Answers

1 (a) *An effective non-executive chairman would bring scrutiny to Mr Tong and his corrupt activities.* Having to report to a chairman would mean that he would have to justify his behaviour if challenged by the chairman and this would make corruption less likely. The chairman usually needs to report in a chairman's letter to the shareholders on the state of the board and the company's governance, and in so doing, needs to be a trustworthy figure, capable of chairing an effective board, and holding other directors to account. An effective chairman could stop Mr Tong's corrupt payments by establishing a transparent tendering process and insisting that all supply contracts are subject to that process.

Mr Tong's behaviour is completely unacceptable and represents an ethical failure of leadership on his part. If others see Mr Tong receiving corrupt payments, *the 'tone from the top' may mean that other managers lower down the organisation may also seek corrupt payments* and this militates strongly against the efficiency of internal processes. It means that contracts are awarded on the size of the bribe and not on the basis of the value for money for shareholders. Companies and countries which tolerate corruption are self-selecting for themselves a lower efficiency and poorer value for money for shareholders (or taxpayers in the case of governments).

The *shareholders are receiving poor value for money from Mr Tong's leadership* because not only is he paid a 'substantial' reward, he also accepts corrupt payments for the award of contracts. This means that the tendering process is unlikely to be fair and transparent as he is likely to award contracts on the basis of how much of a bribe he will receive from the supplier. An effective chairman could ensure he gave his energies to pursuing value for money for the shareholders and not concentrating on his own corrupt forms of income.

An effective chairman *could encourage the establishment of internal controls and an internal audit function for the monitoring of all activities related to the tendering and allocation of contracts*. By making these functions report to a non-executive audit committee, the transparency and integrity of these processes can be assured and this is in the interests of shareholders because it ensures that all supply contracts are based on best value for money and not on the size of the bribe paid to Mr Tong.

(b) (i) Importance of completeness of remuneration report

Remuneration reports are important because they provide shareholders with information on how much the executive directors are paid and how their remuneration is configured. This is important so that shareholders know *how they are motivated and how well their rewards are aligned to the interests of shareholders*.

If there are payments (albeit illegal payments) missing from the remuneration report, then shareholders are not receiving accurate information on how Mr Tong is being rewarded. This, in turn, undermines the whole purpose of remuneration reporting as it is intended to convey important disclosure to shareholders. *Missing payments means that shareholders are not being given the whole picture in the remuneration report and this represents a serious agency failure.* The chairman of the remuneration committee (usually a senior non-executive director) should ensure that this information is fully accurate.

Agency issues with the incomplete remuneration report

Inaccuracy or a lack of completeness in a remuneration report means that the *shareholders are not receiving a full picture* of what Mr Tong earns. This undermines the purpose of remuneration reporting because shareholders do not know how Mr Tong is rewarded for performance and this means that shareholders, who collectively own the company, are receiving false information and this is a serious agency failure on the part of Xuland Oil.

The shareholders of Xuland *are being lied to in the remuneration report* and this is a serious lapse of trust on the part of Xuland Oil. As the collective owners of Xuland Oil, all material information should be disclosed to facilitate shareholder decision-making, but an incomplete remuneration report is a breach of this trust. The acceptance of bribes on his awarding of company contracts is such a serious breach of the trust placed in the CEO, that shareholders have a legal and ethical right to know bout this income, yet it is unaccountable in terms of the remuneration report.

The incompleteness of his income also means that shareholders *are unable to assess Mr Tong's performance in terms of his leadership of the company*. Shareholders may look at what the CEO is paid and assess that against the company's performance in that year to decide whether they are getting good value from the CEO. Without a full picture of his income and how he is rewarded to act in the shareholders' interest, shareholders are unable to see how his income is linked to company performance.

(ii) The agency problem is reduced when the interests of directors and shareholders are aligned. One way of doing this is to make the rewards of directors linked to the performance of the business they are managing. Shareholders tend to prefer this approach for several reasons.

It *motivates the directors in that they make more income* (usually in performance bonuses or share options) when the company does well. Typical measures upon which performance bonuses are based include return on equity or performance based on the nature of the company's operations such as sales, internal control compliance or other, context-specific measures. In each case, improvement is in line with the interests of shareholders in creating shareholder value.

It *encourages directors to think about creating shareholder value*, as it is this which provides directors with higher bonuses or the maximisation of the value of share options. This includes retaining talent, operating efficiently in resource markets and innovating to produce efficiencies and controlling internal activities. Any increase in organisational efficiency or effectiveness will serve the interests of shareholders and also potentially add to the bonus for the director and, accordingly, performance-related rewards serve the interests of both shareholders and directors.

It *makes directors more accountable to shareholders*. The issue of how directors remain strongly accountable to shareholders is one of the key challenges in corporate governance. By forcing directors to create shareholder value, the accountability link is strengthened as they are motivated to think in terms of maximising shareholder value. Directors are less likely to behave in ways which reduce shareholder value, and are more likely to think about how to maximise their own value to shareholders.

(c) The proposed new mandatory environmental reporting requirement will represent a challenge to many companies which do not currently produce an environmental report. Xuland Oil is currently resisting the requirement, but it is likely that because the shareholders are international in their distribution, they may not be able to resist the requirement over the longer term. Any reporting requirement, including environmental reporting, must have effective internal controls in place to ensure that the information reported is accurate, complete and in a state which can be employed and understood by shareholders and other interested stakeholders.

The requirements of the new reporting requirement contain some specific internal control issues.

The company *will need internal controls to monitor and assure* the collection of relevant metrics for the measurement of environmental measures. This will include measurements on resource consumption (e.g. water, energy) and emissions (e.g. of excess heat, pollutants). These will need to be accurately measured in order for Xuland Oil to be able to reports its progress each year against agreed measures in line with the reporting requirements.

The internal controls need to ensure that the *metrics are measured in the same way each year* to allow for year-to-year comparisons. Accordingly, standard forms of measurement will need to be established, which can be repeated consistently year-on-year in order to report consistently to interested readers. In this regard, agreed ways of measuring will need to be agreed, perhaps written up into a manual of agreed practice and enforced and audited by the internal audit department. There may be some need for environmental impact or resource usage targets to be set and variances between these targets and actual performance measured and investigated.

Because of the need to report on how environmental impact is being mitigated, it is important to have suitable 'good news' stories to report, and favourable trends in resource consumption and emissions. *Internal controls can be employed to continually monitor certain measurements in order to ensure there is progress to report upon.* It may be, for example, that water or energy use can be reduced by improving or redesigning internal processes which would be a good news story to report in subsequent years. The same argument could be applied to any of the company's emissions, such as of noxious emissions, polluted water or similar.

Internal audit can *audit the processes used to gather and measure the environmental inputs and outputs*. The need to audit this information assures the accuracy of the reporting. This is important in making the report trustworthy, and therefore, trusted by users. The integrity of reporting rests upon an internal process which assures the robustness of the measurement and reporting, and internal audit facilitates this.

(d) **(i)** Corruption, of which the offering and acceptance of bribes is an example, is a serious departure from the highest standards of integrity in the operation of an organisation. Mr Tong has shown himself to be corruptible in his pursuit of irregular payments in exchange for the offering of supply contracts. The effect of this is to reduce the efficiency of company operations and to undermine the confidence shown in Mr Tong by the shareholders of the company.

It is likely that Mr Tong and other senior officials in Xuland will resist any attempts to improve the situation for the following reasons:

First, there is a culture of offering and accepting corrupt payments in Xuland. The case scenario explains that there is corruption among police officers, among public servants and others. Once corrupt practices become normalised and *embedded in a culture, and are seen to go unpunished*, it is very hard to challenge them. If people grow up in a climate in which bribes are offered and accepted, they may begin to feel that this behaviour is normal and then it becomes a taken-for-granted part of the culture in Xuland. As with any cultural norm, it can be hard to challenge it in public.

Second, Mr Tong and others in senior positions in business *can make a lot of money in what is seen in Xuland society to be normal business activity*. Mr Tong *does not seem to accept the argument that his personal enrichment is at the expense of shareholder value* and so it seems unlikely that he will see the case for change. He may see his personal enrichment as a right, associated with his position as chief executive of Xuland Oil, and this is manifestly part of the problem: he has no right to additional money other than the pay allocated to him by the remunerations committee. So, it is a moral failure on his part if he sees his personal enrichment as a right.

Third, the senior members of society on Xuland are often highly interconnected, and there *is a culture of making facilitation payments (bribes) for the award of public sector contracts* and other capital investments. If contracts are offered to friends and allies among government supporters, new entrants to the provision of services are unlikely to be successful and this further concentrates power in the hands of a relatively small group of people in senior positions in government and industry.

(ii) When it comes to defeating corruption in any society such as in Xuland, a *complete change in culture is required* in the country. This would involve a radical *change in Xuland including among public servants*, and a change in expectations, in the same way that some beliefs have been changed in some countries in line with changed values. There needs to be a recognition in Xuland that all forms of corruption are wrong, and this would require a change on what are seen as ethical norms in the country.

The change in culture should include *support for anybody challenging corruption*, whether in the public sector or in public companies. Those willing to challenge corruption or the taking of bribes should be supported by senior management in whatever organisation they are working in. This would also help with the 'tone from the top' ensuring that corruption is not tolerated and that management is always supportive of those challenging corruption at any level.

It seems appropriate to *open up public sector vacancies to all ethnic groups in Xuland and not to concentrate appointments to one ethnic group*. By making appointments competitive from any ethnic group, diversity in the public sector will be encouraged and wider range of opinions will be given on matters of public policy. By encouraging diversity, it will be more difficult to condone corrupt behaviour and greater scrutiny will be present. By allowing and encouraging conversation and more intense inter-relationships in this way, all public sector activities will enjoy greater public scrutiny.

Legislation could be introduced, in which any form of corruption is outlawed. There would *need to be high profile prosecutions of officials*, and public servants, so that the intolerance of corruption is recognised by those able to offer and accept corrupt payments. If people are seen to be punished for corrupt practice, then this will help to facilitate the change necessary. This could be accompanied by a tone from the top of society (government ministers and business leaders), stating that government and business contracts are all awarded based on transparent and public tendering processes. If these tendering processes could be made available to the public (such as on government websites), it would create more confidence in the processes.

It could be explained in public places (such as the media) that it is *unlikely that Xuland will develop into a developed country if it continues to tolerate large and small examples of corruption*. Corruption creates inefficiencies in society and it is fundamentally undemocratic, and, in each case, an ethical failure. It also costs businesses and, in government corruption, taxpayers, a great deal of money in lost earnings as contracts are awarded based on the size of the bribe rather than value for money for the taxpayer or shareholder. It needs to be explained that corruption, as Alice Tuesday said, keeps people in poverty and excludes Xuland from becoming a fully developed country with all the benefits of that.

2 (a) The main objectives of any internal control system are to manage the inherent risks faced by the organisation as far as is reasonably practicable. They comprise the following:

1. Business activities should be conducted in an orderly and efficient manner, with internal procedures and practices strictly adhered to. It is apparent that Stefan Krank showed very little regard to both internal procedures and the wishes of his clients when he circumvented internal controls in order to deliver higher returns.

   However, by acting as he did, Krank put those funds which he managed at a far higher level of risk than that authorised by his clients, who were totally unaware of his unauthorised actions. The internal control system failed to ensure that he acted in line with client's instructions.

2. The assets of a business need to be adequately safeguarded, a prime consideration for a business like Fortune Investments whose basic role is to manage funds on behalf of its wealthy clients. Unfortunately, the actions of Krank directly threatened the value of the funds he had under his control, with riskier investments actually resulting in lost value.

   By failing to safeguard his clients' funds, Krank's behaviour could have vicariously damaged the reputation and financial standing of Fortune Investments. This would have arisen if the funds he managed had incurred losses which the company were unable to cover.

3. Fraudulent activities or material errors should be both detected and prevented by the internal control system. Significant errors and any fraud could be detected through management checks and by the audit of internal procedures; neither of which seem evident in the case of Fortune Investments.

   The fact that Krank had been the most successful fund manager for the company, delivering the best results for his clients possibly elevated him to a status which went unchecked, a clear weakness in the company's internal control system. It was only because James Reynolds escalated his concerns about his investment fund to Krank's manager that any action would have been instigated; and this was far too late.

4. Accounting records must be both complete and accurately maintained. This could not have been the case at Fortune Investments because Krank tried to confuse Mr Reynolds with statements which revealed little resemblance to the reality of his investment fund. The company directors have obligations under corporate governance provisions and legal responsibilities to maintain accurate accounting information. Therefore as Krank failed to record the true value of clients' funds, they are at risk of charges of false accounting and the criminal consequences which might arise.

5. Financial information must be prepared and available in a timely fashion. In the case of Fortune Investments, the information on the performance of individual investment funds must be available as and when the client requires it. To suggest that Mr Reynolds looked at his fund on a bad day which did not accurately represent its true performance infers that clients are reliant on Krank to furnish them with information at a time of his choosing. This arrangement is open to abuse and manipulation, as demonstrated by Krank.

Krank's behaviour

Stefan Krank's behaviour clearly breached the duty of care he owed to his clients. He was placed in a position of trust as their fund manager, which he abused in order to satisfy his own personal need to maintain his lifestyle by earning large bonuses. The clients unwittingly believed that their investments were being managed in a fund within their risk profile, when Krank was acting quite recklessly with their money.

Krank was employed by Fortune Investments to use his knowledge and skills to deliver high returns to their clients but within a controlled environment by following procedures and adhering to the expressed wishes of the investors. However, by disregarding company procedures, he failed to act in the best interest of his clients. This was compounded by the confused and wrong information which he gave to Mr Reynolds, further demonstrating a lack of care and diligence in the performance of his duties.

(b) Funds management

Good quality information is necessary so that management can monitor business performance. In the case of Fortune Investments, this would have ensured that they were able to understand the level of risk the business was being exposed to by the actions of Stefan Krank. They could then have taken necessary mitigating actions to reduce the risk to an acceptable level.

However, for this to be possible, the information used would require certain distinguishing characteristics:

1. It would need be accurate particularly because of the nature of the business under consideration. Complete knowledge of how individual funds are performing would allow senior managers to initiate appropriate procedures should they become suspicious about the performance of any individual fund manager. If the board had taken a more proactive stance and obtained accurate information about the funds which Krank managed, then the resultant losses and damage to clients' investments could have been avoided.
2. The information would have to be readily available in real time rather than being reliant on data compiled and submitted periodically by the fund managers. As the individual funds are invested on open capital markets, it should be possible to directly monitor their performance continuously, with alerts set up for any funds which appear to be performing outside agreed parameters. Fortune Investments should have invested in a management information system which enabled real time access to financial markets.
3. The board needs to maintain a comprehensive view of all clients' investments so that they can appraise how the business is performing holistically. Consequently investments information must be complete since any gaps would provide both a confusing and distorted picture which could possibly lead to the wrong decisions being taken.

Investor monitoring

Similarly individual investors, like James Reynolds, should be able to monitor constantly the performance of their funds so that they can be reassured that their investments are safe and delivering expected levels of returns in a risk managed way. This information would allow investors to decide whether to withdraw their money from the fund, maintain their fund as it is, or even invest further. However, such decisions are only possible if the information can be relied on for accuracy and be continuously available.

The current arrangements at Fortune Investments means that investors are overly reliant on their fund managers to supply them with information about the performance of their investments. This allows fund managers like Stefan Krank, acting as the investors' agent, to filter information ensuring that only positive results are reported and so deflecting any criticism of their own performance.

(c) Ethical relativism

Relativism adopts a pragmatic view by accepting that all circumstances are different, and therefore there is a need to apply different moral rules for varying situations and conditions. Indeed, relativists accept that there are numerous sets of moral rules and these can change over time because they are strongly influenced by prevailing cultures. However, the most striking feature of a proponent of ethical relativism is that they will determine what a correct action is by making reference to the conditions they face at that particular time rather than being guided by a pre-determined set of rules.

Stefan Krank's unethical behaviour

Stefan Krank's actions cannot be justified in ethical relativist terms, particularly because of his underlying motive of self-interest. However, by accepting that he 'always aimed to maximise returns on his clients' investments', it is reasonable to conclude that he assumed this pragmatic approach to investment decision making could be acceptable. However, he was aware that Fortune Investments attempted to impose a set of working practices on all fund managers to maintain control over their business, but these did not allow him to achieve his profit maximising objective. Therefore he elected to use his own initiative and skills to deliver strong returns on all funds by whatever means he thought appropriate, which proved to be successful for quite a long time. He was able to justify this to himself because his clients had been happy with the growth in their funds and his employer regarded him as its most successful fund manager, however, his actions clearly contravened company policy and were professionally unethical.

When the financial positions he held took a turn for the worse, he did not revert to a more risk averse approach but instead he undertook a highly dubious and illegal practice. The use of newly invested funds as a means of reporting profit on existing investments was both fraudulent and impossible to defend on any ethical grounds. Yet Krank believed he was doing the right thing and expected that eventually he would recover his position and return to normal levels of performance, so he believed his actions were justified. However, at the root of Krank's actions was his need to maintain his earnings at a level he and his family had enjoyed for several years, but in doing so he was harming those he was paid to serve and displaying a poor sense of morality and professional ethics.

3 (a) Environmental risk can be described as a loss or liability which arises from the effects of the natural environment on an organisation, or a loss or liability arising out of the environmental effects of the organisation's operations.

In the case of Oskal Petroleum, the principal risks will arise out of how its oil exploration, extraction and distribution processes could negatively impact [*environmental footprint*] on the natural environment in the vicinity. This risk would be exacerbated if the operations take place in a sensitive area, such as near a concentration of population or a designated area of significant importance for flora and fauna. A business consequence of environmental risk is that it may suffer significant costs and a loss of reputation if a problem arises.

Therefore during Oskal's forthcoming assessment it is essential that it identifies its sources of environmental risk.

Non-renewables
The core operations of Oskal will result in a steady depletion of non-renewable natural resources, namely oil. However, whilst there is a constant economic demand for oil derived products and services, Oskal has a justification for extracting oil from its onshore and offshore fields. In order to deflect criticism, it could aim to reduce its environmental footprint by implementing complementary measures to promote sustainable development in other areas. It could set a target to reduce the amount of fresh water consumed in its cooling systems; instead it could recycle water through its plant and machinery.

Unplanned spillages
Oil extraction may lead to spillages, most frequently caused by equipment failure, errors committed by employees and extreme environmental [weather] conditions. The environmental consequences of accidental discharges are especially severe when they occur near to shore, or in remote areas which cannot be cleaned up quickly. Oil spills may seriously impair the functioning of the marine ecosystem by: deterioration in the chemical composition of the water and its physical characteristics, resulting in deaths of living organisms as a result of oil products penetrating the surface layers of the skin and plumage, forced changes in migration routes, spawning and so on.

By undertaking carefully planned maintenance of all facilities, training employees to the highest standard and developing robust early warning systems, the likelihood and impact of any spillage will be significantly reduced.

Atmospheric emissions
Emissions of pollutants into the atmosphere are a common feature of operating oil fields. The most widespread source of such emissions is the burning of surplus quantities of hydrocarbons in the course of testing and exploiting wells. The burning of fossil fuel such as oil has been shown to make a significant contribution to climate change by emitting high quantities of greenhouse gases, which are known to damage the ozone layer and possibly leads to 'global warming'.

Although it would be clearly impossible for Oskal to operate as an oil company without some level of atmospheric emission, the overall effect could be reduced if the firm developed an environmental management system and considered its environmental impacts more holistically, offsetting its greenhouse gas emissions with improved recycling, waste management, etc.

Regulatory non-compliance
Due to the dangerous and environmentally damaging nature of the oil industry it is highly regulated, however, the regulations can vary significantly between countries and regions. So a firm like Oskal, with global operations, must have systems in place which ensure full compliance with all local and international regulations in all of its oilfields. Failure to do so could result in high financial penalties and the possible removal of operating licences, both of which would badly harm the business.

(b) The board of Oskal must have a thorough understanding of all the key risks which affect the company, as well as an appreciation of what is being done to effectively manage them. The COSO Enterprise Risk Management (ERM) framework describes a way of linking a company's objectives to what it needs to do to actually achieve them, namely manage its risks.

ERM considers risk management in the context of business strategy, but applying it to every level of the organisation. Therefore everyone in the organisation has some responsibility for ERM, but the board is ultimately responsible and should assume ownership of risk management. ERM is primarily designed to identify potential events which, if they occur, could harm an organisation and to manage risk within its defined risk appetite. Consequently ERM should be able to provide reasonable assurance to the board of Oskal, and vicariously to its shareholders, that the business will achieve its strategic objectives.

ERM is an iterative process which comprises eight discrete stages:

Control environment
This is essentially the general tone from the top which the company adopts towards risk management, and so provides the basis for how risk is viewed and addressed. Emanating from the top of the organisation, the control environment is embedded in the company's culture and defines its risk appetite. Oskal will need to accept a level of risk commensurate with the level of returns expected from its shareholders, however, the board must also bear in mind the nature of the risks inherent to its industry.

Objective setting
The company's risk appetite must be aligned to its business strategy, which is achieved by the setting of suitable risk-adjusted objectives. The objectives must be agreed before management is able to identify any potential events which may affect their

achievement. Oskal is likely to set challenging objectives to generate profitable returns for its shareholders, but within its risk tolerance boundary.

Event identification
These are the internal and external events, sometimes triggered by uncontrollable sources, which can ultimately affect the company's ability to achieve its objectives. Some of the events may present the business with positive opportunities whereas other present risks. In the case of Oskal, this could include an extreme weather event causing a fracture to an oil pipeline.

Risk assessment
Risks are analysed, considering likelihood and impact, as a basis for determining how they should be managed. Since likelihood can be measured in terms of probabilities and impact in terms of its financial consequences, it is possible to quantify the risk assessed and then prioritise relative importance to the operations at Oskal.

Risk response
Although not an automated process, management can then select an appropriate response to the individual risks assessed. Responses include avoiding the risk altogether, reducing it to an acceptable level, transferring it to a third party or accepting the risk if it falls within the pre-determined appetite. This will be key to Oskal as they will not wish to jeopardise the business by an inappropriate response to a potentially damaging risk.

Control activities
The company then devises policies and procedures, which are implemented to help ensure the risk responses are effectively carried out. At Oskal, this will include the standard operating procedures for its oil rigs to ensure that health and safety remain a prime consideration and environmental spillages are kept to a minimum.

Information and communication
Relevant risk information must be communicated in a manner which is readily understood, and in a timeframe which enables people throughout the company to carry out their responsibilities. In Oskal, it is essential that managers have information on the performance of all aspects of the business so that they can detect any unforeseen deviations and take appropriate mitigating action to avoid the consequences of the risk being realised.

Monitoring
Finally the whole process of ERM is monitored and modified as necessary. Like any system, it requires periodic update to reflect the changing operational environment, regulatory framework and the specific risks faced by Oskal.

[**Note:** *Other appropriate risk management frameworks could be used to structure an answer to this requirement]*

(c) Integrated reporting
Integrated reporting <IR> is a more concise communication of an organisation's strategy, governance and performance. It demonstrates the links between the organisation's financial performance and its wider social, environmental and economic context. Additionally, it illustrates how organisations create value from their activities over the short, medium and long term. The main purpose of <IR> is to enable more effective board level decision making, improve the quality of information available to investors, and encourage more integrated thinking and business practices.

The use of <IR> at Oskal will encourage the preparation of a report which shows its performance against strategy, explains the various 'capitals' used and affected, and gives a longer term view of the organisation and enable its stakeholders, like host governments, to make a more informed assessment of the organisation and its prospects.

<IR> capitals
All organisations depend on various forms of capital for their success. These 'capitals' store value which eventually become the inputs to the company's business model. The capitals will increase, decrease or transform through the various activities undertaken by the organisation. Therefore it is important that a company like Oskal is able to measure and monitor the use of its capitals, which can be incorporated into its annual report.

These capitals are classified under the following six headings under <IR>:

Financial capital is the pool of funds available to a company, including both debt and equity finance. The focus is on the source of funds, rather than its application which results in the acquisition of manufactured or other forms of capital. Oskal must be able to source sufficient financial resources to deliver its strategy and achieve its objectives, so by providing such information to its investors it will inspire greater confidence.

Manufactured capital is seen as human-created, production-oriented equipment and tools, with a distinction drawn between inventory and plant and equipment. These are the tangible assets which are employed by the company to create value. In Oskal, this would include the very expensive drilling and extraction equipment.

Intellectual capital is a key element in the company's future earning potential, with a tight link and contingency between investment in R&D, innovation, human resources and external relationships which can ultimately determine the company's sustainable competitive advantage. The intrinsic value in Oskal lies within its many oil reserves and it is essential that an accurate valuation appears on its statement of financial position, as any significant error could affect its share price. Oil companies usually have a considerable stock of intellectual capital and have large R&D budgets.

Human capital is the individual capabilities, knowledge, skills and experience of the company's employees and managers, as they are relevant to the task at hand. Oskal is operating in a knowledge-based industry and is highly dependent on the ingenuity of its employees to create and maintain its business value. Therefore reporting information on human capital will give a very valuable insight for the users of annual reports.

Social and relationship capital in a business context include community acceptance, government relations and customer loyalty. It is only by building relationships that a company can retain its social licence to operate. This is particularly pertinent for Oskal, which must maintain a licence to operate in each country, which is granted by the host governments. So investing in developing a sound business relationship with government authorities will ultimately help it to continue in business.

Natural capital includes naturally occurring resources, such as oil, which can be used by businesses to provide a return. The extraction of oil is the core business of Oskal, so providing detail about the levels of extraction compared to previous periods, and by area, will give stakeholders a very useful insight into the operation of the company. Oil companies also need to report on their 'environmental footprint' and the impact they have on the wider natural capital such as on the quality of water, causing damage to land and the sub-terrain, or to the atmosphere.

4 (a) Insider trading

Insider trading can be described as the illegal purchase of shares by someone who is in possession of useful inside information specific and precise about a company's performance and business prospects, and would affect the share price if made public. Clearly John Mathers abused his position as finance director at Parkstone to personally profit from the knowledge he had of an impending major contract which would be viewed positively by the financial markets. The sensitive inside information used by Mathers in this crime had not been made public at that time, yet he knew that when it was made public it would have a significant positive effect on the company's share price.

Directors' responsibilities

As a member of the board of Parkstone, Mathers had a duty of care to indemnify the company against any losses caused by any negligent behaviour. He held a fiduciary position in relation to the company, where he was required to act in good faith and in the best interest of both the company and its shareholders. In fact as a director, he had a duty not to make a personal profit from the company's business activities; so by failing to fully disclose his interests he was negligent in his duties.

As the company's finance director, Mathers would have both expressed and implied authority to deal in all financial matters which pertain to the ongoing success of the company, acting as an agent for the shareholders and promoting the success of the company. It is apparent that the insider trading perpetrated by Mathers compromised his core duties and responsibilities as a director of a public company in general, and as its finance director in particular. Apart from breaking the law, there were clear violations of corporate governance provisions which define the role of directors and safeguard the interests of shareholders and other stakeholders.

Confidence in the market

When news broke that Mathers had misused inside information to gain an advantage for himself, it would have caused a general loss of confidence in the integrity of the market, with the effect that investors would be reluctant to invest as much in the market going forward. For Parkstone, if it gains a reputation of insiders misusing sensitive and confidential corporate information for their own purposes, it will see its share price fall and the required cost of capital [returns to shareholders] rise significantly.

In the stock market more generally, if insider trading is viewed as more systemic, the loss in confidence among shareholders may result in them withdrawing their investments. This in turn will drive up the cost of capital for all companies by way of a compensating risk premium, possibly damaging the prosperity of the whole domestic economy. It is possible that if the equity finance required for corporate investments cannot be raised, it leads to market failure and, in the worst case scenario, to a crash of the whole stock market system. Therefore insider trading can have severely damaging consequences if it is not eliminated at source.

(b) As a professionally qualified accountant, John Mathers was duty bound to comply with the following five fundamental principles which underpin the code of ethics issued by his professional body:

Professional behaviour

Accountants must comply with all relevant laws and regulations and shall avoid any action which may discredit the profession. It is clear from the statement made by the judge in court that Mathers knew that by insider trading he was breaking the law, so when he was caught it would have come as no surprise that he was liable for prosecution by the authorities. The publicity arising from his crime would have identified his professional status as a qualified accountant, and so indirectly brought the accountancy profession into disrepute.

Integrity

Integrity requires accountants to be straightforward and honest in all their professional and business relationships. Integrity also implies fair dealing and truthfulness, two characteristics which Mathers clearly failed to display. He was in effect found guilty of misleading his colleagues, possibly providing them with false statements about his real intentions and actions. The fact that he used a false name to cover his tracks when purchasing shares illegally clearly illustrates his profound lack of integrity.

Professional competence and due care

All accountants have a continuing duty to maintain their professional knowledge and skill at a level required to ensure that employers receive competent professional service, and at the same time they must act diligently in accordance with applicable technical and professional standards when providing professional services. The behaviour of John Mathers, although not suggesting a lack of knowledge and skill, was misplaced. He did not act with due care in the interests of Parkstone, but instead proceeded to damage the reputation and standing of the company in the market.

Confidentiality
Accountants must respect the confidentiality of information acquired as a result of professional and business relationships, and shall not disclose any such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose. Similarly, confidential information acquired as a result of professional and business relationships shall not be used to the personal advantage of members or third parties. The $120k profit earned by Mathers from insider trading was only possible because he used confidential business information for his own elicit purposes, and so represented a breach of professional confidentiality.

Objectivity
Accountants should not allow any bias, conflicts of interest or the undue influence of others to compromise their professional or business judgement. Mathers was placed in a position of trust as the finance director of a listed company and he had a fiduciary duty to act in the best interests of its shareholders. However, by using his insider knowledge of the forthcoming contract, he abused this trust placed in him, instead he acted in his own self-interest with greed as his primary motive.

(c) Public accountability
The board of Parkstone has a duty and obligation to ensure that the building works covered by the terms of the government contract are satisfactorily performed and completed within the agreed timescale and within budget, otherwise the company may face a consequential penalty for failure. However, as the contract is publicly financed, it assigns additional obligations on the company and its board, as they have effectively been entrusted with limited public resources.

The board is accountable for both the financial and social outcomes of the works undertaken to those who have assigned such responsibilities to it, in this case the government authority who awarded the contract. In effect the board must ensure that public money is spent properly.

Public interest
Public interest is concerned with delivering benefit for the general public at large, as opposed to solely serving the interests of a company and its shareholders. This view holds that society as a whole has a stake in publicly funded ventures, such as the Parkstone building contract, and therefore warrants protection by the government.

The insider trading at Parkstone has no direct impact on the contract which was awarded. However, it may subsequently affect the ability of the company to deliver the building works as specified, for example, if shareholders withdraw their investments due to a loss of confidence in the company and its management. Therefore it is essential that the board of Parkstone is able to demonstrate that they have used public money only for the purposes intended, and the contract has achieved value for money.

Value for money
Parkstone should be able to confirm and report to the government authority that they are delivering value for money using the following criteria:

Economy
This entails obtaining suitable quality inputs at the lowest price available. Parkstone would have been awarded the contract following a competitive tendering exercise, so provided they stay within budget it will be an economic use of public money.

Efficiency
This involves delivering the required works to an appropriate standard at minimum cost, time and effort. In effect the government will get an acceptable return on the public money invested in the social housing, and Parkstone will be able to deliver a profit to its shareholders.

Effectiveness
This criterion is primarily concerned with delivering desired pre-determined objectives. So provided Parkstone is able to build the 2,000 social houses to the standard in the particular specification covered by the contract, and within agreed timescales, it will have been an effective use of public money.

1 **(a)** Up to 2 marks for each relevant point to a maximum of 8 marks.
(8 marks)

(b) **(i)** Up to 4 marks on the importance of completeness in remuneration reports.
Up to 4 marks for explaining how inaccuracy of information in the remuneration report leads to an agency problem.
(8 marks)

(ii) Up to 2 marks for each relevant point made, aligning the benefits of aligning executive remuneration with shareholder value.
(6 marks)

(c) 2 marks for each relevant point on IC or IA at Xuland Oil.
(8 marks)

(d) **(i)** 2 marks for explanation of corruption.
2 marks for each relevant barrier. Related to Xuland.
(8 marks)

(ii) 2 marks for each relevant point on changing culture.
(8 marks)

Professional marks
(4 marks)

2 **(a)** Up to 2 marks for each internal control objective evaluated in relation to Fortune Investments.
1 mark only if the fact that objectives were not achieved is not included. (Max = 10 marks)
Up to 2 marks for each criticism of Krank's behaviour. (Max = 4 marks)
(12 marks)

(b) Up to 2 marks for each characteristic of good information for fund management. (Max = 6 marks)
Up to 2 marks for each characteristic of good information for investor monitoring. (Max = 4 marks)
1 mark if the point lacks detail or application.
(7 marks)

(c) Up to 2 mark for explanation of ethical relativism.
Up to 2 marks for each aspect of Krank's behaviour examined.
Only 1 mark if not explained in terms of relativism.
(6 marks)

3 **(a)** Up to 2 marks for description of environmental risk.
Up to 2 marks for an evaluation of each source of environmental risk. (Max = 4 marks)
Up to 2 marks for each risk reduction suggestion. (Max = 4 marks)
(9 marks)

(b) Up to 2 mark for each descriptive element of a risk management framework.
[*The suggested solution uses COSO*]
Only 1 mark without reference to the Oskal situation.
(8 marks)

(c) Up to 4 marks for a detailed explanation of integrated reporting.
1 mark for each capital explained in context. (Max = 6 marks)
½ mark if not related to Oskal Petroleum.
(8 marks)

4 **(a)** Up to 2 marks for a description of the insider trading/dealing.
Up to 2 marks for a description of how directors' responsibilities are compromised by insider trading.
2 marks for every point explaining how Mathers' actions could impact on investor confidence in the stock market. (Max = 4 marks)

(8 marks)

(b) Up to 2 marks for each principle discussed in the context of the insider trading described.
Maximum of 1 mark if the point raised did not specifically refer to the actions of John Mathers and only a maximum of ½ mark available for identifying or listing each of the fundamental principles.

(10 marks)

(c) Up to 2 marks for an explanation of public accountability in this situation.
1 mark if point not related to the scenario .
Up to 2 marks for a description of public interest issues at Parkstone.
1 mark if point not related to the scenario.
1 mark for each value for money criterion evaluated.

(7 marks)