



## Chartered Secretaries Qualifying Scheme – Level One

# Corporate Governance

June 2011

Thursday morning 9 June 2011

**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 is worth 25 marks. You must attempt **four questions only**.

# Questions

Answer **four** questions from this paper.

1. Ambio is a TSX listed company. It recently made a takeover bid for a large foreign company, as part of a strategy of the board of directors to grow the business globally. The decision to make the bid was taken after a series of board meetings on company strategy, and the board recognised that there was a significant business risk in extending the company's foreign operations. To finance the purchase cost of the takeover, the company announced that it would have to make a large rights issue of new shares. Several major shareholders objected to the bid, on the grounds that the offer price was too high. Some shareholders had meetings with the company chairman to discuss their views, which the chairman passed on to the full board of directors. Eventually, the board gave way to shareholder pressure and agreed to reduce the offer price for the takeover. However, the board of directors of the takeover target rejected the lower offer, and the takeover negotiations came to an end with failure to agree terms.

Ambio will incur very large costs in connection with the failed bid, mainly from fees and expenses payable to investment banks, firms of lawyers, accountants and other advisers. The total amount of costs written off will be equal to the company's total equity dividend payments to shareholders in the previous financial year. Many shareholders have expressed their anger about these costs, and have blamed the company chief executive officer (CEO) for proposing the ill-advised takeover bid and the company chairman for failing to lead the board in a challenge to the CEO's proposal.

## Required

- (a) Discuss, with reasons, whether the board of directors of Ambio has failed to comply with expected standards of best practice in corporate governance, in deciding to make the takeover bid and then to revise the offer in response to shareholder pressure.  
(8 marks)
- (b) Describe how institutional investors with shares in Ambio should follow best practice in stewardship in their dealings with the board of directors of the company.  
(8 marks)
- (c) Suggest what measures might now be taken by shareholders who remain angry and dissatisfied with the chairman and the CEO of Ambio, and believe that they have provided inadequate leadership for the company.  
(9 marks)

(Total: 25 marks)

2. Setton Services ('Setton') is a small private Canadian company, which was established five years ago by Les Setton ('Les'), an individual with great personal energy and entrepreneurial skills. He and members of his family own 100% of the shares in the company, which became profitable three years ago and continues to grow successfully. Les manages the company and is also the chairman of the board of directors, which consists of himself and three executive directors. He has a strong personality and dominates decision-making by the board.

Les thinks that he will continue to run the business for about three more years, and then hopes to sell it or to take the company on to one of the smaller stock markets in Canada. He can foresee that his young management team might want to buy the company from him, or that he might receive a takeover bid from a larger company.

Donald Mack ('Donald') is a good friend of Les, and has experience as a company secretary. He suggested to Les that if he plans to sell the company or to turn it into a public company in the next few years, he should consider making improvements in corporate governance. Les replied that he was not sure what corporate governance was, but that he thought the company was well-managed and successful, and so did not need any changes. He certainly believed that the board and the company's management had to remain entrepreneurial and that corporate governance measures would inevitably mean more administration and bureaucracy. Donald said that he understood Les's concerns, but that improvements in corporate governance could benefit the company and assist Les with his future plans.

Les also commented that he was considering a new incentive scheme, in which he would award new shares in the company to his executive directors and senior managers on condition that certain financial performance targets were met in two years' time. He considered that such a scheme would help to motivate his senior managers and align their interests with his own objective of selling the company in the not-too-distant future.

### **Required**

- (a) Explain the difference between governance of a company and management. State your views, with reasons, about whether governance imposes bureaucracy on a company and stifles entrepreneurship. *(8 marks)*
- (b) Excluding changes in remuneration policy, suggest changes that might be made to corporate governance practice in Setton, and explain how these would benefit the company or help Les with his future plans. *(10 marks)*
- (c) Discuss the possible implications of the proposed policy of rewarding senior executives with grants of shares in the company. *(7 marks)*

*(Total: 25 marks)*

3. Sara King ('Sara') has just been appointed as independent director (ID), consistent with NI 58-101 Disclosure on Corporate Governance Practices of a medium-sized listed company. She has been asked to act as a member of the three-member audit committee, which has oversight and responsibility for review of the company's risk management system. At an introductory meeting with the chairman of the audit committee, Sara is told about some of the business risk issues facing the company at the moment:

- (i) The company operates in a highly competitive industry, in which there are rapid technological developments. The global and national economies have been through a period of recession, but a period of sustained economic growth may now be under way. The company's CEO has proposed a major investment in a new online service to meet customer demand in the expected economic upturn. To finance the investment, the company would probably have to increase its borrowings substantially.
- (ii) The company's external auditors have written to the board of directors commenting on the fact that the company does not have a disaster recovery plan, but might be well advised to develop one.

The board does not have a separate sub-committee with responsibilities for the risk management system.

The chairman of the audit committee tells Sara that business risk, including the need for a disaster recovery plan, are on the agenda for the next board meeting. He adds that it will be important for members of the audit committee to contribute effectively to the meeting, in view of strong views expressed recently by some directors about the lack of value of IDs to the functioning of the board.

### **Required**

- (a) Explain the nature of business risk and the responsibilities of the company's audit committee for business risk management.  
*(7 marks)*
- (b) What is a disaster recovery plan and how may such a plan contribute to best practice in corporate governance?  
*(5 marks)*
- (c) As company secretary, prepare a briefing note to Sara on how to be an effective ID, and commenting on what some of the common criticisms of IDs are.  
*(13 marks)*

*(Total: 25 marks)*

4. Newman is a large multinational mining company. It has plans to invest in the construction and operation of a new mining facility in Canada's Far North. In time, the mining operations are expected to employ thousands of workers, many of them from the local area. Canada's Far North has a rapidly-growing native population, education standards are currently fairly low and there are concerns about standards of public health. The region has been divided into two territories which have newly elected territorial representatives. In one territory, there are several different native languages being used.

The board of directors of Newman has made considerable efforts in recent years to promote the image of the company as a 'global corporate citizen'. One of its board members, an executive director, has been given special responsibilities for corporate social responsibility (CSR). In carrying out his work on CSR, this director regularly seeks the advice of the company secretary. They are planning a fact-finding visit to the Far North where the proposed investment is planned and, on their return, the director will report to the board on the CSR issues that the company will need to consider if the decision is taken to invest in Canada's Far North.

**Required**

- (a) How can CSR reporting help define the company as a good corporate citizen?  
*(10 marks)*
- (b) As company secretary accompanying the CSR director, prepare a board paper in advance of your fact-finding visit, in anticipation of the issues that the visit may raise. Discuss the risks and opportunities that the company may need to consider with regard to CSR if it invests in Canada's Far North and, in particular, the:
- (i) Social issues.
  - (ii) Environmental issues.

Where appropriate, give examples of current best practice and issues that other companies may have faced in similar circumstances.

*(15 marks)*

*(Total: 25 marks)*

5. Hans Denkmal ('Hans') is the chairman of Pindrop, a TSX listed company. He is regarded by the investment community as a successful and competent chairman, partly because of his interest in best corporate governance practice. He has strong views about what the role of a company chairman should be, which correspond to the principles and provisions in the NP 58-201.

A major problem has just arisen in his company, concerning the chief executive officer (CEO). The company has reported a big loss on a contract with a major customer, and a reason for the loss appears to be that much of the work on the contract was sub-contracted to another company at a very high price, and the sub-contracting agreement was very unfavourable to Pindrop. The amount of work sub-contracted was very large. It has now been discovered that close family members of the CEO of Pindrop own more than 15% of the company that did the sub-contracting work. When challenged by Hans about this matter, the CEO denied any breach of duty or other wrongdoing. He added that if he was taken to court by the rest of the board of directors, or by a shareholder, he would defend himself vigorously and would expect to receive financial protection in these circumstances from the company's directors' and officers' liability insurance.

### **Required**

- (a) Describe the role and accountabilities of the chairman of a listed company, with regard to board effectiveness and investors' expectations of a successful and competent chairman.
- (12 marks)*
- (b) Explain, with reasons, whether the CEO appears to be in breach of his statutory duties as a director of Pindrop and recommend what action the chairman should take.
- (9 marks)*
- (c) Explain the nature of directors' and officers' liability insurance and suggest whether this will protect the CEO financially against any legal action by the company against him for breach of statutory duty.

*(4 marks)*

*(Total: 25 marks)*

6. The newly-appointed chairman of a TSX listed company has asked the company secretary for his opinion and advice about a number of issues that are causing him some concern. He has discussed these concerns with the chief executive officer (CEO), but thinks that the CEO does not show enough concern for the risks, particularly in view of the fact that the company is in the process of preparing its annual report and accounts. The chairman mentions three issues in particular:
- (i) He has been puzzled by the extent of the questions that the external auditors have been asking all members of the board about the going concern status of the company. He thinks it may be because another client company of the audit firm went into liquidation unexpectedly a few months ago.
  - (ii) He has read reports in the financial media about the growing concerns of some institutional investors about the lack of reliability in the financial reports of many companies. As he is not an accountant, he is not sure what measures can be taken to make sure that financial reporting is reliable. He has tried asking the finance director, but could not follow all of the technical detail that he was given in reply.
  - (iii) Like many other company directors, he has become much more aware about reputation risk and its consequences, following the events in 2010 involving the tragic explosion and oil leakage at BP's well in the Gulf of Mexico. The chairman thinks that his board should be giving much more attention to the implications of reputation risk for their own company.

**Required**

- (a) Explain the nature of a going concern statement and, using Saucier as a basis for your argument, outline the responsibility of the directors of listed companies in Canada for such a statement.  
(7 marks)
- (b) Explain the various measures that are taken to provide reliable financial reports to shareholders, or improve the reliability of financial reporting.  
(8 marks)
- (c) Using the example of BP, or any other example with which you are familiar, explain the possible implications for a major global company, and the possible consequences, of an event that causes serious damage to a company's reputation.  
(10 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.*

