UNIVERSITY OF PETROLEUM & ENERGY STUDIES
DEHRADUN
End Semester Examination –April, 2018

Name of the Program: MBA Core/General | **Semester – IV**
Subject Name: Business Ethics & Corporate Governance | **Max. Marks : 100**
Subject Code : MBC1814 | **Duration : 3 Hrs**

Section A

Attempt both the part. Each carries 10 marks.

I. Choose the correct answer with explanation (1X 10 =10 Marks)

Q1. The primary stakeholders are:

a. Customers.
b. Suppliers.
c. Shareholders.
d. Creditors.

Q2. The goal of corporate governance and business ethics education is to:

a. Teach students their professional accountability and to uphold their personal Integrity to society.
b. Change the way in which ethics is taught to students.
c. Create more ethics standards by which corporate professionals must operate.
d. Increase the workload for accounting students.

Q3. The corporate governance structure of a company reflects the individual companies':

a. Cultural and economic system.
b. Legal and business system.
c. Social and regulatory system.
d. All of the above.

Q4. The internal audit function is least effective when the department:

a. Is non-independent.
b. Is competent.
c. Is objective.
d. Exhibits integrity

Q5. Under the ___________, both internal and external corporate governance mechanisms are intended to induce managerial actions that maximize profit and shareholder value.

a. Shareholder theory.
b. Agency theory.
c. Stakeholder theory.

d. Corporate governance theory.

Q6. Which of the following is a problem presented by ethics audits?

a. They may be used to reallocate resources.
b. They identify practices that need improvement.
c. Selecting auditors may be difficult.
d. They may pinpoint problems with stakeholder relationships.

Q7. An organization's appropriate tone at the top promoting ethical conduct is an example of:

a. Ethics sensitivity.
b. Ethics incentives.
c. Ethical behavior.
d. Consequentialist.

Q8. An independent director is one who:

a. Did not attend a school supported by the company.
b. Does not have outside relationships with other directors.
c. Does not have any other relationships with the company other than his or her directorship.
d. All of the above.

Q9. The chairperson of the board of directors and CEO should be leaders with:

a. Vision and problem solving skills.
b. The ability to motivate.
c. Business acumen.
d. All of the above.

Q10.The social economy partnership philosophy emphasizes:

a. cooperation and assistance.
b. profit maximization.
c. competition.
d. restricting resources and support.

II. Examine the veracity (True and False)of the statement with explanation (1X10=10)

a. Minimal social responsibility focuses on contractual stakeholders and mainly takes economic and legal considerations into account.
b. Ethical issues may arise in global business because different nations have different beliefs about what business activities are acceptable or unethical, and these beliefs stem from differences in their cultures.
c. The process of assessing and reporting a business's performance in fulfilling the economic, legal, ethical, and philanthropic responsibilities expected of it by its stakeholders is called a social audit.

UPES UNIVERSITY WITH A PURPOSE

d. An ethical climate can be defined as a set of values, beliefs, goals, norms, and ways of solving problems shared by the members (employees) on an organization of any size, for profit or nonprofit.
e. Centralized organizations tend to be more ethical when compared with decentralized organizations.
f. Ecology refers to the science of the interrelationships among organisms and their environments.
g. In recent years, business has played a significant role in adapting, using, and maintaining the quality of sustainability.
h. The Global Compact invites companies to consider how they can take account of human rights instead of setting out specific provisions for companies.
i. Minimal social responsibility focuses on contractual stakeholders and mainly takes economic and legal considerations into account.
j. Employee turnover is a useful indicator for assessing employee issues.

Section B
Write short notes on any four (5X4=20)

1. Ethical issues in Hostile takeover
2. Positive and negative externalities
3. Trusteeship and Agency theories
4. Cultural Ethics
5. Moral reasoning and Cognitive barrier

Section C
Case Study Analysis (60 marks)

NORTHERN MINES LIMITED (A)

Sitting back in his chair, Andrew Fisher, a director and member of the audit committee of Northern Mines Limited, suddenly realized that this July 23 audit committee meeting was going to go on later than anyone expected. Andrew had been reviewing an April 8 letter from the external auditor to management, which had been sent to all committee members as part of the pre-meeting information package, and he had come across an item of concern that the audit committee had not previously discussed.
In one section of the letter, a reference was made to the tailings disposal plan associated with the closure of two of Northern Mines' Ontario uranium mines (Exhibit 1). The plan recommended by management involved the conventional flooded tailings approach, at an estimated cost to the company of $22.5 million. The letter, however, also mentioned two alternative methods, each with an estimated cost of about $300 million, that had been examined (but not recommended) in

an independent consultant's report. Andrew was both surprised and concerned. This was the first time that he, and he presumed the other members of the audit committee, had heard of these alternative tailings disposal suggestions. Although Northern Mines had provided $22.5 million for waste management associated with the tailings disposal for the two mine closures, an additional liability of about $280 million could apparently exist if the company was forced by regulatory agencies to adopt one of the two alternative cleanup methods described in the letter. The $280 million represented about 55 per cent of the company's current retained earnings.
Ultimately, the audit committee would have to decide if a potential additional liability existed, and if so, how the company would account for it. Andrew was already starting to think about how the audit committee should proceed: first, they would have to decide if an investigation of this matter was warranted, and then if necessary, what information they would need in order to decide whether and how to account for and disclose it in their financial statements.

Northern Mines was a leading diversified Canadian mining company. Headquartered in Toronto, the company had major interests throughout Canada, the United States, the Far East, and Latin America. Mining operations encompassed all activities related to exploring for and producing ores and metals ready to sell on the world commodity markets. Northern Mines' mining interests included underground uranium mines in Ontario and the United States and wholly or partly-owned mining ventures in a variety of other metals in other parts of the world. The company had originally been founded to develop a number of uranium deposits near Runsum, Ontario, which at one time became known as the "uranium capital" of the world. However, as the Ontario ore bodies began to run out, and richer deposits were discovered elsewhere, management had diversified in anticipation of withdrawing production at Runsum.

URANIUM MINING

The Northern Mines' Ontario uranium mines were underground mines. The ore was mined and initially crushed underground and then hoisted to the surface for milling. Because the uranium deposit was low grade, the ore had to be finely ground and then processed by a sulphuric acid treatment to extract the uranium. In 1990, 2.7 million tons of ore were processed from three mines at a recovery rate of 93 per cent to yield 4.3 million pounds of uranium. The mining and milling operations resulted in a large quantity of waste rock and tailings, which contained mildly radioactive elements and pyrites that generated acid when exposed to oxygen and water. If the tailings were released into the environment, through groundwater seepage or runoff, contamination of the groundwater could occur. Consequently, the tailings had to be disposed of in a manner that would control releases and prevent contamination of the groundwater.

A NEW STRATEGIC FOCUS

In 1990, the board of Northern Mines made a decision to refine the strategic focus of the company: Northern Mines would build on its distinctive competencies in the mineral resource sector. As part of the effort to concentrate on profitable mineral resource mining, Northern Mines closed two of its three uranium mines in August 1990: the Lakeview and Martin mines. As the spot price of uranium had declined from a high of US$43.40 per pound in 1978 to under US$10 per pound in the 1990s, production at the company's three high-cost mines had been dependent on long-term contracts that ensured a reasonable profit margin. When further profitable contracts could not be secured, because of depressed uranium market prices and the comparatively low grade and high operating costs of the Ontario mines, the company decided to close the Lakeview and Martin mines. An existing long-term contract with Ontario Hydro

UNIVERSITY WITH A PURPOSE

guaranteed a high enough price to keep the more modern and efficient Sorrel mine operating at a profit.

FINANCIAL POSITION

Northern Mines was a major competitor in the mining industry in Canada. When 17 publicly traded mining companies in Canada were evaluated based on total assets, revenues and profitability, Northern Mines placed in the top six in each category. At the time of the audit committee meeting, the North American economy, especially the Canadian economy, had been in a deep recession for over a year. The recession had put downward pressure on the commodity price of metals around the world. The profitability of Northern Mines' mining segment was dependent on the quantity produced, the cost of production and the price received. Both the quantity and the costs were variables under Northern Mines' control, but prices were largely determined by world markets. Consequently, production decisions were largely determined by prevailing prices; the effect was to make mining a cyclical industry (Exhibit 2).

Although earnings from operations were down for the third consecutive year, Northern Mines had not posted a loss in over 30 years. Management expected that earnings for the current year would again be lower, yet still positive. Earnings estimates were down due to continued low commodity prices for metals and the expected necessary writeoffs because of the accelerated closure of the two uranium mines. A special one-time provision of $85 million against pre-tax earnings had been recently allocated to cover the estimated costs of the shutdown of the Lakeview and Martin mines. Together with provisions made in previous years, a total of $125 million had been accrued to cover all costs associated with closure of the two mines. The $125 million provision included employee costs, shutdown and demolition costs, ongoing care and maintenance, the writeoff of the remaining assets, and environmental and regulatory costs associated with tailings disposal. The closure of the two uranium mines also required the approval of a comprehensive waste management plan by a government regulatory agency, the Atomic Energy Control Board. Northern Mines had submitted for approval what management believed was the most ecologically sound and economically feasible proposal for waste management. Based on management's submitted proposal, $22.5 million of the total provision of $125 million had been estimated for environmental and regulatory costs associated with waste management.

THE AUDIT COMMITTEE

The Northern Mines audit committee met quarterly to review the financial statements and related notes before their presentation to the board for approval. In addition, the audit committee had to review and approve the Management Discussion and Analysis (M, D &A) section of the annual report to ensure that it was complete and accurate (refer to Appendix 1: Note on Audit Committees). Other responsibilities of the audit committee included

(1) systematically reviewing the corporation's accounting and financial controls and reporting procedures, and reporting its findings to the board of directors; and

(2) reviewing the work of the external auditors, recommending to the board their annual fees, and nominating the auditors to be approved by the shareholders at the annual meeting.

The Northern Mines audit committee was composed of five members, all of whom were outside directors of the company and who had been members of the board for at least three years. Each of the members of the audit committee had previously held a senior management position in a large corporation and had a sophisticated knowledge of business. Richard Young, the chairman of the audit committee, had professional accounting experience and had been chief executive officer of a major Canadian company for many years. Although none of the members of the audit

committee had expert knowledge of the environmental science of mine closures or the regulatory process for the approval of the waste management plan, they all could recognize when a particular issue needed further investigation. Andrew believed that current communications between the audit committee and Northern Mines' management
were very good.

Several business journals had recently published articles about the increasing demands and expectations that were being placed on directors and audit committees. Although all of the members of the audit committee were aware that they could be personally liable for any financial damages related to improper financial reporting through their fiduciary responsibility as directors, they were concerned about the possibility that as members of the audit committee, they could face even greater legal liability. Andrew had read much of the recent literature on what was being asked of audit committees and wondered if any director could adequately perform the increasingly stringent duties of a member of an audit committee.

THE AUDITOR'S LETTER

When Andrew brought up his concerns about the reference to the additional cost of the two alternative waste management methods mentioned in the auditor's letter, it was evident that the other members of the committee were equally surprised and concerned. The current provisions for mine closure costs and waste management had been made based on management's best estimates and had been accepted by the board. The letter did not disagree with the chosen alternative, but simply mentioned that Northern Mines might be forced at some point in the lengthy regulatory process to adopt an alternative method of cleanup, which
could result in a potential liability of up to $300 million. The audit committee was responsible for ensuring full disclosure of any material liability they knew about to the shareholders. However, it was not clear from the auditor's letter to management whether or not a disclosable potential liability existed. Andrew had several unanswered questions: Why hadn't management
mentioned the alternative waste management methods before? Was there a potential liability, or were the auditors being too cautious? If no liability existed, why had the auditors mentioned it in their letter? If a potential liability existed, why hadn't the auditors asked for a note? How would the liability be accounted for if it existed?

Andrew knew the audit committee would have to decide whether it believed that an additional potential liability existed, and if so, whether it would be necessary to include it in the financial statements or notes. No one in the room wanted to think about how much time it would take to investigate the issue, but it was obvious they needed to develop a plan of attack.

An example illustrating the increased liability of directors is the 1992 judgment in which two officers/ directors of Bata
Industries were found guilty of violating the Province of Ontario's Environmental Protection and Water Resources Act. The
president and vice-president/general manager were found to be responsible for failing to take adequate measures to prevent
leakage of storage drums at a shoe plant. They were personally fined $12,000 each.

Exhibit 1

EXCERPT FROM THE AUDITOR'S APRIL 8 LETTER TO MANAGEMENT
Management Letter for the Year ended December 31

Observation	Implication	Recommendations	Management's Comments
5. CONTINGENCY — ENVIRONMENTAL RESTORATION			
The Approved Budget for the Martin and Lakeview Curtailment Program allocates a total of $28.7 million to environmental costs. This amount includes $22.5 million in respect of ongoing waste management in a "wetlands" tailing containment area. The Division proposes to flood the tailings area and establish vegetation as a means of controlling the generation of radiation and acid-bearing solutions. An independent report has been commissioned to attempt to convince the Atomic Energy Control Board (AECB) that the wetlands concept is a preferable approach to site restoration in environmental terms, as well as being the only economically viable solution. The consultants have indicated that the principal alternatives are: (a) deep disposal in an existing lake (which may be unacceptable), and (b) backfilling the tailings into the disused mine workings. The cost of each of these alternatives is estimated at $300 million.	The Corporation appears to have a potential contingent liability of up to $300 million.	This contingent liability should be reviewed by senior management on a regular basis until the issue has been resolved with the AECB, to ensure that the Corporation has adequately provided for these costs.	The principles of deep disposal and our flooded tailings concept are essentially the same. It would not be acceptable for the Company to move tailings to another lake when we can flood the tailings in place. Backfilling mine workings is not a solution. Less than 50 per cent of the tailings could be returned underground. Backfilling, therefore, solves less than half the problem. Senior management is continually reviewing step-by-step progress made with the AECB. Therefore, management will always be in a position to recognize any additional liabilities.

Exhibit -2
Financial Highlights

UNIVERSITY WITH A PURPOSE

	Year	Year -1	Year -2	Year -3
Earnings (millions of dollars)				
Revenue	$ 1,343.1	1,711.9	1,979.1	1,532.6
Investment & other income	57.7	41.6	32.1	36.3
	1,400.8	1,753.5	2,011.2	1,568.9
Cost of mine production and metal sales	969.4	1,311.1	1,482.5	1,167.0
S,G & A	160.3	161.8	170.2	144.2
Interest expense	35.3	33.9	33.9	37.2
Depreciation	62.6	67.1	68.2	64.8
Exploration	14.9	11.1	7.4	3.7
Writeoff of capital assets & provision for mine closure	39.9	-	-	-
	(1,282.4)	(1,585.0)	(1,762.2)	(1,416.9)
Earnings before tax, minority interests, and gain on sale of discontinued operations	118.4	168.5	249.0	152.0
Income and mining taxes	(42.1)	(60.5)	(105.2)	(45.4)
Earnings from continuing operations, before minority interests in subsidiaries	76.3	108.0	143.8	106.6
Minority interests in net earnings of subsidiaries	(0.9)	(3.4)	(29.1)	(13.5)
Earnings from continuing operations	75.4	104.6	114.7	93.1
Gain on sale of discontinued operations, net of inc. tax	11.9	-	-	-
Earnings b/extra. items	87.3	104.6	114.7	93.1
Extraordinary items, net	-	(31.5)	19.7	-
Net earnings	$ 87.3	73.1	134.4	93.1

INSPECTION COPY
Not For Reproduction

Appendix 1
NOTE ON AUDIT COMMITTEES

An audit committee is a committee of the board of directors to which the board delegates its responsibility for oversight of the financial reporting process. The Canadian Business Corporation Act and the corporation acts of many provinces contain provisions requiring the creation of audit committees and rules governing their composition and responsibility in public companies.

The objectives of an audit committee, as stated in a research study published by the Canadian Institute of Chartered Accountants, are as follows:

(a) To help directors meet their responsibilities, especially for accountability;
(b) To provide better communication between directors and external auditors;
(c) To enhance the external auditor’s independence;
(d) To increase the credibility and objectivity of financial reports; and
(e) To strengthen the role of the outside directors by facilitating in-depth discussions between directors on the committee, management and external auditors.

UNIVERSITY WITH A PURPOSE

Audit committees are generally comprised of a minimum of three directors who are elected by the full board. To enhance the independence of the audit committee, the majority of the directors are usually outside directors. Although committee members with a knowledge of accounting or law can be advantageous, it is also desirable that members have a broad general management background and experience as senior managers so that they can relate to the pressures of top management. In the past, audit committees have met annually or semi-annually. However, with mounting pressure from regulatory authorities to require audit committees to also review interim and quarterly financial statements, some audit committees are meeting at least once each quarter.

Several studies and guidelines were published in the early 1990s by large accounting firms, the Canadian Securities Administrators, and other regulatory bodies concerning the role of audit committees. Many of these studies focused on how audit committees could work to reduce the risk of inadequate financial reporting, and explored the continually evolving role of audit committees. As directors have been faced with growing expectations from shareholders, the government and the public, pressure has mounted for greater accountability. As mentioned in several studies, audit committees have been targeted as one route for increasing director accountability and ensuring the integrity of financial reporting.

1. Identify and specify what financial reporting problem might exist. How and why might it exist? (20)

2. As a member of the audit committee, what factors would influence your decision about whether to investigate the issue? (10)

3. Should the audit committee conduct further investigation? If so, formulate a plan of action outlining the steps the audit committee would take to investigate the concerns raised by the auditor. (10)

4. What information would the audit committee need? If not, why did the auditors mention their concern in the letter to management? (10)

5. What are the implications of your decision? (10)

UNIVERSITY WITH A PURPOSE