Answers

1 (a) Social footprint and potential social implications.

Social footprint

The term 'footprint' is used to refer to the impact or effect that an entity (such as an organisation) can have on a given set of concerns or stakeholder interests. A 'social footprint' is the impact on people, society and the wellbeing of communities. Impacts can be positive (such as the provision of jobs and community benefits) or negative, such as when a plant closure increases unemployment or when people become sick from emissions from a plant or the use of a product. Professor Kroll's findings have both positive and negative impacts upon society and communities in the case of P&J.

Potential implications

The discovery by Professor Kroll will lead, whether by a tightening of controls or by a reduction in P&J's activities, to lower exposures to X32 in Aytown and Betown, and hence there will, over time, be *less X32-related disease*. There will, in consequence, be fewer people suffering, and, accordingly, less misery for the affected families and friends of sufferers. A *lower mortality* from X32-related disease will benefit communities and families as well as those individuals directly affected. However, as they are continuing to manufacture the product, if Professor Kroll's findings prove correct, larger numbers of people using the product will ultimately be affected worldwide.

Loss of jobs in the various stages of the P&J supply chain. The forecast losses, even in the best case scenario, would be likely to involve the loss of jobs and employment levels at P&J plants and its suppliers. The worst case scenario, in which the company itself would be lost, would involve the loss of the 45,000 P&J jobs plus many more among suppliers and in the communities supported by the P&J plants (such as in local businesses in Aytown and Betown).

Loss of, or serious damage to, communities in which the operations are located. This includes the economic and social benefits in the developing countries and a very high level of social loss in Aytown and Betown (in Emmland), where both towns are highly dependent on a single employer. It is likely that Aytown, effectively a 'company town' with 45% of the jobs at P&J, will be very badly affected and the good causes in Betown, such as the nursery and adult education classes, will no longer be able to be supported. The loss of a major employer from a town can lead to a loss of community cohesion, net outward migration and a loss of, or deterioration in, community facilities.

There will be a *loss of economic value for shareholders*, and a reduction in the standards of living for those depending upon the company's value for income or capital growth. This might result in a reduction in pension benefits or endowment values, where P&J shares are a part of the value of such funds. Individuals holding P&J shares may lose a substantial proportion of their personal wealth.

[**Tutorial note:** *Allow other relevant impacts such as loss of taxes to fund states services, increases in state funding to support unemployed/sick workers, etc.*]

(b) Risk diversification.

Diversification of risk means adjusting the balance of activities so that the company is less exposed to the risky activities and has a wider range of activities over which to spread risk and return. Risks can be diversified by discontinuing risky activities or reducing exposure by, for example, disposing of assets or selling shares associated with the risk exposure.

Problems with diversification of risks

In the case of P&J, the case highlights a number of issues that make P&J particularly vulnerable and which would place constraints on its ability to diversify the X32 legal risk.

A key risk is that the company's portfolio of activities is heavily skewed towards X32 with *60% of its business in X32* when Kroll's findings were published. This is a very unbalanced portfolio and makes the company structurally vulnerable to any health threat that X32 poses. It means that a majority of its assets and expertise will be dedicated to a single material and anything that might be a risk relating to sales of that material would be a risk to the whole company.

The case says that the *plant cannot be adapted to produce other materials*. A mine, for example, cannot suddenly be 'adapted' to produce a safer alternative. The case also says that processing plants are dedicated exclusively to X32 and cannot be modified to process other materials. This means that they either continue to process X32 or they must be completely refitted to work on alternative materials.

As a result of that, P&J is *unlikely to be able to dispose of X32 assets profitably* now that Kroll's findings are known about and the reasons for the health concerns have been identified. The reaction of society to X32 was highlighted by Hannah Yin as a key factor in determining the likelihood of the risk and this might make it difficult to sell the assets on to others.

Finally, the obvious way to diversify the risk is to expand the remaining 40% of the portfolio to become more prominent. However, the company has *little by way of retained earnings and is already highly geared* with little prospect of further borrowing. This is likely to limit its options for developing new products as a means of diversification. Share issues would be a possible way of re-financing, but with such a high exposure to X32 losses, this would be problematic.

[**Tutorial note:** *Some candidates may attempt to interpret the data in the case numerically. Allow marks if relevant points are made.*]

(c) Criticisms of Hannah Yin's behaviour related to fundamental principles.

There are five fundamental principles that apply to all professionals including professional accountants. They are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. In this case, the fundamental principles that Hannah Yin has breached are integrity, objectivity and professional behaviour.

Criticise Hannah Yin

Hannah *betrayed the trust of shareholders*, making a disclosure in her name precisely because she knew she would be believed. This shows a *lack of integrity* and is also very *unprofessional behaviour*. Her status as a professional and her performance over recent years had built up a stock of trust in her. It was her responsibility to maintain and cultivate this trust and to continue to give shareholders good reason to trust her as a professional accountant. To make biased and partial disclosures precisely because she was trusted is cynical and a betrayal of her duty as a company director and as a professional. As a professional with integrity, Hannah Yin should have the highest levels of probity in all personal and professional dealings. Professionals should be straightforward and honest in all relationships, and never take part in anything that might undermine, or appear to undermine, the trust which society has placed in them.

Furthermore, she *accepted inducements* to comply with Mr Ho's wishes. A significant increase in share options made her disproportionately concerned with the short-term maintenance of the company share price, and this helped to cloud her judgement and *reduced her objectivity* as a professional. She may have reasoned that it would have been against her own economic self interest to disclose the worst case scenario because it would reduce the value of her share options in the short term. Hannah Yin should not have allowed bias, conflicts of interest or undue influence to cloud her judgements on professional decisions. This means, for example, that she must not allow the possibility of particular personal gains to over-ride the imperative to always uphold the public interest and represent the best interests of shareholders.

Finally, she *knowingly and intentionally misled shareholders* by only reporting the most optimistic risk forecasts. This is a clear breach of the integrity and *professional behaviour* required of a person in her position. The principles of transparency and fairness require companies to be truthful and complete in their disclosures to shareholders, especially when price-sensitive information (such as the health risks of X32) is involved. Professionals such as Hannah Yin should comply fully with all relevant laws and regulations, whilst at the same time avoiding anything that might discredit the profession or bring it into disrepute. This involves complying with the spirit as well as the letter of whichever regulations apply.

(d) Article for *Investors in Companies*.

(i) Strategic and operational risk and explain why findings are strategic.

Trouble at P&J

These must be difficult times to be a director at P&J, Emmland's largest producer of X32. What does a board do when it is faced with having caused a large number of terrible health problems for employees and users of X32, whilst at the same time having no strategic alternative but to carry on and try to manage what are sure to be enormous long-term liabilities?

Strategic and operational risks

The company is facing a highly strategic risk since the publication of Professor Kroll's findings. Whereas operational threats are those affecting a part of a company, perhaps a risk to a raw material or the loss of a product market, a strategic risk is one that has the possibility, if realised, to affect the company as a whole and its future strategic success. We have seen similar risks before to important industries where, for example, entire industries have disappeared from some developed countries because of changes in international labour market costs and political changes. These are examples of strategic risks materialising, and the effects can be disastrous for those affected.

Strategic risk to P&J

P&J shareholders will appreciate knowing that Kroll's report has the effect of being a strategic risk for P&J for at least three reasons. To begin with, his findings potentially *affect the whole company* rather than just parts of it, such is the extent of P&J's exposure to this commodity through vertical integration. Presumably this strategy had previously been thought a good idea, with the company directly owning all three stages in the supply chain, from mining, to processing, to the manufacturing operations in Emmland. All stages are threatened by Kroll's findings. Plus, if product sales eventually slow down and stop, its sources of cash flow will also disappear.

Second, this is bound to *affect P&J's strategic positioning* and the way that it is viewed by investors, suppliers, employees and a range of other stakeholders. It has a weaker offering to potential skilled employees than before Kroll's findings were published, it will be harder to raise capital and also to sell its products. Its reputation as a sound company will be reduced as a result, and these things matter in a highly developed country such as Emmland.

Third, and perhaps most importantly, this could eventually be a *threat to the company itself*. This depends upon how large the liabilities eventually become and how well the company handles the issue in the coming years, but this is a real possibility if the worst-case projections turn out to be accurate. Its heavy reliance on X32 over many years has left it with a 60% dependence on X32, which was fine when the material was in high demand, but it leaves the company very vulnerable when and if that market falls away.

Given these risks facing P&J, this is not a share that will be attractive to investors for the foreseeable future.

(ii) Board responsibilities for IC and criticise Mr Ho.

Responsibilities for internal controls

Readers will also be alarmed to hear of the decision by CEO Laszlo Ho to impose a limited tightening of X32 process controls that only involved doing so where the company was visible to the Emmland public, a compromise he called 'Plan B'. The board's responsibilities for internal control are detailed in the COSO guidance on this subject and are very clear. Mr Ho's, and the P&J board's, responsibilities for effective internal controls include, in this case, control over X32 fibres in the working environments of each stage in the whole X32 supply chain.

The responsibilities include *establishing a control environment* capable of supporting the internal control arrangements necessary. This includes a suitable 'tone from the top' and a high level commitment to effective controls. It also involves *conducting risk assessments* to establish which risks need to be controlled by the internal control processes (health risks, perhaps?). The introduction of relevant control activities is especially important when a hazardous material like X32 is being considered. This, of course, applies to all of the company's employees and not just those based in Emmland. It is also the board's responsibility to provide *information and maintain relevant communications* with those affected by the control measures, and to ensure that important measures are fully implemented and understood. Finally, the COSO guidelines specify that all controls should be *monitored* for the degree of compliance and for their effectiveness. This should be a continuous, ongoing process, capable of immediately highlighting any weaknesses or breaches in the implemented controls.

[**Tutorial note:** *Other models can be employed other than COSO.*]

Criticisms of Mr Ho's 'Plan B'

In the case of P&J, Mr Ho has taken a deliberate and premeditated decision to *ignore the health needs* of some of the company's employees on the basis of cost. X32 has been clearly shown to be a health risk and Mr Ho is knowingly allowing employees to be exposed to the material in the course of their normal jobs. The people in the mines and processing facilities will still be exposed to X32, and will presumably continue to get ill and die in the full knowledge of the company management. This is a failure of the fiduciary duty that the P&J board owes to its employees.

Mr Ho is implementing an upgrade to internal control, *not on the basis of need but on the basis of how visible the changes will be* to investors, most of whom will be based in the developed world. So residents of Aytown and Betown can look forward to a tightening of controls to limit their X32 exposure whilst those in countries with no health and safety legislation cannot. This could be seen as a cynical move to manage the company's image in Emmland. They are taking advantage of the relative weakness of their developing countries' host governments and being selective in whom they extend the necessary X32 process controls to.

Recent events have raised a number of very serious issues for P&J. It is difficult to know what the future will hold for the company, with such a substantial external threat and with management so determined to act unethically in managing that threat. I do not predict an easy time ahead for P&J shareholders.

2 (a) How sound corporate governance addresses company failure.

Corporate governance is the system by which organisations are directed and controlled. A sound system of corporate governance, whether rules or principles-based, is capable of reducing company failures in a number of ways.

First, it *addresses issues of management*, management succession and *alignment of board interests* with those of shareholders. This reduces the agency problem and makes it less likely that management will promote their own self-interests above those of shareholders. By promoting longer-term shareholder interests over personal or short-term interests, companies are less likely to come under the types of pressures that might lead to failure.

Second, a sound system of corporate governance helps to *identify and manage the wide range of risks* that a company can face, some of which will be capable of causing the company to fail. These might arise from changes in the internal or external environments, and most codes specify a strict set of management procedures for identifying and controlling such risks.

Third, an effective code will *specify a range of effective internal controls* that will ensure the effective use of resources and the minimisation of waste, fraud, and the misuse of company assets. Internal controls are necessary for maintaining the efficient and effective operation of a business, whereas weak or absent controls are more likely to lead to the conditions that could threaten its survival.

Fourth, effective codes *encourage reliable and complete external reporting* of financial data and a range of other voluntary disclosures. By using this information, investors can establish what is going on in the company and will have advanced warning of any problems. This need to report creates an accountability of management to shareholders and restricts the types of actions and behaviours likely to threaten company survival.

Fifth, *compliance with a code underpins investor confidence* and gives shareholders a belief that their investments are being responsibly managed. This confidence extends to other stakeholders such as tax authorities, industry regulators and others, some of whom can cause a great deal of trouble for the company if they believe the company is being poorly managed.

Finally, sound corporate governance will *encourage and attract new investment* of share capital and also make it more likely that lenders will extend credit and provide increased loan capital if needed. This could help some companies survive in difficult times in terms of cash flow and capital requirements when companies with poorer corporate governance reputations may receive less of such support.

(b) Rules and principles, and why 'comply or explain' is effective.

Rules and principles

In a rules-based approach to corporate governance, provisions are made in law and a breach of any applicable provision is therefore a legal offence. This means that companies become legally accountable for compliance and are liable for prosecution in law for failing to comply with the detail of a corporate governance code or other provision.

A principles-based approach works by (usually) a stock market making compliance with a detailed code a condition of listing. Shareholders are then encouraged to insist on a high level of compliance in the belief that higher compliance is more robust than lower compliance. When, for whatever reason, a company is unable to comply in detail with every provision of a code, the listing rules state that the company must explain, usually in its annual report, exactly where it fails to comply and the reason why it is unable to comply. The shareholders, and not the law, then judge for themselves the seriousness of the breach. This is what Martin Mung meant by markets punishing bad practice.

Comply or explain

Comply or explain is intended to allow latitude in compliance with details of corporate governance provision, but is not 'optional' in the usual meaning of the term. Listing rules insist on compliance with codes in many countries with 'comply or explain' allowed when compliance with detail is not possible or desirable, usually in the short to medium term. If the shareholders are not satisfied with the explanation for lack of compliance, they can punish the board by several means including holding them directly accountable at general meetings, by selling shares (thereby reducing the value of the company) or by direct intervention if a large enough shareholder.

Comply or explain is seen as an alternative to a rigid 'rules-based' approach and is effective for the following reasons:

It enables the policing of compliance by those who own the entity and have a *stronger vested interest* in compliance than state regulators who monitor compliance in a legal sense. This places the responsibility for compliance upon the investors who are collectively the legal owners of the company. It makes the company accountable directly to shareholders who can decide for themselves on the materiality of any given non-compliance.

It *reduces the costs of compliance* and recognises that 'one size' does not fit all. There may be legitimate reasons for temporary or semi-permanent non-compliance with the detail of a corporate governance code, perhaps because of size or the company adopting its own unique approach for highly specific and context-dependent reasons.

It *avoids the need for inflexible legislation*, which, itself, is sometimes also ineffective. Whereas the effectiveness of a 'comply or explain' principles-based approach relies on the ability and willingness of shareholders and capital markets to enforce compliance, rules-based approaches rely on the effectiveness of law enforcement officials.

(c) Accountability and provisions resulting in 'greater accountability'.

Accountability

Boards of directors are accountable to the shareholders of the company. This means they are answerable to them in that they can be called to give an account for their behaviour and actions as agents of the shareholders. In the context of the code, it is recognised that boards do not always fully reflect the wishes and needs of shareholders and this can represent a failure of accounting from the board to the shareholders. The measures proposed aim to close that gap and make it less likely that unqualified or ill-equipped people will be appointed to, or remain on, the board.

Resulting in greater accountability

Corporate governance codes have had provisions for the retirement of directors by rotation for some time. This is when a fixed period of time is set for directorships, after which the default position is that the director retires or leaves the service of the company unless actively re-elected by the shareholders to serve another term in office. Enhancing accountability to shareholders is a key objective of any corporate governance code. The shortening of service contracts from three years to one year may result in greater accountability for the following reasons:

It will enable shareholders to *remove underperforming directors* much more quickly and to impose their will upon a board with less delay than previously. Rather than paying for underperforming directors to remain in post, with possible damage to the company as a result, or by paying out severance costs, they can simply decide not to re-elect them at the end of the one-year service contract.

It will enable shareholders to *rebalance or refresh* a board in the light of environmental changes or changes in strategy, rather than waiting for a period of time for the three-year terms of previously re-elected directors to elapse. This would make the company more responsive to the wishes of shareholders and reduce the feeling that any director has a 'right' to be on the board at any point. However, a shorter period may leave the board under greater pressure to demonstrate short term success and that could be at the expense of longer term prosperity.

The availability of biographical details will enable shareholders to *clearly see the experience of a candidate* and decide for themselves whether they are likely to add value at a given point. The effect of this will be to act as a 'check and balance' against vested interests that may exist between and among directors. It also places a responsibility upon candidates seeking election or re-election to a board to actively demonstrate their suitability rather than just expecting it as an entitlement.

3 (a) Ineffective internal controls.

Well designed IC systems can be ineffective for a number of reasons.

Costs outweighing benefits. This is when an IC system provides poor value for money or it provides more assurance than is needed (i.e. the control is over-specified). In such a situation, the control will not be supported or trusted by those working alongside or within the control, and this will reduce its effectiveness.

Failures in human judgement when assessing a control, or fraud in measuring or reporting a control. Where a control relies upon human measurement, error is always a possibility either through lack of training, incompetence, wilful negligence or having a vested interest in control failure (such as with Jane Goo, who believed she could gain financially by a product failing to pass successfully through a quality control standard).

Collusion between employees, perhaps with a vested interest in misapplying or circumventing a control. The risk of this is greater when two or more people believe they may gain by it. It could be, for example, a sales team misquoting sales figures against a budget or directors misreporting accounting data to increase their bonuses or maintain a higher share price before exercising share options. The collusion between Jane Goo and John Zong (who received part of the payment) was one of the factors that may have led to the failure of QC controls being effective at Yaya.

Non-routine or *unforeseen events* can render controls ineffective if they are intended to monitor a specific process only. Most internal controls are unable to cope with extraordinary events and so need to be adapted or circumvented when such events occur.

Previous or existing controls *can become obsolete* because they are not updated to meet changed conditions. A control introduced to monitor a process or risk that has changed, reduced or been discontinued will no longer be effective. Changes to key risks, for example, need to modified if they are to continue to remain effective in controlling the risk.

(b) IC deficiencies at Yaya.

Jane Goo was *fraudulently entering compliance reports* with *no-one required to countersign* them or confirm her checks. The system did not require a second signature and no-one saw the product compliance reports after completion, so Jane had no one to review, confirm and assure that her QC measurements were true or accurate. She believed herself to be poorly paid and this may have increased the incentives for her to carry out the deceit. Additionally, it appears she was left to 'destroy' the goods that failed QC, allowing her to sell the goods externally. Segregating the disposal of the goods from the creation of the reports would also have helped prevent this fraud occurring.

Linked to this, there was *collusion between Jane Goo and John Zong*, who received part of the proceeds for his complicity in the fraud. This meant that the both of the people in the QC department were involved and the isolation of the laboratory made the discovery of their activities less likely.

There was *no control capable of automatically signalling to management* that the failure rate had increased. The fact that the rate rose gradually and not in a steep change seems to have made the change less visible, but a maximum acceptable failure rate with an appropriate measurement system would have triggered a signal to management that the rate had risen above it.

The way the QC department was viewed by the company meant that its activities would have received less scrutiny than other parts of the business. The QC department was *marginalised and located away from other activities* and the combination of these factors made it unlikely that they would often be disturbed. The fact that there was no automatic reporting link between QC and Mr Janoon was perhaps symptomatic of the marginalisation and this contributed to the problem.

The operations director Ben Janoon was *negligent as a manager and had little control* over the process. He rarely visited the QC lab, failed to monitor product failure rates, and failed to spot a fourfold increase in product failure rates. It was he that designed the system and with such a large number of weaknesses in the system, he must bear some of the responsibility for the lack of control, if not for the actual fraud itself.

(c) General qualities of information specific measures.

Qualities of useful information to Mr Janoon
Useful information has a number of general qualities that distinguishes it from less-than-useful information. This is a very important element of an internal control system, as evidenced by a lack of information flow to Ben Janoon at Yaya Company. Information flowing to Mr Janoon should be relevant, reliable, timely, understandable and cost-beneficial.

Relevant means that anything that Jane Goo feels should be brought to Mr Janoon's attention should be included in the information. Any changes to the overall quality of finished goods should be voluntarily reported, for example, any issues that would prevent the QC lab performing its important function or any changes to product failure rates.

Reliable refers to the trustworthiness of the information and whether or not it is a faithful representation of what is being conveyed. It concerns the assumption that it is 'hard' information, that it is complete, correct, that it is impartial, unbiased, accurate and complete. Mr Janoon needs to know that the information he receives from Jane Goo is a true reflection of what is actually the case in the QC lab and that, for example, the reported failure rates are not understated for her personal gain.

Timely refers to the fact that information has a time value. Information that is late, for example, may be completely useless to the receiver. Information should arrive so that it can be processed effectively by the receiver and used for decision-making as it was intended.

Mr Janoon does not understand the science behind the QC processes and it is therefore important that any information from the QC lab is *understandable* by him. Because Jane Goo and John Zong had relevant scientific qualifications, it was important that information fed to Mr Janoon was free of jargon and in a form that is meaningful to him as a non-scientist.

Cost beneficial means that the cost incurred to generate the information does not outweigh its benefit. Simple reports on QC compliance at Yaya would probably be very cost-beneficial, for example, but in other situations, special reports can be expensive to produce and have little consequence to end users.

[**Tutorial note:** *other approaches to this answer may also be taken.*]

Specific information-flow measures
Mr Janoon could receive *more frequent reports*, maybe weekly or monthly, on QC failure rates. The fact that two years went by without him noticing the increased failure indicated that he had no effective information flow on the problem. A reliable flow of key QC metrics would enable him to plot these metrics over time, thereby highlighting any changes over time. Providing a predetermined format for Jane Goo to complete would ensure that he obtained the necessary information and it would place the information flow in his hands rather than with Jane Goo.

The information he receives could be of *a higher quality*, with more detail and possibly 'drilled down' data on product compliance against specific metrics. The 'drilled down' data would have detected the fact that Jane Goo had failed products that should, according to the product specification, have passed, and this could also have detected the fraud earlier.

Regular *routine physical contact* with QC employees, especially the QC manager. The fraud was partly caused by the environment within Yaya that saw QC as marginal and inconvenient, and partly by Jane Goo, believing that her work was unaccountable and unmonitored. By moving the QC lab closer to the main operations or establishing a clearer formal reporting regime from the QC manager to the operations director, the quality of information flows would be improved, and opportunity for fraud diminished.

4 (a) Tucker and Route A.

Is the decision to choose Route A profitable?
Yes. This will be cheaper for the company (RDC) because it avoids the need to make the compulsory purchase of Mr Krul's farm. This will save the company $1 million and enable a profit to be made, over 10 years, of $5 million. The equivalent 10-year profit figure for Route B would, accordingly, be $4 million.

Is it legal?
The case says that both routes (A and B) had been given planning permission, so there is no difference between them on matters of legality. Route A is a legally allowable option as it has planning permission from the local government authority.

Is it right?
This depends upon the ethical perspective adopted. Route A would deliver a higher profitability for RDC and also preserve important local social and economic benefits by keeping Mr Krul's farm. The farm supports local jobs, perhaps has an important role in the local community and, being a farm, provides a source of local food. If these benefits are seen as more important than the future of the birds, then it is right to choose Route A. If the claim of the birds and their impact on the local ecosystem is more important than the profitability of the project and the benefits provided by the farm, then it was wrong to choose Route A.

Is it fair?
This depends upon how the legitimate and reasonable claim of Mr Krul to remain on his land is weighed against the claim of the colony of birds to survive. The choice of Route A ignores the claim of the birds' right to gain access to their feeding site and because the birds are endangered, it may threaten their future. It is fair to Mr Krul, but unfair to the colony of birds. Mr Krul, however, employs people who would otherwise lose their jobs, potentially having a negative impact on them and their families. In addition, the farm has been in Mr Krul's family for four generations and that may also be a relevant factor when considering the fairness of the decision.

Is it sustainable and/or environmentally acceptable?
Route A was probably the less environmentally-sustainable of the two options. Because Route A was chosen, it will mean destroying the important feeding site for the colony of threatened birds. This will threaten the population of these birds and the case suggests that this may represent a threat to the environmental sustainability of local ecosystems. The loss of the feeding ground and the birds may therefore have other unforeseen environmental consequences. Whichever route is chosen, an environmental benefit may accrue because of the replacement of car journeys with increased rail travel.

Summary.
The company chose to prioritise cost-savings and the impact of the farm on the local community over the negative environmental impact that Route A entailed. This may have something to do with Eddie Krul having a louder 'voice' than the birds and so more able to express his claim than the voiceless birds (the pressure group did not speak up until after the decision was made). RDC essentially had two choices which would both have had negative effects on some of the stakeholders. It chose to take the decision that was less sustainable but more favourable to shareholders and the stakeholders in the farm.

(b) Importance of recognising all stakeholders.

A decision such as the selection of a new route for a major construction project such as this is bound to create 'winners' and 'losers'. In any project such as this, it is important to identify and recognise the claims of all of the stakeholders for several reasons.

Stakeholder recognition is necessary to gain an understanding of the *sources of potential risk and disruption*. 'Save the Birds', for example, has threatened to disrupt the construction of Route A as it seeks to protect the birds' feeding ground. Mr Krul, similarly, threatened to bring legal action in the event that Route B was chosen.

Stakeholder recognition is important in terms of *assessing the sources of influence over the objectives and outcomes* for the project (such as identified in the Mendelow model). Stakeholder influence is assessed in terms of each stakeholder's power and interest, with higher power and higher interest combining to generate the highest influence. The local government authority, for example, had no view on which was chosen but as a high power stakeholder (capable of granting or withholding legal permission), it could have been very influential had it expressed a view either way.

Stakeholder recognition is necessary in order to identify *potential areas of conflict and tension* between stakeholders, especially relevant when it is likely that stakeholders of influence will be in disagreement over the outcomes. A survey of the stakeholders in a rail-building project such as this, once mapped in terms of influence, would signal which stakeholders are likely to cause delays and paralysis by disagreement and whose claims can then be studied for ways to reduce disagreement.

There is an *ethical and reputational case* for knowledge of how decisions affect stakeholders, both inside the organisation or external to it. Society can withdraw its support from organisations that it perceives as unethical or arrogant. This can affect organisational performance by reducing their reputations as employers and suppliers of future services. RDC may acquire a reputation for environmental damage and this could mean they lose public trust on future projects of this type. A 'deep green' perspective would take an unfavourable view of companies that failed to recognise some stakeholder claims.

(c) Stakeholder claims.

Stakeholder claim

A stakeholder is any person or entity that can affect or be affected by the actions or policies of an organisation. In the case of RDC, two 'affected' stakeholders are Eddie Krul and the colony of endangered birds. The local government authority is both affected by the decision and can also have an influence over the decision. A claim is the outcome sought or the outcome that would most benefit or do least harm to a given stakeholder. It is what that particular stakeholder 'wants' or would want, if it were able to understand and voice its claim.

Assessment of the claims

Mr Krul was seeking to maintain his house and land by getting RDC to choose Route A. His claim is based partly on his family having been on the same land for four generations and that he employs a number of local people. As a 'vocal' critic, he is able to clearly articulate his views and lobby for his preferred option. He clearly understands what would happen to him if Route B was chosen and can clearly voice that concern to decision-makers.

The only concerns of the local government authority were making sure the investment went ahead with the benefits it believed would accrue to the local region. Its claim is to ensure that the investment and jobs are attracted and in pursuit of that, takes no view on the competing claims of Mr Krul and the colony of birds. It could be criticised for being passive in this decision and for assuming that RDC could evaluate such a decision adequately themselves, in both economic and ethical terms.

The colony of birds is ostensibly a voiceless stakeholder, although it does now have 'Save the Birds' claiming to speak on its behalf. The bird colony does not understand that its feeding ground is threatened but it will incur material loss when Route A is developed. Because it does not have an effective voice (other than the 'outrage' of 'Save the Birds' after the decision was taken), it was unable to contribute to the debate over the choice of route. The local government authority did not prioritise one stakeholder over the other when granting RDC permission to develop either route.

1 **(a)** 2 marks for definition of social footprint.
2 marks for each implication identified and discussed.

(10 marks)

(b) 2 marks for description of risk diversification.
2 marks for each problem with diversification.

(10 marks)

(c) Half mark for identification of the correct fundamental principles breached by Hannah.
Up to 2 further marks for explanation of how each professional or ethical principle is breached.

(Maximum 9 marks)

(d) **(i)** 2 marks for distinguishing between operational and strategic risk.
2 marks for each reason why risk is strategic.

(8 marks)

(ii) 1 mark for each control responsibility.
2 marks for each relevant criticism to a maximum of 4 marks.

(9 marks)

Professional marks for structure, logical flow, persuasiveness and tone of the article.

(4 marks)

2 **(a)** 2 mark for each point examined on CG and failure.
2 marks for explanation of corporate governance somewhere in answer.

(Maximum 10 marks)

(b) 2 marks for distinguishing between rules and principles.
2 marks for each argument supporting comply or explain to a maximum of 6 marks.

(8 marks)

(c) 2 marks for an explanation of accountability.
2 marks for each relevant discussion point on greater accountability.

(Maximum 7 marks)

3 **(a)** 1 mark for an explanation of each relevant point. Half mark for identification only.

(5 marks)

(b) Up to 2 marks for each IC deficiency explained.

(10 marks)

(c) 1·5 marks for each quality of information discussed in the context of the case, to a maximum of 6. Half mark for identification only. 2 marks for each relevant measure proposed to a maximum of 4 marks.

(10 marks)

4 **(a)** 1 to 2 marks for a discussion of each point. Half mark for identification only.
2 marks for a balanced summary.

(10 marks)

(b) 2 marks for each relevant point discussed. Half mark for identification only.

(8 marks)

(c) 2 marks for an explanation of a stakeholder claim.
2 marks for an assessment of each claim.

(Maximum 7 marks)