Chartered Secretaries Qualifying Scheme – Level 1

Corporate Governance

Sample paper

Time allowed: 3 hours and 15 minutes (including reading time)

Do not open this examination paper until the presiding officer or an invigilator tells you to.

You must not take this paper out of the examination room.

The examination paper contains six questions. Each question carries 25 marks. You must attempt four questions only.
Questions
(Answer four questions from this paper)

1. You have just been appointed as company secretary of a medium-sized listed company. In discussions with your chairman, you discover that he has serious concerns about the quality of decision-making by the board of directors. He believes that decisions by the board are often taken on the basis of insufficient information and without due regard for either risk or the environmental, social and governance (ESG) issues involved. He mentioned that a recent example of poor decision-making had been a decision by the board to invest a large amount of money in developing a major new product, only to discover later that there were serious concerns about the environmental impact of the product and a very high probability that the product would be banned by the government’s Product Standards Agency. The board had therefore cancelled the product development project, with a large write-off of the expenditure already incurred.

This was just one example of badly-informed decision-making by the board and the chairman says that there have been others. He wants to improve the work of the board, but is unsure about what needs to be done, and he has asked for your views and advice in the form of a report.

Required

Write a report to the chairman, advising him on the measures that might be taken to improve the quality of decision-making by the board. In the report, you should take into consideration the concerns that he has expressed and the recent example of poor decision-making that he mentioned.

(25 marks)

2. For some years Lee Tomm (‘Lee’) was the assistant company secretary of a large listed company but he has now decided to take up the offer of employment at a senior advisory level with a government organisation. This organisation, the Consumer Protection Board (CPB), has responsibility for monitoring and controlling monopolies and mergers in industry and for protecting the consumer against anti-competitive practices.

Lee is aware that the CPB has been criticised in the media for poor governance. It does not engage much with its stakeholders, such as the government department that provides its funding and consumer protection groups.

In his time as assistant company secretary of the listed company, Lee was involved in a variety of corporate governance matters, and he is aware of the importance of good governance. He considers this to be important for non-profit-making organisations as well as for companies, although he understands that governance priorities in the CPB should differ in some respects from those in listed companies.

(continued)
Required

(a) Discuss the main differences between corporate governance in a major stock market company and governance in a state-owned organisation such as the CPB.

(21 marks)

(b) Suggest how the skills and experience gained by Lee with the listed company can be transferred and applied to his new role with the CPB.

(4 marks)

(Total: 25 marks)

3. You are the company secretary of a listed food manufacturing company. Your chairman informs you that he has been asked to meet with two major shareholders of the company. These are institutional investors who together own about 6% of the company's equity shares. Both of them have stated publicly their policy of socially responsible investment (SRI), and the purpose of the meeting will be to discuss social and environmental issues and the company's policy on corporate social responsibility.

Required

Write a briefing note to prepare the chairman for his meetings. The briefing note should include a discussion of the following issues:

(a) The nature of SRI for institutional investors and its relevance for the governance of companies.

(5 marks)

(b) The ways in which institutional investors may pursue a SRI strategy, and the social and environmental risks facing the company that may be of concern to investors.

(10 marks)

(c) Suggested ways in which the company may respond positively to the concerns of its shareholders and potential new investors about social and environmental issues, and how the company secretary may assist with these measures.

(10 marks)

(Total: 25 marks)
4. Hotbrot Company is a medium-sized listed company. Argo Plant (‘Argo’) is a wealthy business entrepreneur and the original founder of the company. He owns 28% of the ordinary shares and is the major shareholder, but he is no longer a member of the board of directors, having resigned several years ago when the company obtained its stock market quotation.

Although he is no longer a director, Argo continues to show considerable interest in the business affairs of the company. Recently he has been demanding that the board should consult him on issues of business strategy and dividend policy. He also believes that at least two non-executive directors should resign because they contribute nothing of value to the board. Two members of the board agree, and argue that Argo should be consulted regularly on important issues, given his success in leading the company in the past. However, the majority of the board members are hostile and resent Argo’s continual interference.

After a recent argument with the chairman, Argo has threatened to sue members of the board for gross dereliction of their duties as directors. He has also demanded the resignation of a board member who is the owner of a property company that has just sold a property to Hotbrot Company at a price that Argo considers excessive. The chairman was unaware of this matter.

**Required**

As company secretary, prepare a report for the chairman advising him about the appropriate measures for dealing with the board’s relationship with Argo and also the various complaints that Argo has made.

*(25 marks)*
5. The chairman of a medium-sized listed industrial company has called a board meeting to discuss risk and risk management within the company. He is concerned by a recent fall of about 40% in the company’s share price, following poor interim financial results and adverse media reports claiming that the problems of the company were the result of poor risk management and exposure to excessive business and other risks.

The chairman has also been angered by a number of incidents reported to him by the chief executive officer.

(i) There has been a serious breach of health and safety regulations at a foreign subsidiary, resulting in a number of deaths and serious injuries to employees.

(ii) An important new IT system was introduced by the company a few months ago, apparently without adequate testing of the back-up system in the event of system failure.

(iii) Some large expenditures on capital assets were made without proper authorisation and invoices are not available for some of the money spent. Two managers have been dismissed as a result.

Required

(a) Explain the difference between business risk and internal control risk. (5 marks)

(b) Suggest how a system for the management of business risk should operate within the company. (10 marks)

(c) Using the Turnbull Guidance, explain the nature of the internal control failures in incidents (i) to (iii), above, and explain who should have responsibility for the implementation and the effectiveness of a system of internal control. (10 marks)

(Total: 25 marks)
6. The remuneration committee of a UK listed company is having problems in reaching an agreement about the remuneration package of Ross Tuck (‘Mr Tuck’), an individual who has been invited by the board of directors to become the company’s new Chief Executive Officer (CEO). The lawyer representing Mr Tuck has recently made several demands that the remuneration committee is now considering. According to the lawyer, Mr Tuck would like a higher basic salary and pension contributions: he has suggested that the company should contribute an amount each year equal to 5% of Mr Tuck’s total remuneration from the company, excluding the pension contributions themselves. The company operates a share option scheme for its senior executives, but Mr Tuck would like to receive long-term incentives in the form of grants of shares, depending on the achievement of agreed performance targets. He would also like his employment contract to provide for the payment of two years’ basic salary in the event that the company is taken over, and, if he is dismissed for any other reason, he would want to receive one year’s basic salary in full at the time of dismissal.

The remuneration committee has used the services of remuneration consultants, who have suggested that Mr Tuck’s demand for a higher basic salary may be reasonable. The company is in the top 50% by size of its peer group of companies, and the salary that the individual is demanding is comparable with the salary for a CEO in the top 10% – 20%. Since it is the objective of the company to increase its market share, a higher basic salary could be justified.

The chairman of the remuneration committee doubts the value of using remuneration consultants, and is not sure how the committee should respond to the demands of the prospective CEO.

Required

(a) Explain the advantages and disadvantages of using remuneration consultants when negotiating a remuneration package for an incoming senior executive.

(8 marks)

(b) Suggest, with reasons, how the remuneration committee should respond to the demands of the lawyer for the prospective CEO in order to maintain best standards in corporate governance practice within the company.

(13 marks)

(c) Explain how the company secretary, as secretary to the remuneration committee, may assist the committee in its dealings with Mr Tuck.

(4 marks)

(Total: 25 marks)

The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.