

NACD Directorship Certification **Practice Exam Cases** 2021

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INSTRUCTIONS

Testing Advice

When selecting your answers to the cases presented, respond solely based on the information provided in the particular step and assume the mindset of an average director in that situation. Try not to reflect on your previous experiences with similar situations.

You are encouraged to work through each case, one at a time. The step and the relevant questions are presented on the page. The following page includes the answers organized by “Appropriate actions” and “Incorrect/Not necessary action(s).” As you review your responses, reflect on the rationale provided and the core elements of governance that the cases are testing. Apply that reasoning and approach to the subsequent cases.

Part II of the certification exam consists of 10 case study problems, each with three or four steps. Candidates will have 95 minutes allotted for this portion of the exam (absent any applicable accommodation). The case study problems provide information about a situation that a corporate director might encounter. A question and several action choices are provided, which are possible actions or decisions that the corporate director might choose *in light of the information provided about the situation at the point that the specific question is asked*.

Subsequent steps will offer additional information about the situation (along with the information presented in the previous steps) and new answer choices. *Remember to only choose answers to the questions about the situation that make sense in light of the information about the situation that has been provided at the point that the question is asked.*

1. For each step, candidates are expected to select ALL of the answer choices that are appropriate for the situation, based on the information provided at that point in the case. Candidates should select as many actions as necessary to respond to the situation presented; however, they should not choose actions that are inappropriate (actions that are not relevant to the situation at hand or that fall outside of the board/director’s role) or would be considered optional or not necessary at the particular point in the case study. You must choose at least one (1) action for a step before moving forward in the case. **Note:** In the case studies, new information is shared during each step in the case. During the exam, you are unable to return to any of the previous steps because it may affect prior decisions made. You are encouraged to approach the practice case studies in the same way. While working through the practice case studies, try to complete all of steps with that in mind. Case studies are scored on a point basis, where each step is scored independently of the previous or subsequent steps. For each step, points are awarded for selecting an appropriate action, and points are deducted for choosing an action that is inappropriate or not necessary based on the information provided.
2. Using the table at the end of each case, tabulate the number of correct answers you selected for each step and the number of incorrect answers you selected for each step. Fill out the form and find your final score for that case. You receive one point for each correct answer and you are deducted one point for each incorrect answer.



COMPANY RIVALS

Step 1

Two public, manufacturing competitors, Company X and Company Y, are rivals in a single market, both offering a high-end product and a low-end product. Each company competes only in this type of product. Company X is the market leader in the high-end product segment and Company Y is the market leader in the low-end product segment.

You are a director of Company X, which is holding a board strategy retreat. The board materials for the strategy retreat contain the overall financials for Company X, the company profit and loss statement, the statement of financial condition, and five-year company-wide projections.

What information is needed at this point to evaluate the competitive landscape of the market?

- ☐ A. Market share of each competitor by segment
- ☐ B. Margins of high-end and low-end products for Company X and Company Y
- ☐ C. Total revenue for Company X and Company Y in each product segment
- ☐ D. Organizational structure of each company
- ☐ E. Board diversity of Company Y
- ☐ F. Compensation programs for the executive leadership teams of Company Y
- ☐ G. Investor presentations by Company Y
- ☐ H. Product pricing by segment
- ☐ I. Environmental liability history of Company Y

Step 1: Answers**Appropriate action(s):**

- A. Market share of each competitor by segment
- B. Margins of high-end and low-end products for Company X and Company Y
- C. Total revenue for Company X and Company Y in each product segment
- G. Investor presentations by Company Y
- H. Product pricing by segment

Incorrect/Not necessary action(s):

- D. Organizational structure of each company
- E. Board diversity of Company Y
- F. Compensation programs for the executive leadership teams of Company Y
- I. Environmental liability history of Company Y

Step 1 Rationale:

The board is preparing for its strategy retreat and requires certain information to have meaningful discussions and make informed decisions. At this stage, financial and market information is the most relevant data. Answer choices A, B, C, G, and H provide that information. Choices D, E, F, and I are not relevant to the current discussions of the board.

Step 2

One of the Company X board members hears a rumor that Company Y wants to invest heavily to introduce new offerings in the high-end product segment. Company X is a long-established manufacturing company with a balanced board of skilled directors. Company Y is a newer, smaller company. The chief executive officer (CEO) of Company Y was chief financial officer (CFO) at Company X for 10+ years. The CEO of Company X has communicated to the board that he does not believe the rumor and Company Y's actions are a nonissue for Company X.

How should the Company X board respond at this point?

- ☐ A. Agree with the CEO largely due to Company X's strong history of high returns.
- ☐ B. Mandate that the CEO change the sales/marketing organization.
- ☐ C. Discuss the capabilities of Company Y with the management team of Company X.
- ☐ D. Wait 12 months and then assess the impact of Company Y's actions.
- ☐ E. Request financial scenarios from management reflecting possible changes in market share and margins with an improved product in the high-end segment by Company Y.
- ☐ F. Hold an executive session of the board, without management present, to discuss alternative responses.
- ☐ G. Call customers to ask their opinion.
- ☐ H. Engage an outside consultant to assess the market and report findings to the board.
- ☐ I. Review current product offerings and ask management to compare/contrast Company X's offerings to those of Company Y.

Step 2: Answers

Appropriate action(s):

- C. Discuss the capabilities of Company Y with the management team of Company X.
- E. Request financial scenarios from management reflecting possible changes in market share and margins with an improved product in the high-end segment by Company Y.
- I. Review current product offerings and ask management to compare/contrast Company X's offerings to those of Company Y.

Incorrect/Not necessary action(s):

- A. Agree with the CEO largely due to Company X's strong history of high returns.
- B. Mandate that the CEO change the sales/marketing organization.
- D. Wait 12 months and then assess the impact of Company Y's actions.
- F. Hold an executive session of the board, without management present, to discuss alternative responses.
- G. Call customers to ask their opinion.
- H. Engage an outside consultant to assess the market and report findings to the board.

Step 2 Rationale:

The board needs to establish known facts about the competitive landscape at this point as it cannot make decisions based on rumors. Bearing in mind that the role of the board is to engage with and challenge management's assumptions, answer choices C, E, and I provide additional facts and/or approaches for the board and management to consider. The remaining answers either overreach the board's role (B, F, G) and/or initiate action without taking steps to understand the current situation (A, D, H).

Step 3

The CEO of Company X has come back to the board and shared that indeed Company Y is planning to introduce a new high-end product that will compete in Company X's market-leading high-end segment. This will require Company Y to increase spending in marketing and sales. The CEO of Company X is seeking the perspective of the board.

Which actions are an appropriate response at this point for Company X's board?

- ☐ A. Recommend management reduce the price of Company X's low-end product.
- ☐ B. Suggest an increase in spending for research and development to ensure that Company X's high-end product remains competitive.
- ☐ C. Dismiss the CEO.
- ☐ D. Reduce the price of Company X's high-end product.
- ☐ E. Create a new incentive plan for the sales force.
- ☐ F. Explore an acquisition of Company Y.
- ☐ G. Recruit a marketing expert to the board.
- ☐ H. Reach out to staff at Company Y to confirm Company Y's actual plans.
- ☐ I. Add a new product.

Step 3: Answers

Appropriate action(s):

- A. Recommend management reduce the price of Company X's low-end product.
- B. Suggest an increase in spending for research and development to ensure that Company X's high-end product remains competitive.

Incorrect/Not necessary action(s):

- C. Dismiss the CEO.
- D. Reduce the price of Company X's high-end product.
- E. Create a new incentive plan for the sales force.
- F. Explore an acquisition of Company Y.
- G. Recruit a marketing expert to the board.
- H. Reach out to staff at Company Y to confirm that company's actual plans.
- I. Add a new product.

Step 3 Rationale:

Given that the CEO has asked for guidance, the board should feel comfortable proposing specific next steps for consideration that would address the competitive issues the company is facing. Answer choices A and B provide those recommendations. The remaining choices all go far beyond the scope of the CEO's request and while they may be steps that the board wishes to contemplate, they do not follow from the narrow facts of the case or they reflect the board taking on too much management of the day-to-day, which should be left to the CEO and management team.

Case 1: Self Score

Correct answers	1. From Step 1	
	2. From Step 2	
	3. From Step 3	
Total Correct Answers	4. Sum of lines 1-3	
Incorrect answers	5. From Step 1	
	6. From Step 2	
	7. From Step 3	
Total Incorrect Answers	8. Sum of lines 5-7	
FINAL SCORE	Line 4 minus Line 8	



RESTAURANT STRATEGY

Step 1

A private company has been developing and operating full-service restaurants for more than 47 years. The 200+ units are a highly differentiated sports-theme concept located in 27 US states. A high percentage of the units are owned by franchisees. The company provides their customers with on-premises and delivery options for convenience.

The company has reported flat customer visit growth for the last six (6) quarters. Unit growth continues in the low single digits as franchisees expand and new franchisees are attracted to the brand. Meager revenue growth has resulted from menu price increases. The board is conducting an early-cycle strategy session in advance of the annual strategy and budget review to examine the current situation.

What information is needed by the board at this point to assess the reasons for flat customer visits?

- ☐ A. Market share of competitors in the specialty sports restaurant segment
- ☐ B. Recent-quarter company marketing promotions across all platforms
- ☐ C. Franchisee feedback on proposed plans for new menu items
- ☐ D. Data on evolving customer preferences and their impact on the company
- ☐ E. Quarterly supply-chain detail from key distributors
- ☐ F. Information about behaviors that will drive growth in the snacking segment
- ☐ G. Information on the context and motivations underlying current customer purchase decisions

Step 1: Answers**Appropriate action(s):**

- A. Market share of competitors in the specialty sports restaurant segment
- C. Franchisee feedback on proposed plans for new menu items
- D. Data on evolving customer preferences and their impact on the company
- G. Information on the context and motivations underlying current customer purchase decisions

Incorrect/Not necessary action(s):

- B. Recent-quarter company marketing promotions across all platforms
- E. Quarterly supply-chain detail from key distributors
- F. Information about behaviors that will drive growth in the snacking segment

Step 1 Rationale:

The issue facing this company is declining customer visits across all units. The board needs data-driven insights to help keep current customers, win new customers, and make strategic adjustments. Answer choices A, C, D, and G provide that information. Choices B, E, and F are far too narrow and/or not relevant.

Step 2

After their session, the board confirmed that the restaurant industry and full-service segment were in growth mode in the United States. The board determined that the brand's historically successful approach and offerings in the full-service segment may need a refresh but not an overhaul.

Insights on customer data indicated low satisfaction scores with restaurant experiences. Management reported that the flat guest count trend was temporary, resulting from weather effects and weak marketing promotions.

What information does the board need at this point to determine the cause of negative customer sentiment?

- ☐ A. Forecasts on the aging population and how this shift will affect visits to the company's restaurants
- ☐ B. A benchmark survey of the prices of menu items by geographical area
- ☐ C. A comparison of on-premises dining versus delivery in the last quarter
- ☐ D. A plan to convert to the fine-dining segment
- ☐ E. Customized analytics on the company's new, lost, and retained customers
- ☐ F. Impact of promotional efforts on customer counts in the last year
- ☐ G. A comparison of sales in company-operated units versus franchised units for the last year

Step 2: Answers**Appropriate action(s):**

- B. A benchmark survey of the prices of menu items by geographical area
- E. Customized analytics on the company's new, lost, and retained customers
- F. Impact of promotional efforts on customer counts in the last year
- G. A comparison of sales in company-operated units versus franchised units for the last year

Incorrect/Not necessary action(s):

- A. Forecasts on the aging population and how this shift will affect visits to the company's restaurants
- C. A comparison of on-premises dining versus delivery in the last quarter
- D. A plan to convert to the fine-dining segment

Step 2 Rationale:

The negative customer experience has emerged as a key driver of the declines in customer visits. The board needs to determine the root cause for this decline in customer experience. Answer choices B, E, F, and G will provide answers on price/value, marketing, and overall customer intent. The remaining questions are either too narrow or cover too short a period to derive actionable data.

Step 3

The board holds a special session focused on the information they commissioned. Customer-transaction declines continue at the company and an analysis revealed that visit satisfaction is poor and is negatively impacting the number of returning customers.

This is quite a turn of events, as the company had enjoyed a large and loyal customer base for decades. Customer analytics data uncovered key operational shortfalls as the driver for most of the challenges. In addition, the organization representing the franchisees has been increasingly vocal about their frustrations with the company's direction. The CEO has been fully engaged in all the board's recent sessions.

What should the board do at this point to position the company for improved sales and customer visits?

- ☐ A. Instruct management to lower all menu prices.
- ☐ B. Request a comprehensive plan to improve customer satisfaction.
- ☐ C. Direct management to focus on the most-valuable customers with a new brand-loyalty program.
- ☐ D. Instruct management to introduce dairy and meat alternatives to the menu.
- ☐ E. Explore the most promising opportunities for growth over the next five (5) years in the full-service segment.
- ☐ F. Establish nonfinancial metrics for monitoring customer satisfaction.

Step 3: Answers**Appropriate action(s):**

- B. Request a comprehensive plan to improve customer satisfaction.
- F. Establish nonfinancial metrics for monitoring customer satisfaction.

Incorrect/Not necessary action(s):

- A. Instruct management to lower all menu prices.
- C. Direct management to focus on the most-valuable customers with a new brand-loyalty program.
- D. Instruct management to introduce dairy and meat alternatives to the menu.
- E. Explore the most promising opportunities for growth over the next five (5) years in the full-service segment.

Step 3 Rationale:

Management must address the operational issues associated with the restaurant experience. Answer choice B drives the CEO responsibility to create a plan and execute; choice F establishes accountability for management and the responsibility of the board to be a resource to management. The remaining choices are too narrow, overstep the bounds of the board's role, or do not completely address the need.

Step 4

Management has proposed focusing on expanding franchising, updating the menu with trendy items, and accelerating off-premises sales as imperative to improving customer sentiment. Customer visits continue to decline.

What should the board do at this point?

- ☐ A. File for Chapter 11 bankruptcy protection to reorganize the business and emerge as a stronger organization built for the future.
- ☐ B. Approve management's proposal to update the menu with trendy items.
- ☐ C. Reject management's strategy.
- ☐ D. Direct management to institute a customer-centric culture measured by data and analytics.
- ☐ E. Set new performance standards for the CEO.
- ☐ F. Instruct management to create an operational plan to improve customer sentiment.
- ☐ G. Instruct management to meet with franchisees to understand their concerns and report to the board.

Step 4: Answers

Appropriate action(s):

- C. Reject management's strategy.
- D. Direct management to institute a customer-centric culture measured by data and analytics.
- E. Set new performance standards for the CEO.
- F. Instruct management to create an operational plan to improve customer sentiment.
- G. Instruct management to meet with franchisees to understand their concerns and report to the board.

Incorrect/Not necessary action(s):

- A. File for Chapter 11 bankruptcy protection to reorganize the business and emerge a stronger organization built for the future.
- B. Approve management's proposal to update the menu with trendy items.

Step 4 Rationale:

The CEO's plan ignores the data and demonstrates poor judgment. Answer choices C, D, E, F, and G address the leadership failures and confirm the need for the company to enhance the customer experience. Choice A is not yet appropriate and will not work if leadership failures are not addressed. Choice B does not align with the analysis findings and disregards the CEO's poor judgment.

Case 2: Self Score

Correct answers	1. From Step 1	
	2. From Step 2	
	3. From Step 3	
	4. From Step 4	
Total Correct Answers	5. Sum of lines 1–4	
Incorrect answers	6. From Step 1	
	7. From Step 2	
	8. From Step 3	
	9. From Step 4	
Total Incorrect Answers	10. Sum of lines 6–9	
FINAL SCORE	Line 5 minus Line 10	



MERGER OF EQUALS

Step 1

Two major retailers, who have been intense competitors for years, carve out a merger plan driven by declining consumer interest in their industry. The two public company boards are selectively merged; the new 10-person board comprises five (5) board members from each of the two previous boards. Both chief executive officers (CEOs) were relieved of their duties shortly before the consummation of the deal and the board chair was designated as the interim CEO.

The company has no clear location for the headquarters and “two of everything,” including chief financial officers, general counsel, chief human resource officers, etc. To complicate matters, there is an activist investor from one of the companies serving on the board who came in just prior to the deal and pushed the merger. Two (2) of the 10 board members on the new board are his nominees.

The new board holds its first meeting. Five (5) directors from one of the original companies have been on the prior board together for more than a decade. The five (5) board members representing the other company comprise the activist, his two nominees, a new board member elected less than one year earlier, and a retired CEO who has the longest tenure on that company’s prior board at two years. The tension is thick as the new group assembles.

What are the immediate priorities for the board?

- ☐ A. Select a coach to help the new board to adjust.
- ☐ B. Determine the senior management team and select the location for the headquarters.
- ☐ C. Establish a search committee and hire a search firm to find a CEO.
- ☐ D. Establish a board and committee meeting schedule with agendas.
- ☐ E. Engage external counsel to advise the board as it navigates new governance challenges.
- ☐ F. Request that management develop an interim operating plan.

Step 1: Answers**Appropriate action(s):**

- C. Establish a search committee and hire a search firm to find a CEO.
- D. Establish a board and committee meeting schedule with agendas.
- E. Engage external counsel to advise the board as it navigates new governance challenges.
- F. Request that management develop an interim operating plan.

Incorrect/Not necessary action(s):

- A. Select a coach to help the new board adjust.
- B. Determine the senior management team and select the location for the headquarters.

Step 1 Rationale:

Attracting a CEO is the most critical step this board can take. The board must also prioritize strong governance and functioning given the ongoing integration.

Answers C, D, E, and F address these critical items. All other decisions about the senior management team and location for the headquarters should be made by the new CEO. The board, while it needs to gel, does not have time to have a consultant “help them,” nor do they need to add even more new board members at this time.

Step 2

The search committee hires a new CEO who is tremendously qualified, very driven, and a master at obtaining merger synergies. However, he negotiated a very large salary, creating concerns about disclosing his compensation to the public. He also has a very “command and control” style. He immediately makes critical decisions, including selecting the members of the new C-suite and definitively choosing the location for the headquarters. Despite these accomplishments, the board continues to experience tension and factions.

Signs of tension also begin to surface regarding support for, or against, the CEO’s leadership style. While the company slowly begins to become more functional, the board becomes even more dysfunctional. The activist steps off the board, having secured the deal and supported the hiring of the new CEO. The board sets up two years of meetings and priorities.

Which step(s) should this board take at this point to function more effectively?

- ☐ A. Fill the open board seat with a mutually agreed-upon new director who is acceptable to both sides.
- ☐ B. Ask the CEO to determine who stays and who goes as the board attempts a refresh to become more productive.
- ☐ C. Initiate a confidential search for a CEO replacement that would be agreeable to all.
- ☐ D. Initiate a formal process for the board to address and resolve issues.
- ☐ E. Change the bylaws of the new company to reduce the size of the board so that it can be nimbler.

Step 2: Answers**Appropriate action(s):**

- A. Fill the open board seat with a mutually agreed-upon new director who is acceptable to both sides.
- D. Initiate a formal process for the board to address and resolve issues.

Incorrect/Not necessary action(s):

- B. Ask the CEO to determine who stays and who goes as the board attempts a refresh to become more productive.
- C. Initiate a confidential search for a CEO replacement that would be agreeable to all.
- E. Change the bylaws of the new company to reduce the size of the board so that it can be nimbler.

Step 2 Rationale:

The board needs to force integration of the two sides and one way to do that is to mutually agree on the new board member. The CEO, however, should not drive the decisions about who is or is not on the board. Answers A and D are relevant to the situation at hand. Furthermore, replacing the CEO at this early point in his tenure makes no sense since he is making critical decisions and building his team.

Step 3

The management team, now fully in place, begins to realize the merger's synergies and bottom-line results improve dramatically over two years. However, top-line results continue to decline. The board asks management for a strategic plan outlining a longer-term plan for top-line improvement. Management comes back with a plan that is similar to the old plan.

The board aligns on believing that this management team is primarily focused on turnaround and not growth. The board begins to function as a more cohesive unit. In the meantime, the CEO is coming up on his three-year contractual term. The CEO lobbies for a very large increase in compensation to renew his contract, citing impressive synergy gains. He maintains that Wall Street credits him with the results and would be shaken if he departs.

The board continues to deliberate on what type of leadership the company needs. There is no question that the synergy gains are impressive, but they are diminishing, and there is no plan in place to guide the company moving forward. There is also a question about the company's ability to attract a new, growth-oriented CEO.

What should the board do at this point?

- ☐ A. Authorize the compensation committee to finalize a new agreement with the CEO.
- ☐ B. Contact a search firm to get their advice about realistic expectations for a CEO search.
- ☐ C. Tell the CEO he will likely be terminated and ask him to begin an exit strategy.
- ☐ D. Instruct the CEO to revise the strategic plan to make it more growth oriented.
- ☐ E. Hold additional executive sessions with the independent directors to gain consensus on the CEO's tenure.
- ☐ F. Ask an investment banker to assist the board in evaluating the company's strategy.

Step 3: Answers**Appropriate action(s):**

- B. Contact a search firm to get their advice about realistic expectations for a CEO search.
- D. Instruct the CEO to revise the strategic plan to make it more growth oriented.
- E. Hold additional executive sessions with the independent directors to gain consensus on the CEO's tenure.
- F. Ask an investment banker to assist the board in evaluating the company's strategy.

Incorrect/Not necessary action(s):

- A. Authorize the compensation committee to finalize a new agreement with the CEO.
- C. Tell the CEO he will likely be terminated and ask him to begin an exit strategy.

Step 3 Rationale:

At this point, more information is needed. Will the CEO negotiate to a more-palatable compensation package to stay or choose to escalate the negotiations? Will the search firm express confidence that they can surface good candidates? Answers B, D, E, and F are all designed to gather additional information for the board. Answers A and C both reflect actions that are too hasty in this context.

Step 4

Several months pass and the CEO is becoming increasingly difficult in compensation negotiations. Several board members think that the CEO needs to be replaced. Other members worry that replacing the CEO will be difficult, based on the information obtained from the search firms. The CEO expresses frustration and threatens to resign.

How should the board respond at this point?

- ☐ A. Negotiate a short-term contract with the CEO to remain in the role and be open about eventually replacing him.
- ☐ B. Request the opinion of senior management about replacing the CEO.
- ☐ C. Talk to analysts to see what their level of concern would be if a change in CEO occurs.
- ☐ D. Designate a search committee and instruct them to hire a search firm to find a replacement for the CEO.

Step 4: Answers

Appropriate action(s):

- A. Negotiate a short-term contract with the CEO to remain in the role and be open about eventually replacing him.
- D. Designate a search committee and instruct them to hire a search firm to find a replacement for the CEO.

Incorrect/Not necessary action(s):

- B. Request the opinion of senior management about replacing the CEO.
- C. Talk to analysts to see what their level of concern would be if a change in CEO occurs.

Step 4 Rationale:

The continued frustration with the CEO's salary negotiations tips the scales in favor of replacing him. His greed signals a lack of interest in the "greater good." However, letting him resign in a huff and walk away immediately causes unnecessary instability and makes an external search even harder. A search committee should be formed, as the CEO will need to be replaced eventually. Management and especially analysts should not have any input into the decision to replace the CEO. Answers A and D are correct.

Case 3: Self Score

Correct answers	1. From Step 1	
	2. From Step 2	
	3. From Step 3	
	4. From Step 4	
Total Correct Answers	5. Sum of lines 1–4	
Incorrect answers	6. From Step 1	
	7. From Step 2	
	8. From Step 3	
	9. From Step 4	
Total Incorrect Answers	10. Sum of lines 6–9	
FINAL SCORE	Line 5 minus Line 10	



LIFO NIGHTMARE

Step 1

The audit committee chair at a \$3 billion retailer gets a phone call, just before year's end, from the chief executive officer (CEO) who tells her that the staff has uncovered a \$40 million problem with inventory. They are unsure as to how this has occurred. The physical inventory count matches the data in the inventory systems but is significantly different from what the financial calculations produced, which is what was booked. The staff is investigating the matter, but the possibility of a major earnings miss or a restatement is real and the path to resolution is unsure. The need to find a resolution is urgent due to the timing of the year-end audit. However, the CEO believes that management will identify the cause of the discrepancy.

What should the chair of the audit committee do at this point?

- ☐ A. Call an audit committee meeting to inform the rest of the committee's members and assess next steps.
- ☐ B. Talk to the chief financial officer to better understand the sequence of events leading to this point.
- ☐ C. Connect with the Investor Relations department and an external adviser to develop a "story" to present when this becomes public information.
- ☐ D. Convene a full-board meeting since an earnings miss and/or a restatement carries reputational risk.
- ☐ E. Tell the CEO that the audit committee will investigate this matter and that the CEO should not be involved.

Step 1: Answers**Appropriate action(s):**

- A. Call an audit committee meeting to inform the rest of the committee's members and assess next steps.
- B. Talk to the chief financial officer to better understand the sequence of events leading to this point.

Incorrect/Not necessary action(s):

- C. Connect with the Investor Relations department and an external adviser to develop a "story" to present when this becomes public information.
- D. Convene a full-board meeting since an earnings miss and/or restatement carries reputational risk.
- E. Tell the CEO that the audit committee will investigate this matter and that the CEO should not be involved.

Step 1 Rationale:

At this point, the audit committee needs to be informed and begin to get involved. However, until more information is available, there is no need to pull in the full board. Much more insight and information is needed, and there is a need to "react" but not "overreact." Answers A and B gather that information appropriately. Answers C, D, and E are over-reactions at this early stage.

Step 2

After several audit committee meetings, it is clear that additional investigation is warranted. The audit committee supports the company's decision to bring in an independent accounting firm to conduct an in-depth forensic investigation into the root cause(s) of the problem. In addition, the audit committee discusses and debates additional steps to take. The audit committee agrees to conduct an in-person, half-day meeting at the company's headquarters.

What should the committee accomplish in this meeting?

- ☐ A. Interview all staff involved to understand their roles and understand what happened.
- ☐ B. Produce pro-forma financial statements to understand the magnitude and effect of the potential earnings miss and/or restatement.
- ☐ C. Decide that committee members will initiate their own investigation to complement the forensic work being done by the accounting firm.
- ☐ D. Assign two of the more technically proficient audit committee members to oversee the forensic investigation.
- ☐ E. Put the chief financial officer on leave until the investigation is complete.
- ☐ F. Review the information available to date and establish a timeline for resolution.

Step 2: Answers**Appropriate action(s):**

- D. Assign two of the more technically proficient audit committee members to oversee the forensic investigation.
- F. Review the information available to date and establish a timeline for resolution.

Incorrect/Not necessary action(s):

- A. Interview all staff involved to understand their role and understand what happened.
- B. Produce pro-forma financial statements to understand the magnitude and effect of the potential earnings miss and/or restatement.
- C. Decide that committee members will initiate their own investigation to complement the forensic work being done by the accounting firm.
- E. Put the CFO on leave until the investigation is complete.

Step 2 Rationale:

The audit committee needs to be involved as the process unfolds to assess who and what in the organization contributed to these events. A plan needs to be put in place for a resolution to the inquiry. Answers D and F address this. Answers A, B, C, and E go beyond the board's role. The interviewing and pro-forma statements would be done by the forensic investigators and management, respectively. No one should be put on leave or face "consequences" until the facts are in. This is especially important because this would require a public disclosure which carries reputational risk.

Step 3

The forensic work is now complete, and it reveals the following:

The controller manages the inventory calculation on a complex Excel spreadsheet where various factors contribute to a complicated series of equations to determine the change in value in inventory using the Last In, First Out (LIFO) methodology. Those factors include changes in quantity and pricing and the flow of inventory in sequential order. Since prices took a dramatic change at the end of the second quarter, the potential for significant change is large.

The controller, working late one night and alone, made a manual change to one of the cells in the spreadsheet and inadvertently changed the entire calculation sequence, dramatically changing the outcome of the carrying value.

Simultaneously, the Information Technology (IT) department changed the inventory tracking systems within the company. At the end of the second quarter, prior to the dramatic change in pricing, there was a small discrepancy between the controller's spreadsheet calculation and the inventory systems carrying value. The controller, thinking that this discrepancy was the result of the system changes, chose to disregard the discrepancy and book his spreadsheet value as the final answer. It is unclear if the auditors were aware of this decision, but they would have agreed to the final valuation because it was not a material change.

The IT systems were accurate; the controller's spreadsheet had an erroneous equation error, and the discrepancy between the two at the end of the third and fourth quarter is material because of the impact of the pricing change. The company needs to announce an earnings miss and make a restatement, but only on an intra-year basis for the current year's quarterly reports.

The audit committee now wraps up its investigation.

What should the audit committee do at this point?

- ☐ A. State that the investigation is complete and return to its regular cadence of meetings.
- ☐ B. Convene the full board to explain what happened and the impact on quarterly and full year results.
- ☐ C. Work with the company's external auditor and the company to prepare for appropriate disclosure.
- ☐ D. Terminate the company's external auditor for not discovering this error.
- ☐ E. Recommend to the CFO that the controller be disciplined for lack of judgment in making a series of decisions independently.
- ☐ F. Recommend that the CEO terminate the CFO for allowing this to happen.
- ☐ G. Recommend to the full board that the CEO be terminated for allowing this to happen.

Step 3: Answers

Appropriate action(s):

- B. Convene the full board to explain what happened and the impact on quarterly and full-year results.
- C. Work with the company's external auditor and the company to prepare for appropriate disclosure.
- E. Recommend to the CFO that the controller be disciplined for lack of judgment in making a series of decisions independently.

Incorrect/Not necessary action(s):

- A. State that the investigation is complete and return to its regular cadence of meetings.
- D. Terminate the company's external auditor for not discovering this error.
- F. Recommend that the CEO terminate the CFO for allowing this to happen.
- G. Recommend to the full board that the CEO be terminated for allowing this to happen.

Step 3 Rationale:

Formal termination of the CFO or CEO is not reasonable as they could not have discovered this strange sequence of events in the normal course of business. The audit committee should continue being involved with management and the auditors to prepare the financial statements and disclosures and review any public announcements. Answers B, C, and E are appropriate actions. Answers A, D, F, and G all go too far given the facts in this scenario.

Case 4: Self Score

Correct answers	1. From Step 1	
	2. From Step 2	
	3. From Step 3	
Total Correct Answers	4. Sum of lines 1–3	
Incorrect answers	5. From Step 1	
	6. From Step 2	
	7. From Step 3	
Total Incorrect Answers	8. Sum of lines 5–7	
FINAL SCORE	Line 4 minus Line 8	



IT HAPPENS EVERYWHERE!

Step 1

A high-profile public company is financially successful and has a highly recognized and charismatic CEO. The company has exemplary policies and is perceived to have a great reputation.

What best practice(s) should the board put in place to monitor and ensure compliance with all aspects of the company's policies?

- ☐ A. Ensure that a whistleblower program is implemented for employees, the C-suite, and the CEO alike and monitor it.
- ☐ B. Ensure that the board composition demonstrates diversity, equity, and inclusion.
- ☐ C. Create an environment that protects the reputation of the company by tightly controlling allegations of misconduct.
- ☐ D. Ensure that management administers annual employee surveys and monitor the results.
- ☐ E. Hold high-performing individuals to a different standard to protect the market value of the company.

Step 1: Answers**Appropriate action(s):**

- A. Ensure that a whistleblower program is implemented for employees, the C-suite, and the CEO alike and monitor it.
- B. Ensure that the board composition demonstrates diversity, equity, and inclusion.
- D. Ensure that management administers annual employee surveys and monitor the results.

Incorrect/Not necessary action(s):

- C. Create an environment that protects the reputation of the company by tightly controlling allegations of misconduct.
- E. Hold high-performing individuals to a different standard to protect the market value of the company.

Step 1 Rationale:

The role of the board is to ensure that programs and processes exist to oversee risks to the organization. This includes both engaging management in the development of programs and the ongoing review of those programs. Best practice also focuses on “tone at the top.” Answers A, B, and D follow those best practices. Answers C and E do not follow best practice and may create more risk for the organization.

Step 2

An employee comes forward to the chief human resources officer (CHRO) to file a complaint of sexual harassment against the CEO. The CHRO immediately informs the CEO of the complaint and the CEO explains that it was a consensual relationship. The employee takes the complaint to a member of the board and demands action.

What should the board do at this point?

- ☐ A. Instruct the CEO to dismiss the employee who filed the complaint.
- ☐ B. Hire external counsel to investigate the facts and circumstances of the case.
- ☐ C. Engage a public relations company to manage the reputational risks that may arise.
- ☐ D. Ask management to conduct an all-employee meeting to manage the situation.

Step 2: Answers**Appropriate action(s):**

- B. Hire external counsel to investigate the facts and circumstances of the case.
- C. Engage a public relations company to manage the reputational risks that may arise.

Incorrect/Not necessary action(s):

- A. Instruct the CEO to dismiss the employee who filed the complaint.
- D. Ask management to conduct an all-employee meeting to manage the situation.

Step 2 Rationale:

The board's responsibility is to act in the best interest of the corporation, not the CEO. Providing an open and honest culture that takes accusations of this nature seriously mitigates reputational and financial risk and builds an environment of trust. Answers B and C build on those principles while also managing the effects of the events. Answers A and D suggest that the company does not take employee reports seriously or that the company is failing to appropriately manage the situation and fails to respect each employee's privacy.

Step 3

Based on the results of an independent investigation, the board dismisses the CEO for misconduct and violation of company policy.

What should the board do at this point to avoid further violations and maintain a healthy culture of respect and integrity?

- ☐ A. Ensure that management implements a process for the annual notification and acceptance of company policies by all employees.
- ☐ B. Require sexual harassment training for all levels of the company, including the board.
- ☐ C. Establish a “claw-back” policy whereby violations of company policy will result in recovery of bonuses and other incentives already disbursed.
- ☐ D. Develop a process to protect future CEOs against claims of misconduct.
- ☐ E. Take actions to discourage communications of misbehavior moving forward.

Step 3: Answers

Appropriate action(s):

- A. Ensure that management implements a process for the annual notification and acceptance of company policies by all employees.
- B. Require sexual harassment training for all levels of the company, including the board.
- C. Establish a “claw-back” policy whereby violations of company policy will result in recovery of bonuses and other incentives already disbursed.

Incorrect/Not necessary action(s):

- D. Develop a process to protect future CEOs against claims of misconduct.
- E. Take actions to discourage communications of misbehavior moving forward.

Step 3 Rationale:

Good oversight by the board requires a clear, documented policy that is available and applied to all employees. Regular training is a best practice, and boards need to monitor the company’s adherence to these practices through regular reporting. Claw-back policies are now a standard practice to hold CEOs accountable for violations of corporate policies. Answers A, B, and C are in line with these best practices, which will help to reduce financial and reputational risk. Answers D and E encourage bad behavior and breed mistrust within the organization and are therefore incorrect.

Case 5: Self Score

Correct answers	1. From Step 1	
	2. From Step 2	
	3. From Step 3	
Total Correct Answers	4. Sum of lines 1–3	
Incorrect answers	5. From Step 1	
	6. From Step 2	
	7. From Step 3	
Total Incorrect Answers	8. Sum of lines 5–7	
FINAL SCORE	Line 4 minus Line 8	

