

ICSA Qualifying Programme

Risk Management

Sample assessment material 2019**Time allowed:** 3 hours (plus 15 minutes 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 **6** questions of which you must attempt **4**. You must attempt **3** questions in Section A and **1** question in Section B. The questions in Section A are based on the pre-released case study whereas the questions in Section B are not based on the pre-released case study.

Each question is allocated 25 marks. There are **100 marks** available in total for the paper.

Note: Unless otherwise specified, you should assume that an Act or an organisation referred to in the questions is a UK Act or organisation.

Case study

Chocs plc

Background

Chocs plc (Chocs) was established in 1951 by Peter Davison. After obtaining a chemistry degree at the age of 21, Peter joined a large food manufacturer in their product development department. He was particularly interested in the confectionery making process and later became a master chocolatier. Peter's vision of creating his own production facility to develop a range of high-end chocolate products, focused on taste, was later realised with the opening of Chocs in 1951, in his home town of Birmingham.

Chocs was started with family money and government support. The opening of the factory in the area was met with great enthusiasm and seen as an opportunity for local jobs and regeneration. The business was heavily involved in the chocolate making process and Peter was keen that his business was 'bean to bar'. The business became known rapidly for its quality products, ethical business practices and customer focus. Peter's ethos was "wherever possible we answer 'yes' to our customers". He was highly regarded as a businessman and with a reputation for being fair in his dealings. He also took an interest in the wellbeing of the cocoa farmers that supplied the raw materials to the factory.

Peter's vision proved correct and the business has grown consistently throughout its 68 years of production. Despite the consistent success, business growth is now slowing. The financial year-end results for 30th June 2019 reflect a turnover of £425million (down by 7% from 2018) and a net worth of £642million (down by 5% from 2018). Profitability has experienced highs and lows over the years. A general decline in profits over the last five years has been attributed to increased competition, rising prices of raw materials and increased labour costs worldwide.

The production strategy of the business has remained consistent – high quality products and choice for the customer. The range of customers and products has expanded. Circa 80% of output is for the retail sector with the remaining 20% being produced for restaurants and other more diverse range sectors, such as specialist cake makers. The business focus is firmly on maintaining its market leader presence while upholding its ethical values. The company sources and purchases 'fairtrade' raw materials although it has experienced a significant rise in prices and is unsure how long it will be able to continue with this.

Chocs has remained a family business in culture and ethos, and at age 99 Peter still tries to attend the AGM each year. The CEO is now Susan Davison, Peter's grand-daughter, she took over from her father (Peter's son, Ben, who remains as Chair) in 2011. Although in many ways unrecognisable from 1951, the Birmingham factory is still the head-office and is the centre of a highly modernised production operation. An external stakeholder would consider this to be a business where all was running well.

- Chocs now has seven sites across the world employing approximately 1,800 people. They differ only in size and capacity but all offer a generalised range of products. At the last Board meeting Susan proposed a review of site capacity with a view to developing specialisation at certain sites, she was concerned that the declining profitability was at least in part due to loss of focus and the risk of Board complacency about future viability; this was not received well by Ben and further discussion was deferred to the next meeting.
- 42% of Chocs shareholding remains with family and family trusts, the remaining 58% is traded (infrequently) on the Alternative Investment Market after a successful IPO led by Ben in 2007. The funding raised enabled expansion, modernisation and a capital return to the family shareholders. The institutional and retail shareholders are mainly longer-term investors and have generally been satisfied with dividend return and share price stability.

Governance

Chocs has seven directors; three months ago, **you** were appointed as Company Secretary reporting to the CEO.

- two executive directors – Susan Davison (CEO) and Kenneth Dwight (CFO);
- three family NEDs – Ben Davison (Chairman) and two of his cousins (Peter Balfour and Elsie Davison) – family NEDs are proposed and elected by a council representing family shareholders;
- two independent NEDs – Ramesh Singh (based in Mumbai) and Stefan Volski (based in Warsaw).

The board meets eight times a year (four times in Birmingham and four times at different operating sites of the business). An Audit Committee and a combined Remuneration and Nomination Committee each meet three times a year, usually coinciding with a board meeting. All NEDs are the constituent committee members, and all meetings are attended by the executive directors.

The AIM investors have been happy with this governance arrangement thus far, not least because the financial returns have remained consistent and in line with expectations.

Risk and control

You were excited at your appointment to such a successful and interesting business, you have made sure you have met each of the directors individually, as well as during meetings. This has raised a number of areas of concern for you.

The key strategic and operational decisions throughout the business seem to be made through closed and un-minuted weekly meetings between Ben (Chairman), Susan (CEO) and Peter Balfour (family NED). Papers presented to Board meetings are short, succinct headline summaries from each operating business. Decisions seem to have already been made and are only brought to the Board for ratification. You have discussed this with Kenneth who told you that this was the culture, he was sometimes at these meetings and that he was treated as family, as his partner is a nephew of Ben.

As Chocs has large scale production capability, health and safety (H&S) features frequently in operational reports, but again is only ever summarised in Board papers, usually in the form of pie charts. Having analysed the figures further, you find that there has been an increase in reportable Health and Safety(H&S) incidents at five out of the seven sites across the past 24 months, but this is barely mentioned in the board reports.

Having read through the Board and Committee papers for the past three years, you find there is very little record of how the directors view the alignment of strategy, risk and control. Each site keeps their own version of a register of the risks pertinent to their site (partly to keep the local H&S regulators satisfied). Each site has a high level of autonomy with regard to its approach to risk management. Monthly local reports regarding risk and any related incidents are amalgamated by a team at the Chocs site in Ireland using a spreadsheet to provide a set of charts which appear as an appendix to the Board papers.

There is no minuted record of director discussion of any level of risk strategy, although you assume this must have happened as there are oblique references to a number of accidents across the world, and to two deaths that have occurred on Chocs sites (one in Poland earlier in the year, and one in Brazil last year). Control, in so far as it exists at all, seems to be delegated to a very low level on individual sites, and then discussed only confidentially at the weekly closed meetings.

Stefan has discussed with you his concerns regarding a lack of risk management awareness. He is also surprised at the lack of apparent concern from the English directors; he has assumed that they just have more experience than him of running this type of business. He is aware of his duties under UK law and plans to raise the issue at the Board meeting, scheduled to be held on the Chocs' site at Sao Paulo next month. He has talked to Ben about the whole H&S and CSR approach but has been told that "CSR is just another acronym designed to take valuable director time".

It has also been brought to your attention in a conversation with Stefan that cocoa farmers in South America have staged a series of protests over low wages and payments that they have been receiving for their goods and services. Chocs has been wrongly implicated as one of the companies who have attempted to hold down prices. This has received media attention and support groups are threatening a media campaign to boycott Chocs' products.

CEO perception

Susan asks to meet with you ahead of the Board meeting in Sao Paulo. Whilst asking for your views she talks about her concerns for the future of the business. She tells you that she has recently been reading about 'Black Swan' risk events and the dangers of not being ready for the 'unknown unknowns'.

You made the following rough handwritten notes for your own use and to remind you of this meeting:

Informal notes for further consideration from meeting with CEO

Disparate, dysfunctional and ill-informed directors.

Major H&S incident with numerous minor injuries at the Sao Paulo site to be reported at the Board meeting, but already being discussed in the Indian media suggesting that the Chocs site has grown too big too quickly.

Lack of concern from directors about risk and lack of formal generic risk procedures across the business.

Kenneth only ever focused on direct financial risk – his area of accountability. The external auditors of Chocs have recommended, in each of the past three years, that Chocs ought to establish a robust internal audit function. Ben and Kenneth had always rejected this as unnecessary costs to the business, and this has not been challenged by the NEDs.

Family enjoy the worldwide reputation but don't understand the need for wider stakeholder consideration, or even why the AIM investors need to be taken seriously

She has just read an article on cyber-risk and realises that this has never been discussed by the directors; technology falls under Kenneth's remit and he has assured her that everything is under control

Institutional investor concern at continuing decline in performance.

Activist shareholders pushing for more regular briefings and questioning the lack of an independent majority around the Board table.

Frustration of being the third-generation family leader, with her father (Ben) still chairing the business and often saying "this wouldn't have happened in my time". She is also worried about his dismissal (as Chair) of the need for a robust approach to CSR and wider stakeholder accountability.

Need for overhaul of governance and senior management structures, but resistance from the family council.

Section A

Answer **three** questions in this section.

1. (a) Analyse the governance benefit for Chocs of incorporating a risk control framework such as the 'three lines of defence' into its risk management strategy. (15marks)
- (b) Discuss how Chocs could improve its approach to Enterprise Risk Management. Suggest the nature and roles of the people that might be required to drive this initiative. (10marks)

[Total for Question 5 = 25 marks]

2. (a) Prepare a briefing paper for the directors of Chocs which categorises the risks that are apparent. Include in your answer the differentiation between risk and uncertainty, and between controllable and uncontrollable risks. (15 marks)
- (b) Discuss the relevance of risk categorisation and the risk management process of 'identification – assessment – monitoring – control'. (10marks)

[Total for Question 2 = 25 marks]

3. Analyse the need for the directors of Chocs to develop an enhanced 'board' awareness of how to control the risks that might emerge from the stakeholder challenges around sustainability and social responsibility at Chocs.

[Total for Question 3 = 25 marks]

4. Having been challenged by the CEO at the Sao Paulo Board meeting, the family and independent non-executive directors of Chocs are concerned about current practices.

Prepare a report for the Board of Chocs assessing the benefits that could be gained from incorporating a risk register into the company's risk reporting framework.

Your report should include the rationale for a register, examples of how a register might be constructed, what it might contain, and how the register could enhance the control and oversight of risk within Chocs.

[Total for Question 4 = 25 marks]

TOTAL FOR SECTION A = 75 MARKS

Section B

Answer **one** question only. Questions 5 and 6 do not relate to the pre-released case study.

5. You have been asked to write a guidance note for a group of new non-executive directors which analyses risk culture, risk appetite and risk tolerance and risk capacity.

Your answer should include the value of differentiating between them and use examples to suggest how and why an understanding of these risk dimensions can benefit an organisation.

[Total for Question 5 = 25 marks]

6. Ivan Popov works for a Russian Bank as a senior investment manager. He has just been transferred from the Moscow office to the London office and it is his first time in London. He has asked you, as a Company Secretary in Private Practice, to write him a paper which discusses the relationships that exist between risk and governance within the UK regulatory environment.

The paper should contrast the UK with other jurisdictions where relevant, and include reference to relevant regulations, codes, sector specific influences, and wider stakeholder expectations.

[Total for Question 6 = 25 marks]

TOTAL FOR SECTION B = 25 MARKS
TOTAL FOR PAPER = 100 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.