	1100
Net Profit(Loss) before tax		(3700)		400
Employees		300		100

KEY PERSONNEL:

GM. Mr. MacDonald Otoyo

Admin Clerk – Filigona Otoyo

FC. Mr. Stanslause Kunani

Petty Cashier- Wyclffe Khanani

NOTES TO THE ACCOUNTS

- During the year the company borrowed 10m. Shillings form the Swift Dissolving Fund (SDF) for cane development.
- The company trebled its employees to be deployed in cane development.
- The company acquired a Mercedes Benz car for the GM during the Year.

BUDGETING

WHAT IS BUDETING?

- A budget is an expression in financial terms of the plans required to meet the strategic objectives of an institution.
- A budget signals a demand for resource (finance) to support the realization of corporate business plans.
- A budget also facilitates the delegation of responsibility to managers in divisions, departments, etc.

CONT…

- Budgeting enables the Board of Directors to specify the assumptions under which the business will be undertaken over the next 12 months, and the broad strategic objectives of the organization, and to communicate organizational policy.

- The assumptions made by the board are the broad limits within which management makes an outline budgetary plan for each department.

GOOD BUSINESS PREPARE ANNUAL BUDGETS FOR THEIR NEXT FINANCIAL YEAR

- BUDGETING INVOLVES:
  - The setting of conservative budget assumptions on which budgets are based.
  - The preparations of income & expenditure, Balance Sheet and Cash Flow Statements which adopt relevant accounting Standards and the accounting principles of the business.
  - Supplementary management reports including non-financial KPI's for internal management based on the budget assumptions.
  - Regular reviews of budget and actual results on the periodic basis.

BENEFITS OF BUDGETS

- Helps co-ordinate business and service operations.
- Helps managers and the board to plan ahead.
- Helps managers and the board to learn- an effective budgeting system will contain feedback loops.
- Helps motivates managers- they have targets, and performance is judged against those agreed targets.

Cont...

A budget can help the Board answer the following questions:

- What is the current performance, how does it differ from budget, and why?
- If events are changing how this will affect estimated performance- if we take no action?
- What can we do to counter unfavorable variances?

BEHAVIORAL ASPECTS OF BUDGETING

- Perceptions- if communication is poor then individuals will not have adequate perception of the budgetary plan.
- Personal objectives- harmonize with organizational objectives
- Participation- involve implementers in the preparation.
- Aspiration- Is achievement rewarded?
- Targets- are they realistic, can they reasonably be achieved?
- Obsession- budgets are for the guidance of the wise and adherence of the fool.
- Excuses- blame the budget for everything that goes wrong.

ASSESSING COMPANY PERFORMANCE

ASSESSING COMPANY PERFORMANCE IS AN IMPORTANT MANAGEMENT/BOARD REQUIREMENT

- Company performance is a reflection of the efficiency and productivity of people and capital.

- Performance can be assessed by the use of:

  - Financial KPI’s
  - Non Financial KPI’s
  - Being “on guard” against possible financial changes in performance

FINANCIAL KPI'S ASSIST IN THE FOLLOWING

- Understanding relationship between revenue, expenses, assets, liabilities and equity.
- Explain reasons for changes in company profitability /performance.
- Identifying satisfactory/ unsatisfactory trends.
- Industry comparison
- Using past performance as a benchmark for planning for the future.

NON FINANCIAL PERFORMANCE INDICATORS

Businesses are encouraged to use non-financial performance indicators for management reporting and budgeting.

These comprise of 3 types:

1. Specific Performance KPI’s concerning a problem are, e.g. Staff Turnover, Sick Days Taken, Machine downtime, stock-outs, etc.

2. Productivity KPI’s measuring output, e.g. labor hours per meter of output, units sold per salesperson.

•Most businesses have 1 or 2 Key NON Financial KPI’s e.g. accounting firms

3. Utilization % of work changed, airlines-load factor

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