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# ACCA – Paper P1
# Governance, risk and ethics
# December 2015
# Revision Mock

### Instructions

- Please complete your personal details above.
- All scripts should ideally be submitted to your Kaplan centre for marking via email to help speed up the marking process. Please scan this form and your answer script in a single PDF and email it to your Kaplan centre.
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# Marking Report

**Notice to Markers**

1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

| | | | |
|---|---|---|---|
| • Time management | • Handwriting | • Presentation and layout | • Use of English |
| • Points clearly and concisely made | • Relevance of answers to question | • Coverage and depth of answer | • Accuracy of calculations |
| • Calculations cross-referenced to workings | • All parts of the requirement attempted | • Length of answers equates to marks available | • Read the question carefully |

2 For each question, please provide suitable constructive comments

| **Question Number** | **General Comments** | **Exam Technique Comments** |
|---|---|---|
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**ACCA REVISION MOCK**

# Governance, Risk and Ethics

## December 2015

Paper P1

**Time allowed**

| | |
|---|---|
| Reading and planning: | **15 minutes** |
| Writing: | **3 hours** |

**This paper is divided into two sections:**

**Section A:** This question is compulsory and MUST be attempted.

**Section B:** TWO questions ONLY to be attempted.

**Do NOT open this paper until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

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# SECTION A

## This question is compulsory

**1** The board of D&T Oil Exploration was meeting for an emergency meeting to decide how to deal with the latest crisis to hit the firm. The meeting had been called following the claim by a national newspaper that they had obtained e-mails and other documents suggesting that a 'severe cost-cutting atmosphere' at D&T might have led to the pipeline corrosion and consequent devastating oil leaks last year in the giant East Slope Bay oil field.

D&T is a large listed multinational energy company which engages in drilling for oil in locations all around the globe. Oil extraction is a controversial activity and opponents say that it invariably endangers key wildlife habitats and harms the planets' pristine wilderness. The East Slope Bay oil field is part of a 'national wildlife refuge' and home to many rare species of animal, in particular the Porcupine caribou. The area remains frozen for most of the year and D&T, together with partner organisations, have developed cutting edge technology to enable oil to be extracted from the area.

In D&T's investor relations literature, the company claims that: *since the 1970s, no major D&T oil or gas project has moved forward until independent experts have assessed the environmental impact. These thorough reviews look at potential problems and at the best ways to address them. D&T follows a set of environmental requirements for all new projects. The goal is to ensure potential issues like waste disposal, emissions reduction and discharges into water are thought through before a project gets underway and carefully monitored from then until the project's end. In the unlikely event of unexpected damage to the environment, full contingency plans can be actioned immediately.*

At the board meeting, the head of the engineering and maintenance department, Delaware Hossein, reported that the leak in question had indeed been caused by a corroded pipe. The spill was discovered by a D&T oil field operator doing a routine inspection at a drill site just over a year ago.

D&T engineers believe ice plugged up the system and likely caused a 2-foot-long split at the bottom of the pipe, allowing oil and water to spray out across a huge area of the East Slope. Large quantities of oil and water also congealed in a large pile under the pipe. Many species of wildlife were affected and the porcupine caribou suffered a significant reduction in its already dwindling population.

Jo Machieveli, the head of environmental operations explained that the clean-up was ongoing and involved bringing in steaming equipment to loosen the frozen material, loading it into buckets and totes and taking it to another area where it was being melted and measured. Unfortunately the hostile surroundings made it difficult for NGO's and charities to access the area to help wildlife and even D&T's own disaster recovery teams found their progress was slower than the initial independent contingency plans made allowances for.

Jonathon McIntyre, the CEO asked if there was any truth in the emails and documentation which the media claimed to have access to. Delaware Hossein acknowledged at the time of the leak, the corrosion prevention program was not doing enough to keep pipes from corroding in the ageing East Slope field but that since then, following an internal controls review, the transit lines in question had been replaced and a new 'aggressive' inspection programme introduced which had increased the number of routine corrosion inspections roughly three fold since the leak occurred.

The CEO informed the board that he had given only one quote to the media since the most recent story broke. 'We maintain high standards of safety and operational integrity,' McIntyre said when asked about the most recent spill.

The board discussed the options open to it in responding to the media. The chairman, who was a qualified accountant expressed serious concerns about the impact of the leaked emails and documents on D&T's image and invited the board to express views freely. The operations director, Glenda Stuart, reminded the board that a year ago, in the midst of extensive media coverage, D&T had admitted liability for the leak and paid a substantial fine to the government. In her opinion, all responsibility was therefore discharged and the media information should be ignored and would soon 'blow over'.

Leonard Bye, the finance director, pointed out that environmental damage to the area was ongoing and the company was bound to certain standards of transparency and truthfulness by its stock market listing. Now might be the time to be honest with stakeholders about the causes of the leak and use the opportunity to reassure them that all possible precautions were being taken to avoid any further disasters and clean up the East Slope. Leonard stated that ethically, he felt this was the right thing to do. The non-executive directors on the board pointed out that investors were bound to be concerned if internal controls and risk management over such high risk operations may have been inadequate.

The CEO agreed that such honesty may be 'expected' by the market and even looked on favourably by analysts. If D&T were seen to behave in a transparent way, it might help to support the company's long term strategic objectives and ultimately maximise shareholder wealth.

Glenda Stuart, whilst accepting the CEO's argument, said that the primary objective of D&T's investors was to see an increase in their wealth and not an improvement in environmental safeguards. She said the kind of investor who chose an oil exploration company, by definition, could not be that interested in protecting the environment and so there was no need to have the kind of dialogue suggested by Leonard Bye.

**Required:**

**(a) Define 'transparency' and assess its importance as an underlying principal of corporate governance. (6 marks)**

**(b) Analyse Leonard's and the CEO's motivations for disclosing information on the lack of internal controls leading to the leak using the normative-instrumental forms of stakeholder theory (10 marks)**

**(c) Assess Glenda Stuart's remarks about D&T investors in the light of Gray, Owen and Adam's pristine capitalist position on social responsibility. (8 marks)**

**(d) Using examples from the case explain the objectives of controls over operations and suggest who has the responsibility for reviewing such controls. Include in your answer an explanation of the importance of such a review. (10 marks)**

**(e) Draft a statement, suitable for release by the CEO to the media to include the following:**

**(i) Explaining why robust internal operational controls are important (6 marks)**

**(ii) An explanation of how D&T's operational safety systems have been improved following the East Slope Bay leak. (6 marks)**

**Professional marks given for layout, logical flow and persuasiveness of the statement. (4 marks)**

**(Total: 50 marks)**

## SECTION B

## Two questions only to be attempted

**2** At a board meeting of TED Chemicals Limited, the directors were discussing some recent negative publicity arising from the accidental emission of a chemical gas pollutant into the local community. The leak had created a great deal of upset in the local community where householders had been forced to stay inside until the gas dispersed. TED relies on the local community for much of its work force and the directors were keen to show TED to be socially responsible. The courts had fined the company for the emission but the directors felt this was not enough to show that they were acting to ensure such a situation would not be repeated.

After the emission, the TED board decided to consult an expert for advice on whether the publication of a full annual environmental report might help to reduce future environmental risks. The expert, Professor Kumar (a prominent academic), said that the company would need to establish an annual environmental audit before they could issue a report. He said that the environmental audit should include, in addition to a review and evaluation of TED's safety controls, a full audit of the environmental impact of TED's supply chain. He said that a report would be very important in addressing the concerns of a growing group of investors who are worried about such things as well as other stakeholders like the local community. Professor Kumar said that all chemical companies had a significant environmental footprint. The CEO of TED agreed with Professor Kumar and added that because TED was in chemicals, any environmental issue had the potential to affect TED's overall reputation among a wide range of stakeholders.

When the board was discussing the issue of social responsibility in connection with the leak, the finance director said that no further demonstration of TED's social responsibility was required. He said TED had been in business for over 60 years providing jobs and paying taxes to benefit society. As far as he was concerned, this was all that was meant by social responsibility. In addition, TED had paid a fine for allowing the emission to occur and this should end the matter.

In the discussion that followed, the board noted that in order to signal its seriousness to the local community and to investors, the environmental audit should be as thorough as possible and that as much information should be made available to the public 'in the interests of transparency'. It was agreed that contents of the audit (the agreed metrics) should be robust and with little room left for interpretation – they wanted to be able to demonstrate that they had complied with their agreed metrics for the environmental audit.

**Required:**

**(a) Explain what is meant by a company's social and environmental footprints and in each case for TED, the likely impact of the company on the local community. (10 marks)**

**(b) Explain the three stages in an environmental audit and explore, using information from the case, the issues that TED will have in developing these stages. (9 marks)**

**(c) Explain what is meant by socially responsible and criticise the finance directors understanding of social responsibility (6 marks)**

**(Total: 25 marks)**

**3** At its last meeting the board of The Western Generating Company discussed its current risk management strategy. Recent negative media coverage of a high voltage cable maintained by the company exploding underground had caused much concern amongst the directors who felt under pressure to explain the causes of the accident. The board wished to establish whether it could give assurances that an accident of this type would not re-occur. Although nobody was injured as a result of the incident, it took place close to a residential area in Country G and the directors were keen to understand why they had been unaware of the risk of such an explosion occurring.

Jonathan Swift, the risk manager, responded to this concern by explaining that the engineering team with responsibility for safeguarding the underground cables reported regularly to both himself and the Risk Committee and robust internal controls were in place over the cable maintenance. The engineers' had stated that, although cables could explode given certain conditions, the chances of this happening were small. They confirmed that it was possible to pump a specialist gas under the ground to completely prevent the conditions leading to explosions but this technology was expensive. Jonathan Swift reminded the board of The Western Generating Companies 'risk appetite' and that shareholders invested in order to get high returns. The board's responsibility was to keep costs low for shareholders and customers alike. Since no casualties had ever been recorded as a result of exploding underground cables, there was no justification for purchasing and using the specialist gas. In fact, it would be cheaper for shareholders to simply pay the clean-up costs as well as any compensation in the event of injuries resulting from explosions.

The Chairman expressed concern over how this attitude affected reputation risk and environmental risk, not to mention The Western Generating Company's duty to the general public in Country G. In her opinion, many residents could have been injured by the explosion and the technology required to utilise the specialist gas should be considered by the board.

**Required:**

**(a) Discuss the role and responsibilities of risk committees as outlined in a principles based corporate governance code (10 marks)**

**(b) Explain why the Western Generating Company cannot guarantee the prevention of further explosions using the ALARP (as low as reasonably practicable) principle. (6 marks)**

**(c) With reference to The Chairman's concerns, explain 'risk appetite' and demonstrate how different risk appetites might affect the decision whether to invest in the specialist gas technology. (9 marks)**

**(Total: 25 marks)**

**4** Alicia Williams joined the board of Gabe and Company, a large food processing company, as finance director earlier this year. Having relocated from another country where she had served in the same large retailer as a finance director for many years, she was interested to see how the board structure and governance arrangements in Gabe and Company differed from her previous appointment.

On joining Gabe, Alicia was given some background information about the company and senior management team. She learned that Gabe was established over 50 years ago and members of the founding family had occupied senior board positions since that time, despite the fact that flotation occurred 20 years ago and the family now owned only 20% of the shares. In addition, all of Gabe's other executive directors were employees who had worked their way up through the company. In fact, Alicia's appointment represented the first 'outside' senior management recruitment to take place in the history of the company. Alicia had overheard the chairman telling a non-executive colleague that Alicia had only been appointed because they felt they needed somebody with international accounting experience given their plans to open subsidiaries abroad.

Alicia took the opportunity in her first weeks to enquire about the role of non-executive directors in Gabe and was told that two former executive members had been recruited as non-executives immediately after they retired from full-time service. This happened approximately 15 years ago. Those two directors plus the Chairman, represented the full non-executive cohort of the board. At present, they were serving alongside eight executive members.

In her previous post, Alicia was used to being held to account by a robust and independent internal audit function and wondered if she would be subjected to the same scrutiny at Gabe and Company. It transpired Gabe and Company did have a small internal audit department which reported to the board but the Chairman admitted to Alicia that it was understaffed and currently had nobody in charge (a 'Head').

When Alicia was introduced to one of the current internal audit staff (who had worked as a management accountant in Gabe and Company until recently) she was told that the work undertaken on Gabe and Company's processing factories was minimal and that a number of factories had never been visited by internal audit. Alicia commented to the Chairman that a Head of Internal Audit should be appointed from outside the company in order to ensure objectivity. In response to this she was told that Gabe and Company always tried to promote from within and was just waiting for the correct candidate to be identified to fill the post.

**Required:**

**(a) Explain 'agency' in the context of corporate governance and criticise the governance arrangements of Gabe and Company. (12 marks)**

**(b) Construct the argument in favour of appointing the Head of Internal Audit from outside the company rather than promoting internally. (6 marks)**

**(c) Define 'objectivity' and describe characteristics that might demonstrate an internal auditor's professional objectivity. Explain why these characteristics may be lacking at Gabe and Company. (7 marks)**

**(Total: 25 marks)**