



## Mock Two

# Governance, Risk and Ethics

P1GRE-MK2-Z17-A

Answers & Marking Scheme

# Paper 1

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# 1 PETRO GLOBAL

## (a) Stakeholders and claims *(Up to 2 marks for each of 4 stakeholders – max of 8 marks)*

### *Shareholders*

The fiduciary duty of the directors of Petro Global will be to maximise the wealth of the shareholders. The shareholders' claim is to have continued growth in the capital value of the company (share price) plus growth in the annual return (dividends). Shareholders may also hope for bonus issues or share buybacks to enhance their wealth. At the very least they require that their investment will not decrease in value.

### *Directors and employees*

For both groups, their claim will be for continued employment. For employees, especially those working at the drilling sites, they require a safe working environment (as such can be provided in Arctic conditions) with appropriate compensation (for working in dangerous conditions). For directors, bonuses and reputation are additional considerations.

### *Local inhabitants – indigenous Arctic population*

There is likely to be two conflicting claims. There will be those who wish to continue the lifestyle that has been in existence for thousands of years. They do not want to be “polluted” by “Western ways”. Alternatively, there will be those who will wish to “progress” into modern civilisation (or as much as the oil companies can bring) plus the opportunity to earn substantial rewards for working at the rig sites or providing services to the oil firms.

### *Petrol consumers*

Those who use petrol and other oil products (e.g. car drivers, lorry drivers, transport, aviation, industrial users) wish to ensure a continued availability of the fuel they use. The cost of switching to alternative fuels may be prohibitively expensive, impractical or not an option (so they may not be able to continue as they have done in the past).

### *Environment*

Basically the fauna and flora (animals and vegetation). They have occupied the Arctic territory for thousands of years and should be able to continue to do so without the threat of extinction or contamination of themselves or the food and water they depend on.

## (b) Impacts and action

### *(i) Negative impacts of planned venture (1 mark each impact – max of 4 marks)*

Oil extraction is recognised as having a high impact on the environment, especially where spillages occur or there is a need to decontaminate discontinued sites. Recent events (e.g. Gulf Horizon, Costa Concordia, Niger Delta) show the actual or potential damage caused by oil.

**Tutorial note:** *Although the case study will not use real names, use real life examples that are relevant to, and support, your answers.*

Generally the environmental damage that may be caused by oil covers the impact on wildlife, vegetation, air, land and water pollution.

Where the oil spillage is on land, this will not only directly impact the vegetation that comes into contact with the oil, but oil may also seep through the ice and soil and into underground water channels. This will result in substantial contamination of the soil at a far greater radius than the original spill, killing any vegetation that comes into contact with it. The contamination may also be long-term (e.g. 10 or more years).

Such vegetation may be part of the animal or human food cycle. This may result in the extinction of endangered species and deaths and illness (e.g. cancers) in humans (especially through drinking contaminated water and eating contaminated food).

The extracted oil will need to be transported to sea terminals. This will usually mean extensive pipe networks, probably above land rather than underground (cheaper and easier to maintain). This raises the risk of contamination through leakage of oil from the pipes, leakage at the terminal during loading onto ships and the possible sinking of loaded ships through collision, for example.

The building of the rigs and pipelines will disrupt the environment. Pipelines may also cross migration paths of various wild animals and disrupt their migration progress.

Leaked oil (as well as gas flaming) will give off poisonous fumes, polluting the air. These fumes may be carried by air flows (winds) over significantly wide areas. Animals, vegetation and humans will breathe the contaminated air with consequential impact (e.g. death, poisoning, birth defects).

Water bound pollution will be carried by tidal currents, again covering significant areas. Air breathing sea animals will be contaminated as they surface to breath. Sea birds will be contaminated if they land on the oil. Fish will be contaminated as the oil breaks up and sinks to the sea floor.

Chemicals that will be used to disperse oil on water, will also add to the contamination.

(ii) *Action by local and national governments (1 mark each action – max of 4 marks)*

Creating internationally recognised and monitored protection zones for endangered wildlife, sea mammals and villages banning extraction and transportation of oil within the zones. An ideal situation for the environmentalists would be for the whole Arctic area to be declared a protected zone.

Only allowing companies with a proven safety record to operate within the Arctic area.

Requiring companies to place “contamination bonds” with the government to cover the costs of cleaning up any spills and compensating those impacted by the spill.

Regular (and detailed) governmental inspection of risk management processes, pipelines and all facilities.

Required use of proven environmental protection technology (e.g. double skinned pipes, automatic pipe shutdown systems to isolate potential problems, 24/7 electronic monitoring of pipelines).

Proven implementation of recommendations following investigations of other oil spillage disasters (e.g. Gulf Horizon)

**(c) Contrasting statements**

**Tutorial note:** *The two perspectives refer to the ethical and moral belief systems in society.*

*(i) Absolutism (1 mark each point of discussion – max of 3 marks)*

Absolutism is a view that there is an unchanging and indisputable (absolute) set of moral rights or precepts that will hold true in all situations.

In the business context, legislation attempts to impose a set of absolute rules on directors and the way they implement corporate governance. Rules based corporate governance codes (e.g. Sarbanes-Oxley) may also be considered as absolutist.

Petro Global paying for repairs to fishing boats, installing WiFi and internet networks, giving away laptops and investing in general infrastructure may not be seen as ethical from the absolutist perspective. Such actions may be considered as bribery and therefore not sustainable.

Obtaining cheap oil to the detriment of wildlife (e.g. polar bears) may also be seen as not absolutist – life in whatever form should be sacred. However, from a pristine capitalist point of view, making as much profit as possible, regardless of the circumstances, could be seen as an absolutist approach.

Using the latest technology and methods and making every effort not to have a spill implies following, adhering to and even exceeding very strict regulations. This would be an absolutist approach especially where the oil company applies the strictest regulations it operates under to all countries it operates in.

*Relativism (1 mark each point of discussion – max of 3 marks)*

Relativism is a view that there are a wide variety of ethical beliefs and practices and what is “correct” in a given situation will depend on the conditions at the time. One person’s moral truth is less likely to be imposed simply because different ethical and belief systems are accepted by others.

In society, relativism allows different beliefs accepting that individuals are entitled to their ethics and beliefs (e.g. different stances on conducting oil and gas drilling in environmental areas of Arctic).

The slogan advocated by some consumers: “Who cares about polar bears, I want cheap petrol!” reflects a relativist view (the end justifies the means) that may have been accepted by the majority of consumers in the past. However, that view may have changed with many taking the stance that it is now morally wrong to destroy animal habitats for an unsustainable product – this approach is often referred to as relative absolutism (the end no longer justifies the means and killing is not acceptable).

In addition many people are changing their views on the way big industrial corporations, like Petro Global, are operating. Big may no longer be considered as “beautiful”; big impacts the global environment (e.g. global warming); big may also imply profits that are perceived to be excessive and possibly obscene.

With this change in perspective, many may not believe the statement “every effort will be made not to have a spill” on the basis that past actions by big companies have always protected profits and that, for example, essential maintenance has been reduced to contain costs.

(d) **NEDs**

*(max of 28 marks as detailed)*

**To:** Alex Hall *(4 marks for logical flow, persuasiveness and structure)*  
**From:** A N Other  
**Subject:** Role of None-Executive Directors

Further to our recent discussions, I am pleased to note below my thoughts on the current position with non-executive directors (NEDs) on our board.

I note three areas for your consideration – the role and responsibilities of NEDs, creating a social and ethical contract with stakeholders and finally an outline of a typical induction programme for NEDs.

Please do not hesitate to contact me should you require any further detail or explanation.

*A N Other*

*Roles and responsibilities (1 mark each point, max of 2 marks each element – max of 8)*

As described in many corporate governance codes (e.g. the Higg's Report (2003), incorporated into the UK code) the roles and responsibilities of NEDs may be broadly divided into four areas:

- Strategy – this recognises that NEDs have the right and responsibility to contribute to strategic success, constructively challenge strategy and offer advice on the strategic direction of the company.

The company must have a clear strategic direction and NEDs should be able to bring considerable experience from their lives and, through using business acumen, ensure that chosen strategies are sound.

- Risk – NEDS should ensure that the company has an adequate system of internal control and risk management in place.

This means monitoring that the systems are robust and defensible, that information provided to investors and other stakeholders is sound and that the company's legal, ethical and moral actions are justifiable.

- Scrutinising (performance) role – NEDs are required to hold executive colleagues to account for decisions taken and results obtained.

They will need to scrutinise the performance of management in meeting agreed goals and objectives. In this respect they represent the shareholders' interests to ensure that shareholder value is not reduced.

- People – NEDs oversee a range of responsibilities with regard to the management of the executive members of the board.

This typically involves issues on appointments and remuneration, but might also involve contractual or disciplinary issues and succession planning.

*Social and ethical contract with stakeholders (1 mark each point – max of 12 marks)*

The concept of a social contract proposes that companies and other organisations may only exist and operate at society's will and therefore must serve (and act in) the best interests of society. The existence of (and decisions made by) companies are justified if they generally serve the public interest.

Society can withdraw from the contract by, for example, boycotting a company's products. This implies that a company will have obligations to society as well as expecting rights to be given by society. It is somewhat difficult for example, for a company to withdraw from the contract as that would effectively mean alienating its stakeholders.

The oil industry's "wake up call" came in 1995 when Royal Dutch Shell (Shell) decided to sink a decommissioned oil rig (Brent Spar) in the North Sea. The resulting public outcry, occupation of the rig by Greenpeace and subsequent boycott of Shell products in the UK had a profound impact on the way Shell's board developed its environmental and social policies. Previously the company's approach tended to be to obtain as many rights as possible from society and to give the minimum back (e.g. only oil products) – a fairly typical pristine capitalist approach. Where responsibilities were required by law, they accepted them but did not exceed such minimum responsibilities nor did they apply such responsibilities to jurisdictions that did not require them by law.

That is not to say the oil industry is now perfect, as demonstrated by BP in Texas and the Gulf Horizon episode. A pristine capitalist approach to cutting costs and the complete failure to handle public expectations (e.g. refusal to accept responsibility, damaging public relations, arrogant approach to those impacted by the oil spill) has resulted in significant damage to reputation and shareholder wealth through shares underperforming the market sector.

Although we have not yet reached such a stage, the environmentalist group's report on "dubious tactics" to win the favour of local inhabitants, their concern over our ability to clean up a spill should we not be able to prevent it, our withdrawal from developing sustainable power sources because of high costs, the increased investment in tar sand extraction and the recent record "obscene" profits all point to a rising tide of stakeholder concern. This implies a failure of the company's board to identify such emerging issues and their impact on the strategic direction of the company. In particular it would seem that the current NEDs have failed in their strategy and risk roles as described above. This in turn may be attributed to the fact that the nominations committee regularly reject NED applicants who do not have oil industry experience and who would be able to look at us from the outside coming in rather than with the blinkers of an oil and gas industrial expert.

Extraction of oil and doing so in a social and ethical way are not mutually exclusive. As a company dealing with an unsustainable product, we should be expanding our research and development efforts into sustainable alternative fuels; doing so will be in the long-term interests of our shareholders and underpin the confidence of the market in the company.

In conclusion on this matter, there is an urgent need to recruit socially and ethically aware NEDs who will be able to challenge the executive directors on the company's strategy. In addition, all of our directors should be made fully aware of the social and ethical requirements of our stakeholders – this is an area that will continually evolve and change, it cannot be considered as absolute. One way of doing so could be to form a working relationship (to draw upon their experience) with the environmental group that has been so critical of us. Inviting their oil industry expert to become a NED may be considered a radical step, but also a necessary one for the long-term benefit of our shareholders.

**Tutorial note:** *Real life examples show a practical understanding and wider reading; not just bookwork. Relating to the scenario is always a requirement.*

*Induction process for NEDs (½ mark each point – max of 4 marks)*

A general induction process for new NEDs should:

- Be comprehensive.
- Be tailored to the needs of the company and individual directors.
- Contain selected written information plus presentations and activities such as meetings and site visits.
- Give new appointees a balanced and real life overview of the company.
- Not overload the new director with too much information.
- Provide the new director with a list of all the induction information that is available to them so that they may call up items if required before these are otherwise provided.

The induction process should also give the incoming director:

- An understanding of the legal, social and ethical requirements of being a director.
- An understanding of the nature of the company, its business and the markets in which it operates.
- A link with the company's people.
- An understanding of the company's main relationships, including meetings with all committees and the company's auditors.

**Tutorial note:** *As only four marks are available, a full, detailed description is **not** asked for.*

## **2 FLING EXPORTS**

### **(a) Risks associated with current approach to air miles**

*(Up to 2 marks for each of 3 risks – max of 6 marks)*

*Abuse by employees obtaining air miles*

This effectively means fraud through directors and senior employees being able to select their own means of travel and accommodation, often at a higher cost, to obtain personal benefits.

As this approach is accepted by the company (without any specific policy guidelines) there is a risk that these senior employees may feel empowered to carry out higher levels of fraud and embezzlement.

Employees at a lower level may consider this approach to be unfair and would use it as justification for carrying out compensating petty frauds in other areas – “if it is OK for them to carry out fraud, it is OK for us to do so as well”.

*Legal risk*

In many tax jurisdictions most benefits-in-kind (perks) are taxable, with the employer usually responsible for reporting the benefit and its taxable value to tax authorities at the end of each tax year.

The personal use of air miles earned through business activity has always been a grey area, but there is the risk that a tax authority will take an interest where they consider the benefit to be significant with a taxable value.

Failure to have discussed the issue of any deemed benefit-in-kind with the tax authorities may result in the company being involved in a tax investigation.

*Demotivation of staff*

At present, directors and senior staff are given relative freedom to choose the airline and hotel they wish to use. This may be seen as a form of motivation and reward – not only because of the style of travel/accommodation but also because of the resultant air miles obtained for personal use. Other staff may also see obtaining air miles as a form of motivation. Withdrawing this scheme could result in certain individuals becoming demotivated.

**(b) Comparing and contrasting the schemes (1 mark each point, max of 6 marks)**

*Current air miles scheme (3 marks max)*

Employees perceive that they have earned the right to use the air miles as they see fit. It is a form of compensation for the time they spend travelling (often out of work hours with no claim for overtime or time off in lieu) and the time they spend away from families.

The potential abuse of the current approach could be solved by requiring all directors and employees to go through a central booking system that would obtain the best deal. Frequent flyer privileges could still be obtained for an individual, but it may mean they will need to belong to several schemes and the miles would not accumulate as quickly.

Some employees may well view the current situation as unethical (even though they may use it) and agree that all air miles should be available only for company business.

*Corporate scheme (3 marks max)*

The corporate scheme lays down the same approach for all, regardless of position. Everyone will be aware of the rules.

The benefit will be to the company as the company incurred the costs of earning the air miles through flights and accommodation. Costs can be controlled and reduced.

Incentives to directors, managers and employees may still be allowed, but only for business use. They would need to be seen to be fair, for example, upgrading of economy to business class where the flight would exceed a certain time limit.

**(c) Air miles incentive as a principal-agent problem** (1 mark each point – max of 4 marks)

Agency and the relationship between directors and shareholders lie at the core of corporate governance. The separation of ownership and control of entities has resulted in potential conflicts of interest between directors and shareholders – divergent interests.

The “agency problem” concerns how the shareholders (principals) control the directors and other senior management (agents) to ensure that the agents act in the principals’ best interests and not their own.

While the fiduciary duty to act in good faith should be for the best interests of the company, agency theory takes the view that this may not always be the case. Not all agents will have the same motivation requirements, so different incentives may be given to different agents to motivate them to behave in the best interests of the firm and not for their own self-interests.

In the situation of air miles, where the bookings are made by the company, the agents may argue that they should be able to keep them to use as they wish. It is not a reward that they can control. Where the bookings are made directly by the agents (with little or no oversight) to obtain the best air miles possible, the principals could argue that the agent is not acting according to their fiduciary duty, especially where no additional benefit accrues to the principal.

In addition, there is always the case that the personal use of air miles becomes an accepted norm and no longer acts as a motivator. Requiring that all air miles can only be used on corporate business may act as a demotivator to some employees who may then demand compensation.

**(d) Application of Tucker’s 5-question model** (1 mark each relevant point, max 10 marks)

The Tucker 5-question model provides a framework against which ethical decisions can be tested. Five questions about a business decision must be answered in the affirmative to confirm that it is ethical.

*Profitable?*

The direct indication is that it will save costs as the air miles will be used for the company’s benefit. However, the demotivating aspect of the proposed scheme and a possible requirement to compensate employees for the loss of their personal use of air miles may offset any savings.

*Legal?*

There is no legal requirement that air miles must be used by the company. Neither is it illegal for companies to insist that employees must use corporate cards when making travel arrangements.

In some jurisdictions the directors’ fiduciary duties are enshrined in law so that obtaining air miles for personal use through overspending, for example, on flights may be considered illegal.

*Fair?*

It is not fair that the company pays for “abuse” in an air miles scheme. Those who currently obtain air miles and do not abuse the system may claim that the change is not fair.

*Right?*

This is perhaps an ethical question – some may argue that it is ethically acceptable for air miles to be used for personal gain (as a just reward for personal inconvenience) others would argue that the air miles were awarded because of company business and should therefore be used for company business. Perhaps feeling valued and praised has a bigger psychological impact on employees' well-being and happiness than giving them air miles.

*Sustainable or environmentally friendly?*

Many airlines have changed the terms and conditions of their air mile schemes because of the significant liability of unclaimed miles. They have made it much harder to earn and retain air miles. In that sense, air mile schemes are not sustainable as miles will be lost if not used within a certain period (e.g. two years).

Environmentalists claim that air mile schemes are not environmentally friendly as they encourage more frequent air travel (air travel that would not otherwise take place) – more people on a plane, the heavier the plane, the more fuel it will burn, the greater the emission of greenhouse gasses. So corporate schemes can claim to be at least environmentally neutral as their managers who fly need to do so regardless.

### 3 GLOBAL ASSETS

#### (a) **Fraud factors at Global Assets** (*1 mark each factor fully explained, max 5 marks*)

- Reliance on the reputation of the CEO. As the past chairman of the technologies stock exchange he was considered to be fully trustworthy.
- Failure by the investing banks to conduct adequate, if any, due diligence. One bank had not invested because of their due diligence, implying those banks who did failed in their due diligence approach.
- Insider view on procedures as the CEO was a consultant to one regulator and his nephew worked as a senior compliance officer at the other regulator.
- Poor controls at the regulators to allow involvement in the regulators by market players and members of their family.
- Poor internal controls by the regulators in failing to adequately check and follow through the complaints that were made to them.
- Poor external auditing. Significant reliance placed by the external auditors on the representations made to them by the CEO's nephew.
- A "light touch" regulatory approach was adopted as the scheme was designed for high-net-worth individuals who could afford to take risks and should be fully aware of what they were doing.
- The CEO had an inside track on the gullibility of investors and their risk appetite (perhaps greed).

**(b) Social responsibility** (2 marks each position fully described, 2 marks fully explaining position of company, max of 14 marks)

*Pristine capitalists*

The dominant view in accounting, finance and economic performance in which the *only* responsibility of the corporation is to make money for shareholders. Thus:

- Economic performance is the only legitimate goal.
- Individual self-interest takes precedence over benefits to society.
- Shareholders can expect maximum returns.

*Expedients*

Basically share the same underlying position as the pristine capitalist (i.e. maximising shareholder wealth). However, they take a long-term view that economic welfare, stability and maximising shareholders' wealth can only be achieved by the acceptance of certain (minimum) social responsibilities.

*Proponents of the social contract*

An attitude that companies and other organisations only exist at society's will and are expected to respect and respond to that society.

Responsibility is reciprocal. In the business-stakeholder relationship, stakeholders accept the organisation's activities as long as it acts in their interests. When the business breaks accepted norms (e.g. by acting unethically) the agreement of society may be withdrawn and the business will collapse.

*Social ecologists*

Those who are concerned for the social environment and feel that because large organisations have been influential in creating social and environmental problems (i.e. have large social and environmental footprints) that they should also be influential in helping to eradicate or minimise these problems.

As economic processes are leading to resource exhaustion, waste and pollution, such processes must be modified. Businesses must adopt socially responsible positions, not because they have to meet the norms of society (social contract) but because they feel a moral responsibility to do so.

*Socialists*

Those who feel that there should be a significant readjustment in the ownership of assets and structuring of society away from capitalists ("power to the people").

All forms of domination (e.g. nation states and multi-national conglomerates) are criticised. There is a call for corporations to have their charters revoked by communities claiming social and ecological exploitation.

Business should be conducted in a different way that recognises and redresses the imbalances in society and provides benefits to stakeholders more widely.

*Radical feminists*

Those who feel that there is something essentially wrong with the aggressive masculine constructs that guide social systems (e.g. aggression, power, hierarchy, domination and competitiveness).

There is a need for more feminine values (e.g. equality, dialogue, compassion, fairness, cooperation and mercy).

A radical rethink of values and social culture is required to move business towards feminine values. Until this happens, accounting and corporate social reporting (CSR) systems are flawed.

#### *Deep ecologists (“Deep greens”)*

Those who hold that humans have no greater right to existence or resources than any other form of life. Life and life forms have intrinsic value and humans have no right to reduce this richness and diversity except to satisfy vital needs.

Just because humans can control and subjugate social and environmental systems does not mean that they should. It is immoral for businesses to destroy other life forms and create imbalance within eco-systems just for the purpose of human economic growth.

#### *Global Assets*

George very much takes the view of a pristine capitalist. He was only interested in maximising his return from the company – in this case by carrying out fraud. His concern was not for his investors or society as a whole.

- (c) **Ethical threats and safeguards** (1 mark each of 3 threats and 1 mark for each related safeguard – max of 6 marks)

#### **Breaches of regulations and internal controls**

The scenario implies that the procedures of the regulator were not followed. Poor internal controls allowed a family member of Global Assets CEO to hide and eliminate damaging reports and complaints about the company.

#### *Safeguard*

- Any member of the regulator identifying suspicious behaviour should be able to report such behaviour.
- Professionals should be encouraged to obtain advice from senior management (concerning their suspicions) their professional organisation or an appropriate professional advisor.
- The regulator should provide a formal dispute resolution process for staff who wish to resolve their concerns over any activity.
- Staff should be allowed to seek unhindered legal advice.

#### **Preparation and reporting on information**

Any employee who prepares reporting information must be able to do so fairly, objectively and honestly. However, they may be pressured to provide misleading information.

#### *Safeguard*

- Staff may consult with superiors if they wish to make a complaint or demand a confidential discussion.
- Staff should consult with those charged with governance at the regulator.

- Professionals should consult with their professional body.

### **Independence**

All employees and advisors of the regulators must be independent of those who are being regulated.

#### *Safeguard*

- The regulators must regularly check the independence of all their employees.
- Employees must confirm at least annually their independence.
- All potential employees must be confirmed as independent before employment.

### **Inducements – receiving offers**

This refers to incentives offered to encourage unethical behaviour. Inducement may include gifts, hospitality, preferential treatment or inappropriate appeals to loyalty. Objectivity and or confidentiality may be threatened by such inducements.

#### *Safeguard*

- All employees must refuse any form of inducement.
- Approaches to employees must be reported to those charged with governance

### **Whistle blowing**

Situations where employees consider disclosing information where ethical rules have been broken by the regulator.

#### *Safeguard*

- A dedicated independent official of the regulator (e.g. senior non-executive) to be nominated as the main contact.
- All approaches to the official must be in strict confidence.

#### 4 GTY

**(a) Footprints** (1 mark each definition plus max 1 mark each relevant point – max 12 marks)

An environmental footprint is the impact of an organisation in environmental terms (resource use, waste generation, physical environmental changes, etc).

The social footprint is the impact of an organisation on people, communities and society. It involves the process of analysing, monitoring, and managing the social consequences of change caused by an organisation.

Environmental impact issues include: (*½ each – max 4*)

- Air pollution and quality – airborne pollutant emissions and nuisance from odours.
- Water quality – availability of water supply, rational supply and use, pollutant emissions to water.
- Soil protection – soil erosion, pollution and contamination, “land take” (i.e. the total area of land needed for a building or development).
- Climate change:
  - emissions and concentrations of greenhouse gas (“GhG”);
  - ozone depletion;
  - effects of climate change.
- Noise – noise emissions, noise nuisance and damage from noise.
- Land and resource use – depletion of non-renewable resources and rational use of natural resources.
- Biodiversity – protection of endangered species and ecologically sensitive areas.
- Natural/cultural heritage – protection and conservation of natural/cultural assets.
- Waste management – waste production/disposal and nuisances from waste.
- Environmental risks – probability and magnitude.
- Human safety and health.

Unlike the environmental footprint, which measures an entity’s use of and impact on natural capital, the social footprint deals with impacts on people and communities, measured through the concept of anthro capital (capital created by people).

Anthro capital, which underlines the well-being of people, comprises three elements:

- Human capital (e.g. personal health, knowledge, skills, experience, human rights, ethical entitlements);
- Social capital (e.g. social networks, cohesion, shared interests, mutually-held knowledge, democratic activities, goodwill, social intercourse); and
- Constructed capital (e.g. physical infrastructures, roads, utilities that are built by people).

Typical issues include: (*½ each – max 4*)

- Human rights:
  - equality of opportunity and entitlement;
  - compatibility with the fundamental rights.
- Social cohesion – social exclusion and risks of poverty.
- Economic cohesion – disparities between incomes, groups of consumers, citizens, workers, etc.
- Employment – opportunities (job creation, enterprise creation) and quality of employment and of the working environment.
- Human capital formation:
  - educational achievements in the population;
  - training and life-long learning opportunities;
  - skills and learning capability.
- Public health and safety:
  - health of the population;
  - safety risks;
  - nutrition, food quality and safety.
- Social protection and social services – accessibility to health services and their long-term sustainability.
- Liveable communities – quality of housing, infrastructures, services and the living environment.
- Culture – preserving cultural diversity and heritage, increasing integration.
- Consumer interests – improving consumer information and choice and reducing consumers' risks.
- Security:
  - crime prevention and protection against terrorism;
  - protection of networks and infrastructures;
  - integration of systems and services.
- Governance – participation and social capital formation (through increased accountability, democracy, citizens and stakeholders' empowerment, etc).

**(b) Audit and assurance** (1 mark each relevant point – max 6 marks)

An audit of a company's financial statements is, in most jurisdictions, a statutory requirement. The financial statements will have been prepared in accordance with a specific framework (e.g. IFRS, US GAAP). The auditors will comply with specific work standards (e.g. ISA). In most jurisdictions the use of IFRS and ISA is a legal or regulatory requirement.

Social and environmental auditing is a method for organisations to plan, manage and measure non-financial activities and to monitor both the internal and external consequences of the organisation's social and commercial operations. It is a tool for measuring and reporting on an organisation's impact through systematic monitoring of non-financial performance and collection of stakeholder views.

The most common frameworks relating to social and environmental auditing include the International Integrated Reporting Framework, the Global Reporting Initiative (GRI 4), AA1000 and the ISO 14000 collection of standards. Although popular amongst certain companies, they are not compulsory, although in South Africa for example, listed companies are required to produce integrated reports or explain why they were unable to do so.

A "difficulty" with such reporting is that the information used and disclosed is rarely quantitative in nature. Most is of a qualitative nature and therefore its application and delivery is "in the eyes of the beholder". Thus, unlike IFRS, comparability can often be difficult although one of the aims of GRI 4 and the International <IR> Framework is to encourage and ensure compatibility as far as possible.

Providing assurance on sustainable disclosures generally involves three elements – agreed metrics (what and how they should be measured), performance measurement against those metrics, and reporting on the levels of compliance or variance. The approach to auditing this detail and providing assurance is given by the general approach of ISAE 3000.

**(c) Performance indicators** (1 mark for each covering at least 2 measures – max 7 marks)

Using the Global Reporting Initiative (GRI) as the basis for performance indicators, typical examples relating to social performance in the workplace include:

- Quality of management
  - Employee retention rates/labour turnover.
  - Ratio of jobs offered to jobs accepted.
  - Ranking of the organisation as an employer in internal and external surveys.
  - Job satisfaction levels.
- Health and safety
  - Reportable cases (including sub-contracted workers).
  - Standard injury, lost day and absentee rates (including casual workers).
  - Investment per worker in illness and injury prevention.
- Wages and benefits
  - Ratio of lowest wage to national legal minimum.
  - Ratio of lowest wage to local cost of living.
  - Health and pension benefits provided by employers.

- Non-discrimination
  - Percentage of women in senior executive and senior or middle-management ranks.
  - Discrimination-related litigation – frequency and type.
  - Support programmes for minorities.
  
- Training/education
  - Ratio of training budget to annual operating costs.
  - Programmes to engage workers to participate in decision-making.
  - Changes in average years of education of workforce.
  - Incorporate achievement associated with training programmes.
  
- Child labour
  - Verified incidences of non-compliance with child-labour laws.
  - Third-party recognition/awards for child labour practices.
  
- Forced labour
  - Number of recorded grievances by employees.
  - Incidents identified through organisation’s auditing of suppliers.
  
- Freedom of association
  - Numbers and types of legal actions concerning anti-union practices.
  - Organisational responses to organising at non-union facilities.
  - Staff forums and grievance procedures in place – percentage of facilities and countries of operation.

**1 PETRO GLOBAL**

- (a)** Stakeholders and claims. *½ mark for each stakeholder.  
Up to 1½ marks explanation of claim.*

8

<p><i>Ideas</i></p> <ul style="list-style-type: none"> <li>– Shareholders           <ul style="list-style-type: none"> <li>• Fiduciary duty of directors</li> <li>• Maximise shareholder wealth</li> <li>• Growth in capital value and annual returns</li> <li>• No decrease in share value</li> </ul> </li> <li>– Directors and employees           <ul style="list-style-type: none"> <li>• Continued employment</li> <li>• Safe working environment</li> <li>• Appropriate compensation</li> <li>• Directors – bonuses and reputation</li> </ul> </li> <li>– Local inhabitants           <ul style="list-style-type: none"> <li>• Continue same lifestyle</li> <li>• Progress into a modern lifestyle</li> <li>• Compensation</li> <li>• Work opportunities</li> </ul> </li> <li>– Petrol consumers           <ul style="list-style-type: none"> <li>• Availability of fuel</li> <li>• Containing costs</li> <li>• Alternatives</li> </ul> </li> <li>– Environment           <ul style="list-style-type: none"> <li>• Threat of extinction</li> <li>• Contamination</li> <li>• Food chain</li> </ul> </li> </ul>
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- (b)** Impacts and actions *1 mark each relevant point.*

8

<p><i>Ideas</i></p> <p><i>Negative impacts (4 marks)</i></p> <ul style="list-style-type: none"> <li>– High impact on environment</li> <li>– Recent events (Gulf Horizon, Niger Delta)</li> <li>– Specific impact (land, sea, air, wildlife, vegetation)</li> <li>– Impact on food cycle</li> <li>– Pipelines – leakage, blocking migration paths of animals</li> <li>– Upstream environmental damage – air, water, tides</li> <li>– Impact of cleaning agents if a spill</li> </ul> <p><i>Action to reduce (4 marks)</i></p> <ul style="list-style-type: none"> <li>– Setting up protection zones</li> <li>– Companies safety records</li> <li>– Close monitoring (24/7)</li> <li>– Use of proven environmental protection technology</li> <li>– Implementation of recommendations from other accidents</li> </ul>
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- (c) (i)** Absolutism – *1 mark for each relevant comment.* 3

*Ideas*

- Explanation of absolutism
- Repairs, WiFi, tablets = bribery
- Life is sacred – deep green view
- Pristine capitalist view
- Use of technology to reduce risks

- (ii)** Relativism – *1 mark for each relevant comment.* 3

*Ideas*

- Explanation of relativism
- Polar bears v cheap petrol
- Changing views on big corporations

- (d) (i)** Role of NEDs *1 mark for each relevant point. Max of 2 marks each.* 8

*Ideas*

- Strategy
- Risk
- Scrutiny
- People

- (ii)** Social contract *1 mark for each relevant comment.* 12

*Ideas*

- What it means
- Examples – customer boycotts
- Specific history (Brent Spar, Shell, Gulf Horizon, BP)
- Impact if contract broken
- Use of dubious tactics by company
- Environmentalist's report indicates board failure to identify emerging issues
- Failure of current NEDs
- NED experience
- Role of nominations committee
- Alternative fuels
- Co-operation with environmental group

(iii) NED induction  $\frac{1}{2}$  mark for each relevant point listed.

4

*Ideas*

- Comprehensive and tailored
- Written, oral and practical
- Balanced view
- Real life view
- Does not overload
- Access to information available when required
- Legal, social and ethical requirements
- Overview of company, its business and markets
- Meeting key individuals and teams
- Alternative fuels
- co-operation with environmental group

Professional marks for logical flow, persuasiveness and structure of **memo**

max 4

50

**2 FLING EXPORTS**

(a) *Up to 2 marks each risk explained.*

max 6

*Ideas*

*Risk of abuse*

- Obtaining air miles – possible abuse and fraud
- Increased costs
- Cascade impact on lower level staff

*Legal risk*

- Tax implications
- Benefits-in-kind
- impact on motivation of staff

(b) *1 mark for each point of comparison/contrast*

max 6

*Ideas*

*Employee scheme*

- Employee perception of right of use
- Form of compensation
- Use of central booking to curtail potential abuse
- Ethical feelings

*Corporate scheme*

- Same approach for all
- Cost savings
- Company incentives to employees, e.g. upgrade of class if long flight

- (c) Principal-agent *1 mark each relevant point.* 4

*Ideas*

- Explanation of agency and agency problem
- Fiduciary duty of directors
- Agent incentives
- Are air miles compensation
- Motivator or demotivator

- (d) Tucker *1 mark each relevant point, max of 2 marks each element.* max 9

*Ideas*

- Profitable: save costs but demotivates
- Legal: Company card not illegal, overspending to gain personal benefit may be
- Fair: Not fair on company re abuse. Those who do not abuse may consider change unfair
- Right: Depends on ethical views held
- Sustainable/environmentally friendly: time limits set on claiming benefits; system not environmentally friendly as encourages more passengers to fly

25

**3 GLOBAL ASSETS**

- (a) *1 mark for each fraud factor explained.* max 5

*Ideas*

- CEO reputation
- Lack of due diligence by investors
- Insider knowledge and application
- Poor internal controls at regulator
- Failure at regulator to follow up on complaints
- Poor external auditing
- Light-touch regulatory approach

- (b) Seven positions: *Up to 2 marks for each element, 2 marks for Geiorge's position.* max 14

*Ideas*

- Pristine capitalist
- Expedient
- Social contractarian
- Social ecologists
- Socialists
- Radical feminists
- Deep ecologists
- Global assets, owned by CEO = pristine capitalist

(c) Ethical threats/safeguards 1 mark each relevant point; 2 marks max each threat 6

*Ideas*

- Breaches of regulations and internal controls: whistleblowing, obtaining advice, dispute resolution, unhindered legal advice
- Preparing and reporting on information: able to do so fairly, objectively and honestly; consultation procedures with those charged with governance
- Independence: regular confirmation, appropriate pre-employment confirmation
- Inducements: must be refused, reporting to those charged with governance
- Whistle blowing: key official, strict confidence

25

4 GTY

(a) 1 mark each definition 2  
Up to 1 mark each relevant point made. max 10

*Ideas*

- definition
- environment footprint = pollution, climate change, biodiversity, working safety, waste management
- social footprint = anthro capital = human capital, social capital, constructed capital

(b) 1 mark for each point explaining key differences max 6

*Ideas*

- financial audit
- social and environmental audit
- frameworks
- qualitative v quantitative information

(c) 1 mark for each performance indicator described. max 7

*Ideas*

- management
- health & safety
- wages and benefits
- discrimination
- training/education
- child labour
- forced labour
- freedom of association

25

**MOCK EXAM FEEDBACK SUMMARY – PAPER P1 MOCK 2**

<b>Q</b>	<b>Part</b>	<b>Topic</b>	<b>Study Text ref</b>	<b>RQB coverage</b>	<b>Commentary</b>
1	(a)	Stakeholders	2	Q3 Rosh & Co Q35 R & M	Identifying the stakeholders is easy, explaining their claim may take a little more thought. Ensure you relate to the scenario and your general knowledge.
	(b)	Environment and risk	12 & 20	Q18 Ultra-Uber Q19 YGT Q33 JGP	You need to be able to pick up on the clues in the scenario and mix them with general knowledge of the subject to gain good marks. Better answers would consider how to reduce probability and impact of environmental damage “collectively”. Note that a columnar answer format would not have been suitable.
	(c)	Ethics	15 & 16	Q22 RDC Q23 TZO Q25 Biggo Q35 R & M Q36 Swan Hill	A sound knowledge of absolutism and relativism was essential plus an ability to apply to the scenario.
	(di & iii)	NEDs	3	Q4 Ding Co Q5 Lum Co	Broadly book learning topics.
	(dii)	Social contract	7	Q11 Help-with-life	Clues within the scenario, but note from the answer how much is drawn from research. Reading around the subject would have given an advantage to gain good marks.
2	(a)	Risk	12	As for 1(b) above	A good analysis of the scenario plus common sense = pass marks
	(b)	Compare and contrast			An ability to analyse situations and make comparisons was essential.
	(c)	Principle-agent	2	Q3 Rosh & Co	Understanding agency theory and applying to the scenario would have ensured a good pass.
	(d)	Tucker	2	Q35 R & M Q38 Coastal Oil	Not knowing the five elements of Tucker will ensure a fail for this part of the question.

**MOCK EXAM FEEDBACK SUMMARY – PAPER P1 MOCK 2**

<b>Q</b>	<b>Part</b>	<b>Topic</b>	<b>Study Text ref</b>	<b>RQB coverage</b>	<b>Commentary</b>
3	(a)	Fraud risk	12	As above	Another part question requiring a good understanding of the scenario. Most of the marks to pass were within the scenario
	(b)	CSR	7, 16	Q10 Help-with-life Q32 Integrated Reporting	Could you remember all of this detail?
	(c)	Ethical threats	17 & 18	Q29 Lobo Q30 Mbabo Q31 Jojo	Basic F8 knowledge, but applied at the professional level. Failure to understand the scenario would result in a fail for this part of the question.
4	(a)	Footprints	20	Q32 <IR> Q33 JGP	Basic bookwork. If known, then pass ... if not, then fail.
	(b)	Environmental audit		Q33 JGP	Audit of financial statements from F8. Social and environmental audit – book work. But straight definitions would gain a bare pass. A good pass requires further detail on <IR> and other frameworks.
	(c)	Performance indicators		Q32 <IR>	Studying actual <IR> and sustainability reports would have given the necessary background to ensure a good pass.