Important notice

When reading these answers, please note that they are not intended to be viewed as a definitive ‘model’ answer, as in many instances there are several possible answers/approaches to a question. These answers indicate a range of appropriate content that could have been provided in answer to the questions. They may be a different length or format to the answers expected from candidates in the examination.

Note: The answer to Question 2 has been updated in June 2017.

Examiner’s general comments

The pass rate for the November 2016 session was 42%, which was down when compared to the previous session. Questions 1 and 2 represented the best results achieved.

In order to do well in the examination, candidates are expected to be able to demonstrate a reasonable knowledge and understanding of corporate governance and to apply the principles to given scenarios. Candidates need to ensure that they study and revise the syllabus in sufficient detail and develop their analytical skills. Reviewing past examination papers should form part of revision.

Examination technique is also important and many candidates would benefit from planning their answers and apportioning time equally across each question. In addition, taking the relevant instructions from the command words used in the questions would assist many candidates in their answers.

The marks available for each part of a question should also be used as a guide in respect of the level of detail required. Questions with a higher mark allocation require answers which demonstrate a depth of
knowledge on the particular topic as well as analysing the scenario given and applying governance principles accordingly.

Many answers did not demonstrate sufficient knowledge of the subject or a good examination technique and writing style.

Candidates should also consider the benefits of wider reading, outside of the recommended study material (the ICSA Study Text). Governance issues reported in the media, features in the ICSA magazine and ICSA guidance notes can provide important insight into the practicalities of governance. Such insights can be of great assistance, particularly to candidates that do not yet have any practical governance experience.
1 Radfin Ltd (‘Radfin’) is a company which manufactures equipment used by the military and the police. Some of the projects it works on, in close consultation with government departments, relate to the development of new equipment and devices which are highly confidential. Radfin operates from 10 sites across the UK.

In six months’ time, the Chief Financial Officer (CFO) is due to leave and some of the non-executive directors (NEDs) will be retiring. The nomination committee has selected a new CFO, who is about to join Radfin, and new NEDs, who will be appointed following the departure of those retiring.

Required

(a) Compare and contrast the contribution which executive directors and NEDs make to the work of a board. [Note: you should not refer to Radfin in this part of the question.]

(10 marks)

Suggested answer

All directors have equal rights to attend and speak at meetings of the board, have the same duties in terms of decision-making and have an equal share of voting rights (one vote per director on a show of hands, with decisions usually requiring a majority of the board voting in favour).

It is important to note that the Companies Act 2006 makes no distinction between executive directors and NEDs and that both have the same director duties and responsibilities as detailed in the Act.

Executive directors are full-time employees of a company and are led by the Chief Executive Officer (CEO). They hold executive management and operational responsibilities (for example, Finance Director) in addition to their duties and responsibilities in the boardroom. They therefore bring direct operational experience to the board meetings, have a very detailed knowledge of the company and should apply this knowledge when considering board matters and making decisions. Due to the “split” position they hold, executive directors often experience tension between being a member of the board (one step down from the shareholders) and a senior operational director (one step up from management). The FRC’s Guidance on Board Effectiveness (2011) has suggested that executive directors see themselves as representative of the shareholders, rather than as executive managers who are responsible and accountable to the CEO.

Executive directors will regularly report and present to the board on operational issues. They will bring proposals to the board for consideration, preparing papers to explain new developments and presenting proposals directly to the board.

In contrast, NEDs are not employees of the company; they are members of the board but hold no executive responsibilities. While they do not have the direct day-to-day experience of the company which executive directors bring to the board, they will often have experience as executive directors in other organisations, so can bring a more objective view, making comparisons with how other companies operate which an executive director may not be able to.

NEDs should therefore be able to bring judgement and experience to the deliberations of the board and provide constructive challenge in those discussions. NEDs should support the executive directors in their management of the business, but also monitor their conduct and performance. Executive directors should appreciate that an essential part of good governance is for the NEDs to challenge and test proposals put to the board.

NEDs can bring such a challenge partly due to their objectivity, which results from their level of independence. Whilst all directors are required to exercise independent judgement, executive directors may often feel more inclined to support the views of the CEO on matters, including strategy. They may also mistrust the NEDs as being outsiders who do not have sufficient knowledge of the company, its business or the industry. Whilst NEDs are “outsiders” to some degree, their inclusion on and contributions to the board, coupled with their independence, brings a much-needed balance of power to the board.
In conclusion, for a board to be effective, it is important that the executive directors and NEDs work together constructively and have mutual respect for each other, including the different, but necessary, expertise and skills they each bring to a board and the decision-making process.

(b) Advise on the elements which would comprise an effective induction programme for the new directors joining Radfin, explaining why these elements are important.

Suggested answer

B.4.1 of the UK Corporate Governance Code (UK Code) states that all directors should receive induction on joining the board and that “to function effectively all directors need appropriate knowledge of the company and access to its operations and staff”.

The role of CFO is as an executive manager and executive director. As such, the new CFO will need to understand the differences in the role of manager and director and the responsibilities related to each.

The induction process is one by which new directors familiarise themselves with the business, its products or services and how it operates. Any induction of a new director should provide essential information and familiarity with the company. Providing copies of minutes of previous board meetings and relevant accompanying documentation (board packs/reports) offers a good background to the most recent issues and discussions that have taken place. Other information that should be provided includes: a copy of the company’s Articles of Association; copies of current strategic documents that have been approved by the board; copies of the latest (and previous) annual report and accounts; copies of the schedule of matters reserved for the board or a summary of the role of the board; and copies of the terms of reference for the board committees.

Presentations may have previously been made to the board explaining the products/services sold by the company and copies of these could be provided. Alternatively, or in addition, any product/service brochures the company publishes could be provided.

New directors holding meetings with key members of senior management and external advisers (for example, auditors, solicitors, and so on) are also an important element within an induction programme.

It is also important for new directors to be aware of the company’s major shareholders and stakeholders and to be involved as early as possible in meeting with these groups. Indeed, the UK Code (B.4.1) states that, as part of the induction programme, directors should be offered the opportunity to meet with major shareholders.

For listed companies, new directors should be informed of the rules for share dealing and their obligations under the Model Code.

For planning purposes, new directors should be provided with a full timetable of board and committee meetings for the current/forthcoming year and any other key dates (shareholder presentations/meetings and due dates for the announcements of financial results).

It is also good practice for directors to be provided with a copy of the directors’ liability insurance policy for them to understand their potential liabilities as a director.

For executive directors, one main objective of an induction programme is to assist them in understanding their role on the board and the related responsibilities and how this differs from their day to day operational activities and responsibilities. It is also important, as suggested by the Improving Board Effectiveness guidance, for a Chairman to encourage the attitude among the
executive directors that they are representatives of the shareholders. This encouragement can certainly be forthcoming as part of an induction programme.

The need for induction is probably more important for NEDs and needs to provide them with sufficient information about the company and how it operates, given that they will not be involved on a day to day basis. The FRC Guidance on Board Effectiveness states that NEDs should devote time to a “comprehensive, formal and tailored induction, which should extend beyond the boardroom”.

The importance of new directors knowing what is expected of them should not be overlooked and this is another area where the Chairman can assist in communicating this within an induction programme.

The overall aim of any induction programme is to make a director an effective member of the board as quickly as possible. However, as the ICSA guidance, Induction of directors, recommends, there should be a variety of methods used including reading material, meetings, site visits and external training. Indeed, an induction programme may extend over a period of time with information provided and activities undertaken at different stages.

**Radfin**

With reference to Radfin, an induction programme would need to specifically address the following:

(i) The new directors being made aware of the security and confidentiality policies within the company and any applicable laws and regulations (such as export licencing and Bribery Act issues).

(ii) Arranging for new directors to meet with key stakeholders (government/police/military) as appropriate, or at least being briefed on these relationships.

(iii) It is noted that Radfin operates from 10 sites in the UK. Arrangements should be made for new directors to visit a number of these sites (but not all of them). Of particular importance would be main manufacturing sites and others which carry high risk factors.

(iv) Given that the new CFO will be joining Radfin shortly, s/he should be given the benefit of a full handover from the outgoing CFO.

(v) The new NEDs should be invited to meet the retiring NEDs before they depart.

**Examiner’s comments**

Question 1 was the most popular question and a majority of the candidates who attempted it answered it well.

In part (a), most candidates provided a good range of the different contributions made by executive directors and NEDs to the work of a board. Many candidates provided detailed (although sometimes excessive) information in respect of the work undertaken by NEDs on board committees. Whilst this is a relevant contribution, only limited marks were awarded for such content.

Part (b) was, in general, answered well, with most candidates detailing the components of an effective induction programme. However, many candidates did not include any details in respect of the documentation that should be provided as part of an induction (for example, Articles of Association, annual reports, recent board meeting papers and minutes, policies and procedures). Many candidates could also have gained additional marks by making reference to key points in the scenario (for example, visits to operational sites, handovers from outgoing directors, policies and procedures relevant to the industry, meetings with customers and product information).
2 Marlow plc (‘Marlow’) is preparing its first Annual Report and Accounts as a smaller listed company with two institutional shareholders. Marlow is considering whether it complies with the UK Corporate Governance Code in certain areas.

One area it is examining is board composition. Marlow has three executive and two non-executive directors (including the Chairman) on its board. The Chairman, Simon Chan, has recent financial experience and also chairs the audit committee. Audit is the only committee of the board.

The board of Marlow has carried out its own performance evaluation in the last year, which was satisfactory.

Required

(a) Discuss how important compliance with the UK Corporate Governance Code is to different types of shareholder, and explain what action shareholders can take if the company does not comply. [Note: You should not refer to Marlow in this part of the question.]

(10 marks)

Suggested answer

Shareholders’ view of the importance of compliance may be influenced by knowledge that the UK Corporate Governance Code (UK Code) is a voluntary code. All listed companies are obliged to disclose in the annual report that they have complied with its provisions in full or provide an explanation in respect of any areas of non-compliance.

The UK Code recognises the potential danger of compliance being a mere “box ticking” exercise and stresses that it is not intended to be a rigid set of rules; and it states that non-compliance with a provision “may be justified in certain circumstances if good governance can be achieved by other means”. Therefore, shareholders may choose to take a relaxed view of certain areas of non-compliance.

However, compliance with the UK Code is of most importance to institutional shareholders who may be following guidance as set out in the UK Stewardship Code and/or voting guidelines as published by organisations such as the Pensions and Lifetime Savings Association (PLSA; formerly NAPF) or the Association of British Insurers (ABI). Therefore, non-compliance with the UK Code could result in an institutional shareholder taking action to further discuss this with the company, raise the issue at a general meeting or to vote against a particular resolution being proposed.

The UK Code provides some guidance as to how shareholders should respond to any non-compliance issues. It suggests that due regard should be given to the particular circumstances of the company and that the size and complexity of the company, in conjunction with the nature of the risks and challenges it faces, should be considered.

Where there are areas of non-compliance with the UK Code which shareholders are not satisfied with, there are a number of actions that shareholders can take. Institutional shareholders will usually seek to discuss the issues with members of the board (Chairman or Senior Independent Director) in the first instance. If, from these discussions, the explanations given for non-compliance are felt by the institutional shareholder to be justified then they may not take any immediate action and instead just continue to monitor the situation. However, as has been seen in many cases, where an institutional shareholder is not satisfied they will often then vote against any shareholder resolutions which relate to the matter in question. In addition, depending on the percentage of share capital held, institutional investors are more likely to hold rights to requisition a resolution to be proposed at a general meeting or to requisition a meeting. Such rights are, however, used as a last resort and institutional shareholders will usually adopt a more proactive approach in holding full discussions with a company’s board to resolve a non-compliance issue, or to at least reach a compromise in the short-term.
For other shareholders in general, it is important for them to be aware of the level of compliance with the UK Code that exists in a company. From this they can then gauge how strong the governance framework is and this in turn will influence their voting and investment decisions. Private individuals and other shareholders with smaller holdings will tend to be more reactive to non-compliance issues. They will often be influenced by the comments or actions of the institutional shareholders and may vote against certain resolutions as a result. However, these shareholders are more likely to be reactive to actual events (for example, wrongdoing by directors, share price crash, reports of misrepresenting financial information) rather than for governance non-compliance issues. In such situations, following such events, smaller shareholders will demonstrate their dissatisfaction by voting against resolutions. In certain circumstances, where smaller shareholders feel strongly about an issue, shareholder activism will arise where these shareholders join forces in order to try and increase their voice and overall voting powers as a group.

Ultimately, any shareholder who is not satisfied with the level of compliance being maintained by a company can decide to sell their shares.

(b) Analyse Marlow’s compliance with the UK Corporate Governance Code in light of the information given above. Suggest how any areas of non-compliance might be explained and justified in the Annual Report and Accounts.

Suggested answer

Under the UK Code (B.1.2), it is recommended that a smaller company has at least two independent non-executive directors (NEDs). Marlow has two NEDs, but this includes the Chairman, Simon Chan. The Chairman of a board is usually only deemed independent on appointment and thereafter is excluded from the total number of NEDs.

It is not clear from the scenario given as to whether Simon was independent on appointment and whether the other NED is independent. If there are any issues in respect of their independence, then these will need to be disclosed and justified in Marlow’s annual report.

For smaller companies, the UK Code (C.3.1) states that the Chairman of a board may be a member of the audit committee but should not chair it, provided he or she was considered independent on appointment as Chairman. However, the UK Code (C.3.1) also states that at least one member of the audit committee should have “recent and relevant financial experience”.

Whilst Simon, as board Chairman, should not be chairing the audit committee, he does have recent financial experience. The non-compliance could perhaps be justified if it is only a temporary situation until additional NEDs are appointed. Additionally, it may be the case that Simon is indeed best placed to chair the audit committee due to his experience (as perhaps the other NED does not have any suitable experience in order to effectively chair the audit committee, although, the company would probably be best advised to report on why Simon has taken on this role, rather than refer to any weaknesses of the other NED).

The UK Code (B.2.1) recommends the establishment of a nomination committee, which should be made up of a majority of independent NEDs. The board Chairman or an independent NED should chair the committee. Executive directors may be members of the nomination committee provided they are not in a majority. Again, it is not clear whether the NEDs of Marlow are independent, so this could be one explanation as to why a committee has not been set up. A further justification could be that Marlow, as a smaller company and newly listed, has not been in a position to make further appointments of directors and the board has felt that a nomination committee has not been required at the present time.

The UK Code (D.2.1) recommends the establishment of a remuneration committee which should be made up entirely of independent NEDs and within a smaller company there should be at least two members. The company Chairman may be a member of the committee, but not Chairman, provided
that he was independent on appointment as company Chairman. Again, it is not clear whether the NEDs of Marlow are independent, so this could be one explanation as to why a committee has not been set up. There will need to be some explanation as to how remuneration has been decided in Marlow. It may be the case that this responsibility has been that of the Chairman. However, no director should be involved in setting their own remuneration and therefore details of how the Chairman’s remuneration was decided will be required. The UK Code (D.2) states that “there should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration of individual directors”. Therefore, Marlow will need to demonstrate that such a formal and transparent procedure exists and was implemented in terms of deciding the remuneration of the Chairman, the NED and the executive directors.

The UK Code (A.4.1) also recommends that the board appoints one of the independent NEDs to be the Senior Independent Director (SID). There is no mention in the scenario as to whether the other NED has been appointed as the SID. Again, relevant explanations that could be reported are that the other NED is not independent or that the appointment was not deemed necessary at the present time.

In respect of board evaluation, the UK Code (B.6) states that the board should undertake a “formal and rigorous annual evaluation of its own performance and that of its committees and individual directors”. In addition, for FTSE350 companies, the evaluation of the board should be externally facilitated by specialist external consultants at least every three years (B.6.2).

It is stated that the board of Marlow has carried out its own performance evaluation in the last year. This is, therefore, in line with the UK Code and Marlow could in fact continue to undertake its own performance evaluations going forward. Whilst Marlow remains a smaller listed company, there would be no need for evaluations to be externally facilitated.

It is not clear whether an evaluation was also undertaken on the audit committee and the individual directors. If such evaluations were not carried out then this will need to be reported and justified. One justification may be that given the size of the board, and as a newly listed company, it was felt that a single board evaluation being undertaken in the first year was sufficient.

Under the UK Code (B.6.1), the board needs to state in the annual report how performance evaluation was conducted. It is good practice also to include key findings of the evaluation and detail how the results are to be acted upon. Indeed, depending on the results, Marlow could use the reporting requirement as an opportunity to demonstrate how some of the areas of non-compliance are going to be addressed.

Examiner's comments

Question 2 was the second most popular question and was also answered quite well.

In part (a), many candidates appeared to struggle to discuss how and why compliance with the UK Code is important to shareholders. Many candidates approached the question by explaining the different types of shareholders, which was not required. Answers provided to the question of what actions could be taken by shareholders were generally better, although some points made were either not explained well or were not relevant. For example, many candidates made reference to shareholders being able to make derivative claims, but this would result from a company not complying with the UK Code.

In part (b), most candidates identified a good range of issues in respect of Marlow’s compliance with the UK Code. Many candidates could have gained additional marks by providing more detail on the composition required for the board committees and the issues this would present to Marlow given the small size of the board. Furthermore, not all candidates identified that the scenario did not state whether the NEDs were independent. Very few candidates highlighted that Marlow had not appointed a SID or, again, the issues this would present. There was also often insufficient detail provided, and some confusion around, the issues regarding the board Chairman being chair or
member of the audit committee (specifically for a smaller listed company, which Marlow is, as stated in the scenario). Many candidates did not expand sufficiently enough on issues in respect of performance evaluation, particularly regarding evaluation of individual directors and committees and requirements for external facilitation.

In discussing how areas of non-compliance might be explained and justified, most candidates correctly suggested that Marlow could make reference to its size and that it had only recently become listed. Higher scoring answers went further by suggesting that Marlow could also state that board and committee composition would be reviewed, the company would seek to appoint additional NEDs and the approach to be taken on performance evaluation.
Charles Lane has been a non-executive director of Belton plc ('Belton'), a listed company, for eight years. He was previously an employee and is a member of the company’s pension scheme. You, as Company Secretary, are preparing documentation for Belton’s next annual general meeting at which Charles will be retiring and standing for re-election.

Sarah Hughes has recently joined Belton as an executive director and holds shares in the company. You recently circulated records of shareholdings to each of the board members, asking them to confirm that the details are correct. Sarah confirmed that her shareholding was correct. The company’s registrars have subsequently informed you that Sarah holds further shares in a nominee account and that these shares were purchased a month before Belton’s interim results were announced.

You have since requested full details regarding the purchase of these shares, but Sarah has responded that she does not believe she has done anything wrong. She informs you that she used a nominee account so that she would not hold the shares in her own name and would not need to declare them.

Required

(a) Discuss whether Charles, in his role as a non-executive director, can be considered independent.

Suggested answer

Under the UK Corporate Governance Code (UK Code) Charles’ status as an independent non-executive director (NED) could be affected by any of the following circumstances.

The UK Code (B.1.1) states that independence would be questionable if the director has been an employee of the company within the last five years. In respect of Charles Lane, it is noted that he was previously an employee. Given that he was appointed as a NED eight years ago, he would not have been able to still be an employee. Therefore, he has not been an employee of the company within the last five years and his independence will not be affected.

The UK Code (B.2.3) states that any NED serving a term beyond six years should be subject to rigorous review and should take into account the need for progressive refreshing of the board. Charles has been on the board for eight years so his continued tenure should be reviewed accordingly in terms of how this may affect his independence. In addition, the UK Code (B.7.1) states that NEDs who have served longer than nine years should be subject to re-election. Charles will not be effected by this in the current year, however, in another year he will have the issue of the “nine year rule” which will further impact on his independence. Whilst the UK Code raises questions over how independent a director can remain after serving for such a long period, both the Higgs Report and the Quoted Companies Alliance have made reference to the fact that there may well be circumstances where a long-serving NED may still add value and make valid contributions to a board, notwithstanding that they will no longer be considered to be independent. In such circumstances an explanation could be given in the company’s annual report in respect of this non-compliance issue.

The UK Code (B.1.1) states that independence would be questionable if the director receives (or has received) additional remuneration from the company other than a director’s fee, or is a member of the company’s pension scheme, or participates in the company’s share option scheme or a performance-related pay scheme.

Through being an employee, Charles is a member of the company’s pension scheme, which is one of the circumstances outlined above and therefore this could affect his independence.

The UK Code (B.1.1) states that independence would be questionable if the director is a significant shareholder in the company. It is not stated as to whether Charles owns shares in the company.
However, given that he was previously an employee it is certainly likely that he may hold shares (perhaps from being a member of share option schemes). It is unlikely that an employee’s shareholding would be at a significant level (at or above 3% per the Listing Rules) but not impossible. Charles’ shareholding in the company will be disclosed within the annual report. Charles’ current shareholding should be checked to ascertain whether he is a significant shareholder. If he is, then this will affect his independence. Overall, the main threat to Charles’ independence is his membership of the pension scheme.

In respect of his re-election at the forthcoming annual general meeting, this question over his independence need not be an issue particularly where justifications can be made for him remaining on the board. Such justifications could relate to the added value he brings to the board and any specialist relevant knowledge or experience he has.

The board would need to consider whether the fact that Charles cannot be deemed independent, under the UK Code, has any consequences to other compliance matters. For example, whether Charles is a member of any board committees and whether he is chair any of them. Issues may arise where the UK Code states that specific committees should: comprise entirely of independent NEDs (remuneration); or comprise a majority of NEDs (audit and nomination). It is not stated whether Charles is appointed as the Senior Independent Director. Finally, the board should consider whether Charles’ non-independence affects the balance of the board in terms of the UK Code recommendation that at least one half of the board, excluding the Chairman, should be independent NEDs.

In conclusion, once the above factors have been considered, it may be that Belton needs to undertake some composition changes to its board and committees. Also, in the following year, Charles’ independence will be brought further into question under the “nine-year rule”. However, a NED not being independent does not mean that they can no longer be a member of the board, or an effective one. It would be for the company to provide relevant explanations and justifications for Charles to remain on the board and for the shareholders to consider his proposed re-election each year at the general meeting.

(b) Prepare a letter to Sarah advising her of her obligations under the Model Code and of the procedures she needs to follow when dealing in shares in future. In your letter, request the specific information to make the notification of the recent share purchase.

(15 marks)

Suggested answer

[On Belton plc letterhead]

Date

Ms S Hughes
[Address]

Dear Sarah

Share dealing and the Model Code

Further to our recent correspondence regarding your shareholdings in Belton (“the company”), I note your comments in respect of the shares held by you in a nominee account. However, I write to advise you that this share purchase has not complied with the regulations set out within the Model Code.

As a director of the company you have certain obligations under the Model Code in respect of dealing in shares of the company, or in shares of another company. The main obligations under the Model Code are as follows:
• Directors must seek clearance from the Chairman (or other designated director) prior to dealing in the company’s shares.

• Directors must not deal in shares at any time that they are privy to price-sensitive information (that which could have a significant effect on the share price if it were published).

• Directors must ensure that none of their connected persons deal in shares of the company without clearance. Connected persons include spouses and infant children.

• Clearance must not be given during a prohibited period. This may be any period during which there is unpublished price-sensitive information that is reasonably likely to result in an announcement being made, or may be a close period. A close period is the period of two months before the release of interim or full year financial results (or the period between the end of the financial year and the announcement of the annual results).

• In exceptional circumstances, clearance to deal can be given during a prohibited period where the director has a pressing financial commitment or would suffer financial hardship if they were unable to deal.

Additionally, the use of a nominee account for share dealing by a director is still subject to the Model Code. Whilst the name of the account may not make reference to the name of the director, the director remains the beneficial owner of shares held therein. Indeed, any nominee accounts held for any connected persons to a director would also be subject to the Model Code if dealing in the shares of the company.

Finally, there are requirements imposed under the Listing Rules for disclosure of dealings by directors in shares of their company. Directors must notify the company of dealings by themselves and by connected persons in shares of the company. The company is then required to make an announcement to the Stock Exchange (through the Regulated Information Service (RIS)) to notify the market of the dealing by the director.

Unfortunately, therefore, there have been a number of breaches of the Model Code. Firstly, in that you did not seek permission from the Chairman to purchase the shares. Secondly, as advised by the company’s Registrars, the share purchase was completed one month before the release of Belton’s interim results. Thirdly, no notification of the dealing was announced to the Stock Exchange. The company will now be making the required announcement. Following this being made, it is very likely that the London Stock Exchange (LSE) will wish to investigate the breaches further and, if so, you and the company will be obliged to provide all relevant information.

Procedure to be followed

In summary, for your future reference, the procedure to be followed for dealing in the shares of the company is:

• To submit a request to deal to the Company Secretarial Department (who will verify that the request is not being made during a prohibited period and there are no other reasons why permission should not be given).

• The request will then be passed to the Chairman for his review and, if approved, permission will be granted. If the request is rejected, then no share dealing can take place and a new request must be submitted at a later date.

• Upon receipt of permission to deal, you may proceed with the share dealing transaction.
Within two days of completing the transaction, you must notify the Company Secretarial Department of the transaction, providing the information as set out in the final section of this letter below.

The company must then issue an announcement to the Stock Exchange to notify the market of the share dealing.

Information required for notification

As mentioned above, the company is required to make a notification to the LSE regarding any share dealings of directors. In order for the necessary notification to be made in respect of the shares purchased under your nominee account, please provide the following information:

- the date on which the shares were purchased;
- the number of shares purchased;
- the price paid per share; and
- the name of the nominee account (including any designatory reference).

Should you have any further queries, then please do not hesitate to contact me.

Yours sincerely,

Company Secretary

Examiner’s comments

Question 3 was quite popular, but very few candidates who attempted it answered it well.

In part (a), most candidates provided details of the criteria for judging independence and related these to Charles Lane. However, answers showed confusion around whether Charles had been an employee within the last five years. Those candidates who correctly analysed the scenario were able to determine that Charles would have been an employee at least eight years ago when he was appointed as a NED. Higher scoring answers contained further analysis of this issue and explained that this could still affect independence, particularly if Charles had been in a senior position and would be dealing with his previous colleagues and perhaps even reviewing projects that he had been involved in as an employee; and highlighted that Charles could also possibly be a significant shareholder.

Most candidates came to the appropriate conclusion that Charles would not be considered to be independent. However, many candidates then suggested that Charles should not stand for re-election, but this would be a board decision. It should be noted that, even where a NED is not independent, his appointment/re-election could still be justified in certain circumstances (for example, due to knowledge and experience he brings to the board).

Part (b) was not well answered. Marks were available for providing an appropriate tone and style for a letter to a director, but very few candidates’ answers were suitable.

Many candidates would have benefitted from planning their answers to this question in order to ensure that each element was dealt with accordingly.

Most candidates correctly set out the obligations under the Model Code, although some made reference to “close periods” without explaining what these are; and whilst the fact that shares held in a nominee account also needed to be disclosed was made in answers, there was often no explanation given as to why.

Many candidates did not set out the information required from Sarah in respect of the transaction in order to make the Stock Exchange announcement.
Wilby plc ('Wilby') is a listed company. Two months ago the Chief Financial Officer, Henry Fasson, left Wilby following the termination of his contract by the company. Henry's severance package, which was paid in full, included a payment for compensation for loss of office and elements of performance related pay.

The Chief Executive of Wilby is frustrated that the full severance package was paid even though there have been significant problems with financial systems and financial reporting which were under Henry’s control.

You, as Company Secretary, have been asked to advise the board.

**Required**

(a) Advise the board of Wilby on best practices in senior executive remuneration and how these can be applied to avoid a similar situation occurring in future.

* (13 marks)

**Suggested answer**

**Principles of executive remuneration**

In any system of good corporate governance, the remuneration of directors and key senior executives should be sufficient to attract and retain individuals of a suitable calibre. At the same time, the structure of a senior executive remuneration packages should motivate individuals towards the achievement of performance that is in the best interests of the company and its shareholders, as well as those of individual executives.

D.1 of the UK Corporate Governance Code (UK Code) states as a principle that “executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied”.

It is generally accepted that senior executives should be able to earn a high level of remuneration in return for the work they do and the responsibilities they carry. It is also generally accepted that the level of remuneration should be linked in some way to satisfactory performance.

However, companies should be discouraged from paying senior executives too much. Excessive payments are against the interests of shareholders since they reduce profits.

A central issue for corporate governance is concerned with the link between pay and performance. The remuneration package should include a performance-related element. Where a director successfully achieves predetermined levels of performance, they should be rewarded accordingly. Furthermore, the view of the UK Code is that the interests of shareholders in the long term should be the priority, over short-term considerations.

In general, the remuneration packages for senior executives should consist of a combination of the following: a basic salary; pension scheme contributions; a short-term reward such as an annual bonus usually linked to the annual financial performance of the company; a performance-related pay element such as a cash bonus; and long-term incentives usually in the form of share option awards which can also be linked to performance.

**Severance payments**

When a company decides to dismiss an executive, it is bound by the terms of the service contract which will include a minimum period of notice in the event of dismissal. A company may be required to pay an executive for the notice period (typically up to one year) without them needing to work out the notice. Alternatively, the service contract may provide for the payment of compensation for loss of office. Additionally, an executive may be entitled to further bonus payments under the terms of their remuneration package, despite being dismissed from their position.
The UK Code (D.1.4) contains a provision relating to compensation payments. This states that the aim should be to avoid rewarding poor performance, with the remuneration committee taking a robust line on reducing the amount of compensation to reflect a departing director's obligation to mitigate losses.

A joint statement on severance pay made by the Association of British Insurers (ABI) and the Pensions and Lifetime Savings Association (PLSA; formerly NAPF) in 2008 suggested that the level of remuneration that senior executives receive provides adequate compensation for the risk associated with their role. The statement called for employment contracts not providing for additional financial protection for any director in the event that the company performs badly. Within its guidelines, it was also suggested that any non-contractual payments should be linked to performance, with no director being entitled to a discretionary payment from the company in the event of termination of their contract for poor corporate performance.

**Application of principles at Wilby**

In view of the recent departure of the Chief Financial Officer (CFO) from Wilby, it is recommended that the company reviews its remuneration policy, including the performance-related pay elements of remuneration packages, and the terms of directors’ service contracts.

Performance targets set for individuals should be sufficiently challenging and related to specific objectives within a particular job role.

Performance objectives should represent the interests of the company and its shareholders, as well as the individual executive. In order to achieve this, suitable measures of performance need to be selected so that the executive, the company and the shareholders gain a comparable benefit from good performance.

The provision of payments of compensation for loss of office should be questioned. Payment of notice periods, of up to one year, could be deemed to be sufficient, particularly in the event of termination of the contract by the company.

Overall, Wilby should consider how to restructure its approach to remuneration to ensure that in future no director whose contract is terminated by the company is then effectively "rewarded for failure".

(b) Explain the current voting rights UK shareholders have in respect of directors' remuneration and evaluate the impact these have had since their introduction. [Note: You should not refer to Wilby in this part of the question.]

(12 marks)

**Suggested answer**

**Remuneration policy**

Under Chapter 4A of the Companies Act 2006, the shareholders of a company have a binding vote on a resolution to approve the remuneration policy. It is an ordinary resolution, requiring a simple majority for approval or rejection. If the shareholders reject the remuneration policy, the board of directors may amend the policy and present the revised policy to the shareholders for approval at another general meeting. Alternatively, they may continue with the most recent remuneration policy to have received shareholder approval.

If a company wants to make changes to the remuneration policy, it must put the new policy to the shareholders for approval at a general meeting.
A company must put the remuneration policy to the shareholders for a binding vote at least every three years. However, since even small changes to remuneration policy require formal shareholder approval, companies may decide to hold a binding vote on remuneration policy at every annual general meeting (AGM).

Once a remuneration policy has been approved, a company will only be allowed to make remuneration payments to directors that are consistent with the approved remuneration policy, which should include the company’s policy for, and payments for, loss of office. If the company wishes to make a remuneration payment that does not comply with the approved policy, any non-compliant payment must be approved by a separate resolution of the shareholders in a general meeting.

The binding nature of the vote on the remuneration policy represents a significant increase in the rights of shareholders in respect of directors’ remuneration. There have not been many occasions since the new remuneration voting regime was introduced (October 2013) where the remuneration policy of a company has not been approved. However, there have been examples where a majority vote in favour has only just been achieved. This could suggest that the impact of the binding vote on the remuneration policy has not been particularly significant.

**Implementation report**

The shareholders also vote on the implementation report annually, at the AGM. The implementation report contains information about how the company has implemented the remuneration policy in the previous year. This will include a single figure for the total amount of remuneration for directors in the year. This total figure will allow shareholders to compare total remuneration payments from year to year.

The shareholder vote on the implementation report is an advisory vote only, not a binding vote. However, if the shareholders vote against an implementation report, the board will be required to put the remuneration policy to the shareholders in a binding vote at the next AGM.

In addition, whenever a director leaves office, the company is required to publish a statement, as soon as reasonably practicable, stating what the payments to the director have been, and what the (ex-) director may receive in the future. This certainly provides more transparency in respect of the full extent of severance payments. However, shareholder voting has no immediate impact on this as a severance package would be based on the remuneration policy already in place.

Whilst the vote on the implementation report is advisory only, it is interesting to note that any vote against it will require the remuneration policy to be put to the shareholders, for a binding vote, at the next AGM. Again, this represents a significant increase in the rights of shareholders in respect of directors’ remuneration and there have been a number of examples in the recent past where shareholders have voted against the implementation report. For example, in April 2016, almost 60% of shareholders voted against the pay package of BP’s chief executive and more than 50% of shareholders voted against pay deals at Smith & Nephew.

However, comments from institutional shareholders and shareholder groups following these votes have indicated that concessions made by the companies are not substantial, amounting to little more than confirmation that shareholder concerns had been noted and promises made to review pay structures and remuneration policy. Therefore, companies may not act immediately following a shareholder vote against the remuneration report; but they are not obliged to. The company can continue to follow its current remuneration policy until the next AGM. This situation, perhaps, puts into question the overall impact that shareholder voting rights can have on directors’ remuneration.
Examiner’s comments

Question 4 was one of the most popular questions, but it was not generally well answered.

In part (a), most candidates provided details of best practices in senior executive remuneration. However, many candidates did not address how these could be applied to Wilby and the given scenario. There was also a significant lack of knowledge in respect of severance and compensation payments shown and very few candidates made reference to the joint ABI/PLSA statement.

Some candidates suggested that Henry Fasson should refund the company for part of his severance package. This would not be possible as the company would be bound by the contract. This was the area in which candidates were expected to provide suggestions as to what needed to be reviewed at Wilby in order to avoid a similar situation happening again.

In part (b), most candidates provided a good explanation of the voting rights in respect of remuneration, although sometimes there was confusion between the different elements and timescales. There was a lack of knowledge shown in respect of the requirement for a statement to be published when a director leaves office.

Very few candidates sufficiently evaluated the impact of the voting rights. Candidates who had demonstrated that they had undertaken wider reading were able to provide good answers, giving examples of recent shareholder voting against remuneration packages at listed companies.
Randall plc ('Randall'), a company listed on the London Stock Exchange, manufactures high quality clothing to customer specifications, often sourcing hand-made fabrics from around the world. References to Randall’s fair treatment of employees and commitment to sustainable sourcing of materials feature heavily in its marketing to customers.

Randall has had a due diligence programme in place for a number of years which sets out requirements that suppliers and raw materials have to meet. The department responsible for maintaining this programme has experienced a significant amount of staff turnover in the last year.

It has recently emerged that one of Randall’s suppliers, based in another country, is not operating its factory to the required standards. In particular, employees in the supplier’s factory are working long days, which exceed the legal limits for their country. Also, it is not using materials from environmentally sustainable sources.

You have been asked to provide advice to Randall’s board.

**Required**

(a) Advise Randall on how it should report (as a listed company) on the issues with its supplier.

**Suggested answer**

The situation described would suggest that internal controls within Randall (the due diligence programme) have failed. This failure is probably the result of the high staff turnover within the relevant department, meaning that knowledge of, and experience in dealing with, the due diligence process has been lost.

The supplier not meeting certain requirements has the potential to harm Randall’s reputation, which could then lead to Randall experiencing a loss in sales and affecting the financial performance of the company.

**Announcement/press release**

It should be noted that under the Listing Rules a company is obliged to make an announcement to the London Stock Exchange should it become aware of any information that would be likely to have a significant effect on the price of the shares if it were generally available.

It is not clear from the scenario as to whether the failure of the supplier to meet requirements is in the public domain. If it is not, then it will be for the board of Randall to decide whether a disclosure under the Listing Rules should be made by way of a Regulatory News Service (RNS) announcement.

If the failure of the supplier is already within the public domain, the board of Randall may consider making an announcement or press release in order to acknowledge it and explain (to the extent that it can) how it is dealing with the issue.

In either case, the board would be best advised to consider its obligations under the Disclosure and Transparency Rules to report significant internal control weaknesses, when they occur, if the company’s financial performance or position will be badly affected as a result.

**Annual report**

The UK Corporate Governance Code (UK Code) and the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting 2014 do not call for disclosures of specific failures in internal controls, or the measures that have been taken to deal with them. However, the Disclosure and Transparency Rules (DTR) for listed companies requires companies to report on the main features of their internal control and risk management systems in relation to
financial reporting. This information is provided within the annual report has a section on internal control. The report should summarise the process that the board has applied for reviewing the effectiveness of the system of internal control, and confirm that action has been taken to deal with any significant weaknesses or failures identified from the review. Where a significant problem is disclosed in the company's annual report, the internal control report should disclose the process that has been applied to deal with the material internal control aspects of the problem.

Therefore, Randall will be required to report on the failing of the supplier within its next annual report. If the failing is deemed to be significant, then an explanation of how this has been dealt with will also be required.

(b) Analyse which categories of risk the failure at Randall relate to and how each category of risk might be addressed.

(10 marks)

Suggested answer

There are likely to be five categories of risk that the failure at Randall will impact on.

Operational risk is evident in that the due diligence process has not been adhered to correctly and the management of the process has not been consistent due to high staff turnover. In order to address this, a review of the internal controls should be undertaken and necessary actions identified. Such remedial actions may include the due diligence process being formally documented and staff being trained on its implementation, application and monitoring.

Operational risk also exists in terms of the potential inability of Randall to manufacture some of its products due to the break in the supply chain, assuming Randall will no longer be using the supplier, and that other suppliers may also have to be reviewed. If Randall chooses to address the issues with the supplier, to bring them in line with the requirements, then operational risks will exist in terms of the time and effort needed to do this and an alternate supplier being required in the short-term. In order to address these risks, Randall would need to determine how it is going to obtain its materials in the short-term; if it is going to work with its non-compliant supplier, how compliance will be achieved and over what time period; and, if it is going to terminate the contract, then how it is going to find a suitable supplier for the provision of materials in the longer term.

It may also be possible to control operational risks by appointing a dedicated team to deal with the supplier issue. Meanwhile, other operations within the business can continue normally and enable Randall to be manufacturing other products.

Compliance risk exists in terms of employees in the supplier’s factory working long hours, which exceed the legal limits for their country. Again, assuming that Randall chooses to address the issues with the supplier, working hours would need to be reviewed to bring these in line with local law. Such changes may affect productivity and could raise issues in terms of the supplier being able to satisfy demand.

Competition risk will arise if Randall has competitors in the market who may be able to benefit from the issues that Randall is experiencing. Whilst Randall operates in a specialist market, a strong competitor could utilise the opportunity to offer similar products which are ethically manufactured and obtain a share of the market. In such circumstances, and depending on how well Randall overcomes its supplier issues, it may well be difficult for Randall to regain its position within the market. In order to address the risk of competition, Randall may be able to rely on the loyalty of its customers if it can be shown to be managing the situation with its supplier and implementing relevant contingency plans. Additionally, if Randall has other product ranges available it could switch its main advertising focus to these whilst it is dealing with the supplier issue.

Reputation risk could be affected significantly given Randall’s position in the market and the fact that its marketing focuses on important environmental/corporate social responsibility issues.
risk includes the loss of customer loyalty or customer support following an event that damages the company's reputation. It is often associated with risks arising from unethical behaviour by a company, or its suppliers, including practices and policies that damage the environment or affect human rights. Communication is likely to be of key importance for Randall to address reputation risk. By keeping customers and shareholders regularly informed about the actions it is taking, how these are working and how it will avoid such problems occurring in future, Randall should be able to minimise the risk to its reputation.

Randall could also consider other ways to develop its reputation, perhaps through charitable donations and other corporate social responsibility activities.

Financial risk could result in terms of loss of revenue if products cannot be made or the level of sales decrease; costs related to working with the supplier to meet requirements; and as a combined result of the impact of the operational, competition and reputation risks. In order to address potential financial risk, Randall should review its financial position in terms of current assets and reserves, the ability to borrow and ways in which cost savings could be made in the short-term.

(c) Discuss how an effective system of internal controls can assist Randall in managing risk in future.

(9 marks)

Suggested answer

An internal control system contains the policies, processes, tasks, behaviour and other aspects of a company that, when taken together, help it operate effectively and efficiently. The operational controls allow a company to respond in an appropriate way to significant risks to achieving the company’s objectives. This includes the safeguarding of assets from inappropriate use or from loss or fraud and ensuring that liabilities are identified and managed.

An internal control system also helps a company to ensure the quality of external and internal financial reporting and financial controls. It also helps to ensure compliance with applicable laws and regulations, and also with internal policies for the conduct of business.

As the above illustrates, there should be operational, financial and compliance controls for dealing with operational, financial and compliance risks, preventing losses or adverse events from happening, or detecting and correcting the problem when losses or adverse events occur.

Operational controls are designed to prevent failure in operations procedures, or to detect and correct these if they occur. Financial controls are internal accounting controls that are sufficient to provide reasonable assurances that proper accounting records are being maintained. Compliance controls are concerned with making sure that a company complies with all the requirements of relevant legislation and regulations. The potential consequences of failure to comply with laws and regulations vary according to the nature of the industry in which a company operates and the regulations themselves.

By having an effective system of internal control in place, Randall would have relevant operational, financial and compliance controls in place and would be able to respond quickly to risks within the business as they emerge and develop. There would be procedures for reporting immediately to the management responsible; for controlling failings that have been identified and undertaking corrective action as required.

An effective system of internal control will provide Randall with reasonable assurance that risks will be suitably controlled. Absolute assurance that there will not be any material losses, fraud, errors or breaches of laws and regulations cannot be guaranteed. The possibility will always exist for poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseen
circumstances. However, with a system of internal control in place, Randall’s management will be able to respond promptly to risks when they arise.

The effectiveness of a system of internal control should be regularly reviewed. The UK Code (C.2.3) states that the board should monitor the company’s risk management and internal control systems and, at least annually, carry out a review of their effectiveness. With such reviews being undertaken, Randall’s management will be able to identify problems more quickly and take remedial action sooner in order to mitigate risks to the business.

Examiner’s comments

Question 5 was one of the least popular questions and was the least well answered.

In part (a), no candidates identified the relevance of the requirements of the DTR in respect of disclosing failures in internal controls if a company’s financial performance or position will be badly affected.

Most candidates made a relevant suggestion of the issue needing to be reported within the annual report. However, there was a lack of understanding in terms of the more immediate requirements (if assessed as being required) to make an announcement to the Stock Exchange and/or a press release.

A large proportion of candidates interpreted the question as being related to corporate social responsibility. Marks were awarded in these cases, but only on a limited basis.

In part (b), most candidates accurately analysed the categories of risk and suggested how these might be addressed. However, some answers were very general in nature in terms of risk categories and lacked the required analysis of the scenario. Some confusion arose in respect of the issues at the supplier and how these corresponded to risks within Randall.

In part (c), most candidates listed the elements of an effective system of internal controls, but many did not discuss how a system could assist Randall.

Many candidates detailed the elements of the COSO Framework. Limited marks were awarded where details were relevant to an effective system of internal controls.
6 Tilson plc (‘Tilson’) is a company listed on the London Stock Exchange. It is has recently acquired a new subsidiary company, Inka, which is located in Europe and has a two-tier board structure. It is intended that Inka will continue to operate independently and a representative from each of its boards will report to the board of Tilson.

You are Company Secretary of Tilson and are assisting the board in developing an appropriate governance framework to take account of the addition of Inka to the group.

In addition, the Chairman of Tilson, Alex Ross, has been invited to join the board of a UK charity and has asked you for some advice in this regard.

**Required**

(a) Discuss the strengths and weaknesses of both unitary and two-tier board structures.  

(15 marks)

**Suggested answer**

**Two-tier boards**

Two-tier boards (used in countries including Germany, Switzerland and Austria) have a structure which contains a supervisory board and a management board.

The management board consists entirely of executive directors and is responsible for managing the company, led by the CEO. The supervisory board consists entirely of non-executive directors (NEDs) and is responsible for the general oversight of the company and of the management board. It is led by the company Chairman and the members of the supervisory board are usually elected by the shareholders. In public companies with more than 500 employees, a minimum proportion of the supervisory board must consist of representatives of the employees.

There has to be a functional relationship between the management board and the supervisory board. The Chairman of the supervisory board plays a key role in ensuring that the two boards work well together, and the most powerful individuals in the company are the Chairman of the supervisory board and the CEO, who is in charge of the management board. The CEO reports to the supervisory board Chairman and, where this relationship works well, the Chairman will effectively speak for the management at the meetings of the supervisory board.

Supervisory board NEDs are not necessarily independent, particularly employee representatives. This can make it difficult to reconcile the views of employee representatives and of major shareholders, without causing antagonism to executives on the management board.

Where there are too many former company executives on a supervisory board there can be a risk of leniency being afforded in respect of activities and performance of the management board. In addition, some independent supervisory board directors might well be senior managers of other companies, where they are management board members. These individuals might therefore sympathise with the views of the management board.

A good relationship between the supervisory board and the management board and, in particular, between the Chairman of the supervisory board and the CEO, is vital for the success of the two-tier board structure. If this does not exist, then the structure will not work effectively.

Supervisory boards can be very large, some with around 20 members and including large numbers of employee representatives, which can result in inefficient meetings.

The percentage of employee representatives required on supervisory boards can mean that some of these members lack competence in considering strategic issues or are not independent from the company.
Concerns have also been raised in the past regarding information leaks, damaging communications between supervisory and management boards. However, the German Corporate Governance Code has suggested that there is intensive interaction between the supervisory and management boards and this is making the two-tier and unitary board structures much more similar. Interestingly, the German Code also suggests that the two types of board structure are equally successful. Developments in some German companies in recent years also suggest that the supervisory boards of large German companies are becoming more responsive to the interests of their shareholders.

Unitary boards

A unitary board (common to most countries) consists of both executive directors and NEDs, under the leadership of a Chairman. Decisions are made collectively and the board is accountable to the shareholders. Although not a legal requirement, in the UK, it is commonly accepted governance practice (under the UK Corporate Governance Code 2014, B.1.1) that the NEDs in a listed company should be independent.

There are criticisms made of NEDs, including the argument that they are ineffective because they devote insufficient time to the company or have insufficient knowledge of the company’s business.

The question has been raised as to whether the two-tier board structure would work in the UK. However, this is no longer seen as a serious consideration due to improvements made by the introduction of board committees (audit, remuneration, nomination and possibly also a risk committees). Committees are able to consider some of the issues in more detail than the full board, and some issues can be dealt with successfully by a committee where involvement by the whole board might be inappropriate (for example, decisions regarding senior executive remuneration).

The criticisms made of two-tier boards, as detailed above, have also contributed to the argument against this structure being adopted in the UK. However, some commentators have suggested that the existence of executive committees, and how these work alongside the full board, mirrors a two-tier board structure to some extent.

(b) Prepare a briefing note for Alex in which you:

- explain the high level principles relating to governance in the voluntary and community sector; and

- refer to any relevant codes or guidelines which will assist Alex in understanding how this differs from the corporate perspective.

Suggested answer

Briefing note

Within the voluntary sector a wide range of organisations exist, including charities. Most charities are governed by a board of trustees. Large charities employ full-time managers and employees, whereas others rely entirely on voluntary and unpaid help.

“Good Governance: a Code for the Voluntary and Community Sector” (published in 2005; revised in 2010) was developed and endorsed by the Charity Commission and the National Council for Voluntary Associations (NCVO), the Association of Chief Executives of Voluntary Associations (ACEVO), the Charity Trustee Networks (CTN) and the ICSA.

This Code defines governance in the voluntary sector as “the way that trustees work with chief executives and staff, volunteers, service users, members and other stakeholders to ensure their
organisation is effectively and properly run, and meets the needs for which the organisation was set up”.

The Code is not mandatory, but organisations that comply with it are invited to state this within their annual report and other relevant published materials. The revised Code contains six high level principles which are set out as ways in which the board of the organisation should provide good governance and leadership:

- Principle 1 states that members of the board should understand their role and responsibilities, both collectively and individually, with regard to matters such as their legal duties, their stewardship of the organisation’s assets and its governing documents.

- Principle 2 states that the board should ensure that the organisation delivers its purposes or aims by ensuring that these remain relevant and valid, by developing and agreeing a long term strategy, agreeing operational budgets, monitoring progress and assessing results and outcomes. Failure to ensure delivery of purpose would mean filing responsibilities to beneficiaries and the people who provide finance and support.

- Principle 3 states that the board’s policies and procedures should include arrangements for finding and recruiting new board members to meet the organisation’s changing needs, providing suitable induction for new board members, providing opportunities for training and development for all board members and reviewing the performance of the board, both as individual members and as a team.

- Principle 4 states that as an accountable body, the board should ensure that the organisation understands and complies with all legal and regulatory requirements, continues to have good financial and management controls, identifies major risks facing the organisation and has a risk management system in place to deal with them. The board should also ensure that delegation of authority to committees, staff and volunteers works effectively and is properly supervised.

- Principle 5 states that the board should safeguard and promote the organisation’s integrity, act according to high ethical standards, manage conflicts of interest and loyalty and maintain the independence of its decision-making. Unethical behaviour could cause serious reputational harm to the organisation.

- Principle 6 states that the board should be open and accountable, both internally and externally. This requirement includes open communications (informing people about the organisation and its work), appropriate consultation on significant changes to the organisation’s services or policies, listening and responding to the needs of its stakeholders and handling complaints constructively and impartially.

Overall, the general principles of good corporate governance relating to companies also apply to organisations within the voluntary sector: fairness, accountability, responsibility and transparency. A major difference between the two is that, within companies, accountability is associated with management accountability to the board of directors and the board’s accountability to shareholders. In the voluntary sector, accountability also involves listening to stakeholders, and responding to their views and complaints.

**Examiner’s comments**

Question 6 was the least popular question and few candidates who attempted it answered it well, although part (a) was mostly answered better than part (b).

In part (a), most candidates provided a very good explanation of the features of the two types of board structure and the strengths and weaknesses of both.
However, in part (b), there was a significant lack of knowledge shown in respect of the high level principles of governance in the voluntary and community sector. Many candidates reverted to detailing the general principles of governance and/or the Nolan principles. Limited marks were awarded where details were relevant to governance in the voluntary and community sector. It was often the case that where candidates had answered well in part (a), their overall result for the question was adversely affected by their mark in part (b).

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.