Answers

1 (a) Internal controls

Circumstances leading to the problem
The case describes four clear causes of the fuel tank problems with the Bobo Foo.

The first one was the brief given by the board in which *cost reduction was emphasised above all other considerations*. This was underpinned in the design team by a 'tone from the top' conveyed on posters that said 'keep it cheap'. The key concepts for the car also conveyed the message of cost and Mr Tsakos's seniority in the company had the effect of cementing the cost message into the design team including Kathy Yao.

This was exacerbated by the second cause which was a radical *reduction in the normal development time*. Whereas the design team were used to working with timetables of 43 months, Mr Tsakos imposed a 25-month time limit on the project. This in itself conveys a powerful message that the board wants the project completed as quickly and cheaply as possible.

Third, the board *ignored the crash test result* for reasons of cost. In order to hasten the product launch, presumably to make a return on investment as early as possible, the company tooled up the factory as early as possible. This meant that it was too late to make changes to the fuel tank positioning without incurring excessive cost.

Fourth, *Kathy did not speak out when pressured by Mr Tsakos* to reduce the development time. She, and other directors involved in the project, should have stood up to Mr Tsakos, but they failed to do so. She was also complicit in ignoring the crash test and allowing the Bobo Foo to go into production before all the tests were completed. Had she felt able to challenge Mr Tsakos, the problems with the car could have been avoided. An effective non-executive presence on the board would also have been a way of countering Mr Tsakos's persistence in 'forcing' the development time for the car.

Internal control measures
Establishing a standard development time sufficient to meet a range of agreed metrics on all new car models. Kathy Yao's private comments to colleagues about her fears for the safety of the car given such a short development time are relevant. If the company places a minimum time to market for a new model (say 40 months or thereabouts), it would ensure that there was sufficient time or all proposed features of any product feature could be fully safety tested. Being so rushed was presumably a factor in the incorrect and unsafe positioning of the fuel tank.

Embed safety metrics into all design briefs in future. None of the key concepts underpinning the Bobo Foo were concerned with safety and none of the messages conveyed in the key design concepts ('cheap to buy, economical to run', etc) included a reference to product safety. Risk mitigation is most effective when it is placed as a normal part of any role. For a car design team such as that led by Kathy Yao, the introduction of a safety metric into the brief could have prevented such an unsafe feature as the badly positioned fuel tank being allowed to happen.

Procedures to sign off each stage of the development process based on safety criteria. Without an effective 'sign off' for each identified stage, the next stage cannot continue. This would involve establishing an agreed set of stages in a development process at which safety criteria should be applied. The crash test would be an obvious such stage. Once the crash test had taken place, it should be made a mandatory procedure that any failings in the vehicle should be addressed before it can be 'signed off' to go into production (unlike at Bobo where the factory was tooled up regardless of the crash test failure).

[**Tutorial note:** *allow latitude in candidate's answers. Reward points that address the causes of the risks.*]

(b) Kohlberg

Explain Kohlberg's levels
Kohlberg's theory of moral development is a framework for classifying a range of responses to ethical situations. Kohlberg argued that these were indicative of the moral development of the individual. Kohlberg identified three levels that people can operate at.

At the preconventional level of moral reasoning, morality is conceived of in terms of rewards, punishments and instrumental motivations. Those demonstrating intolerance of norms and regulations in preference for self-serving motives are typically preconventional.

At the conventional level, morality is understood in terms of compliance with either or both of peer pressure/social expectations or regulations, laws and guidelines. A high degree of compliance is assumed to be a highly moral position.

At the postconventional level, morality is understood in terms of conformance with perceived 'higher' or 'universal' ethical principles. Postconventional assumptions often challenge existing regulatory regimes and social norms and so postconventional behaviour can often be costly in personal terms.

Levels of people in the question
James Tsakos is exhibiting a *conventional level* of moral development. His main concern is with compliance with the expectations of shareholders. The 'good boy-nice girl' orientation component of the conventional level is that which is concerned with how society sees the company and with shareholders being a prominent stakeholder, Mr Tsakos's expressed concerns are about placating and managing their concerns. He is against the universal recall option because of the signal it would send to markets.

Kathy Yao is also exhibiting a *conventional level* of moral development. Although her concern was driven by a personal concern arising from her part in the design of the Bobo Foo's fuel tank, her motivations were concerned with compliance and strategic interests. Whereas Mr Tsakos was more concerned with the expectations of shareholders, Kathy Yao was more concerned with the expectation of customers. Her concern was rooted in what customers thought of the company. She framed her concerns in terms of product safety whilst also pointing to the importance of a reputation for social responsibility and compliance with the interests of society.

Vernon Vim is exhibiting a *preconventional level* of moral development. He pointed to his personal loss of bonus if the recall option was taken and quantified the choice in purely financial terms. It was 'because the board's bonuses were partly based on the company's annual profits' that he opposed the recall option. He was unconcerned with any compliance or higher ethical purpose.

[**Tutorial note:** *allow James Tsakos to be described as preconventional if his motivations are seen as self-serving with the loss of shareholder value.*]

(c) AGMs and EGMs

Distinguish between
Annual general meetings (AGMs) are a part of the normal financial calendar for all limited companies and take place on the occasion of the year-end results presentation and the publication of the annual report. Extraordinary general meetings are called to discuss strategic and other issues with shareholders outside the normal financial calendar.

Purposes of each
Both types of meetings are formal meetings between company directors and the shareholders of the company. They typically involve presentations by the board (typically the chairman and/or CEO) and a chance for shareholders to question the board.

AGMs
The AGM is a formal part of a company financial year. Its purpose is to allow the board to present the year's results, discuss the outlook for the coming year, present the formal, audited accounts and to have the final dividend and directors' emoluments approved by shareholders. Shareholder approval is signalled by the passing of resolutions in which shareholders vote in proportion to their holdings. It is usual for the board to make a recommendation and then seek approval of that recommendation by shareholders. The dividend per share, for example, is recommended by the board but only paid after approval by the shareholders at the AGM. Institutional shareholders may employ proxy voting if they are unable to attend in person.

EGMs
Extraordinary meetings are called when issues need to be discussed and approved that cannot wait until the next AGM. A full year can be a very long time. In some business environments when events necessitate substantial change or a major threat, an EGM is sometimes called. Management may want a shareholder mandate for a particular strategic move, such as for a merger or acquisition. Other major issues that might threaten shareholder value may also lead to an EGM such as a 'whistleblower' disclosing information that might undermine shareholders' confidence in the board of directors. In this case, given the nature of the disclosure, there is a case for James Tsakos to answer in terms of shareholders continuing to have confidence in him as CEO.

Advantages
In the case of Bobo, the *shareholders will be able to gain reassurance* that the public disclosure of important safety concerns being ignored will not threaten shareholder value because of lost sales or damaged reputation. There is a clear risk to the reputation of the company as a whole if it is associated in the public mind with unsafe product designs.

The shareholders can *hold James Tsakos accountable* for his actions and demand explanations. There is a *prima facie* case to answer that he presided over the development of a car with a safety risk to its occupants and then opted to resist suggestions to recall the vehicles to have the safety problems addressed.

Mr Tsakos, in return, will be able to *speak directly to shareholders* rather than through written communication and this may be a more convincing way of explaining his position. Given that the shareholders 'wanted to hold James Tsakos accountable for the decision' and wanted to hear from him directly, the EGM will enable him to address these demands.

Resolutions of confidence or no confidence can be passed if proposed and this would 'clear the air' one way or the other to enable the company to resolve its issues quickly. Shareholders have the right to remove Mr Tsakos if they are not satisfied with his explanations and this could be resolved quickly at an EGM rather than having it drift on to the next AGM, which could be many months away.

(d) (i) Role of CEO

Thank you for attending this EGM. I know that you will have questions in the light of recent media reports about our economy car model, the Bobo Foo, and I hope to address some of these questions in my remarks.

As your chief executive, you will understand that it is my job to lead the company and to protect shareholder interests above all others. These are responsibilities I take very seriously.

In particular, and in explaining how your board arrived at the decision it did, I would like to briefly outline my roles. It is my role to develop and implement policies and strategies capable of delivering superior shareholder value and to assume full responsibility for all aspects of the company's operations. It was I who commissioned the Foo in the first

place in pursuit of the strategy that Bobo should be represented in all of the main car segments. The correctness of that decision is shown by the outstanding sales of the model at half a million units a year in what is a very competitive part of the market.

I must also manage the financial and physical resources of the company, monitor results, and ensure that effective operational and risk controls are in place. Bobo is a profitable company and in designing and developing the Foo, I personally took a direct interest in maintaining its low cost ethos. I assigned our expert design team to create the product and we then submitted it to the crash test to gain information on its safety vulnerabilities.

My role also involves overseeing the management team, co-ordinating the interface between the board and the other employees in the company, and assisting in the appointment of directors to the board. In a large company such as Bobo, it is obviously vital that we have the best people at all levels and I am pleased to be able to have Kathy Yao on the board. She leads our talented team of car designers and the excellent design of the Foo is testimony to their talents.

Finally, it is my role to relate to a range of external parties including the company's shareholders, suppliers, customers and state authorities. The legal issues that have confronted us with regard to compensation claims against the Foo's design are mainly my responsibility and it is to these matters that I now turn.

[Tutorial note: *these paragraphs contain two roles in each. Allow for different ways of expressing the roles.*]

(ii) Defence of company decision

I am very aware of the reason we meet today in this EGM and I want to explain to you why the board took the decision it did, resisting the idea to issue a universal recall of the Foo.

As your chief executive, it is my responsibility to *take a wide range of opinions and viewpoints into account*, some of which are conflicting. The protection and maximisation of shareholder value is, however, my highest and most important duty in all contestable cases. I have many potential accountabilities, but *my primary accountability is to you, the shareholders*.

Accordingly, the decision I took was that which I thought would provide the *best value to shareholders*. This was only my view of course and others will disagree, but given the calculations made available to me, the choice was clear. It would have been an abdication of my fiduciary duty to allow an option to be adopted that reduced shareholder value as significantly as the recall option would have. In making this judgement I took into account the very small number of incidents that have occurred with this product as a proportion of all the Bobo Foo cars sold to date.

The *margin between the two options was not close* with the choice of resisting the recall outweighing the other option by a factor of three in terms of costs to the company. If it were a more finely balanced financial calculation, I may have opted for the recall option but given the projected difference of half a billion dollars over 10 years, I really had no choice because I had no right to erode shareholder value to that extent. I do not necessarily expect you all to agree with me, especially those who may have alternative ethical perspectives on these issues, but I do hope you can accept that the decision was taken in good faith as the most financially prudent and commercially responsible of the two stark options available to us.

[Tutorial note: *allow different ways of expressing these thoughts within the pristine capitalist perspective.*]

2 (a) Criticise and explanation of dynamic

Criticise Raz Dutta's beliefs

Raz Dutta is wrong in both of her assertions. The belief that risks do not change very much is only true in static environments. In reality, the changeability of risks depends upon the organisation's place on a continuum between highly dynamic and completely static. The case mentions changes in some of YGT's risks and this suggests that there is some dynamism in its environment. Clearly then, her belief is very difficult to defend.

Her belief that risks 'hardly ever' materialise may be historically true (but this is also unlikely) but the risk assessment highlighted at least two 'likely' risks which could well materialise. Risk D was assessed as 'highly likely' and Risk B was also likely with a high potential impact. Neither of these variables would be known were it not for intelligence gained as part of the risk assessment. Importantly, Risk B was a 'high/high' risk meaning that it is a likely risk with a high impact once it materialised. Being unaware of this could have caused great damage to the organisation.

Why risk assessment is dynamic

Risk assessment is a dynamic management activity because of changes in the organisational environment and because of changes in the activities and operations of the organisation which interact with that environment. At YGT, the case describes Risk C as arising from a change in the activity of the company: a new product launch. The new product has obviously introduced a new risk that was not present prior to the new product. It may be a potential liability from the use of the product or a potential loss from the materials used in its production, for example.

Changes in the environment might include changes in any of the PEST (political, economic, social, technological) or any industry level change such as a change in the competitive behaviour of suppliers, buyers or competitors. In either case, new risks can be introduced, existing ones can become more likely or have a higher impact, or the opposite (they may disappear or become less important). The case describes Risk D as arising from a change in legislation which is a change in the external environment.

(b) TARA

The strategies for each risk assessment are as follows:

Risk A is accept. This means that the likelihood is low and the impact is low such that even if the risk materialised, it would not have a high severity. The case says that the activity giving rise to Risk A is capable of making good returns so given that both likelihood and severity are low, there is no obvious reason to pursue any of the other strategies with regard to this risk.

Risk B is avoid. When the likelihood and impact are high, it would be irrational to accept the risk and so the risk should be avoided. This may involve changing behaviour or discontinuing a certain activity. The case says that the activity giving rise to Risk B is capable of making good returns, but importantly, it is not strategically vital. Given this, and because the case information does not mention the possibility of viably transferring the risk, there is no reason to bear the risk unless the potential return is very large and the company has a high risk appetite.

Risk C is transfer. YGT says that the activity giving rise to the risk must not be discontinued (so avoidance is not an option) and specifies that it can be transferred ('alternative arrangements for bearing the risks are possible'). To transfer risk is to share it with another party. The most common way to do this is to insure against losses or to outsource or licence the activity to a third party thereby transferring that risk to that third party.

Risk D is reduce. The case emphasises that the risk cannot be transferred (by insurance or outsourcing) but that the activity that gives rise to the risk can be reduced. Reduction involves reducing the risk exposure by carrying out the activity in a different way, doing less of the activity that gives rise to the risk or adopting behaviour that, whilst still exposing the company to the risk, results in a lower impact if the risk is realised.

(c) Related and correlated

Related risks are risks that vary because of the presence of another risk. This means they do not exist independently and they are likely to rise and fall in importance along with the related one. Risk correlation is a particular example of related risk.

Risks are positively correlated if the two risks are positively related in that one will fall with the reduction of the other and increase with the rise of the other. They would be negatively correlated if one rose as the other fell. In the case of environmental risks and reputation risk, they may be positively correlated for the following reasons.

Environmental risks involve exposure to losses arising from an organisation's consumption of resources or impacts through its emissions. Where an environmental risk affects a sensitive situation, (be it human, flora, fauna or other), this can cause negative publicity which can result in reputation damage. These two risks can have a shared cause, i.e. they can arise together and fall together because they depend upon the same activity. They are considered separate risks because losses can be incurred by either of both of the impacts (environmental or reputational).

Activities designed to reduce environmental risk, such as acquiring resources from less environmentally-sensitive sources or through the fitting of emission controls, will reduce the likelihood of the environmental risk being realised. This, in turn, will reduce the likelihood of the reputation risk being incurred. The opposite will also hold true: a reduction of attention to environmental risk will increase the likelihood of reputation loss.

(d) Risk awareness

Explanation
Risk awareness is a *capability of an organisation* to be able to recognise risks when they arise, from whatever source they may come. A culture of risk awareness suggests that this capability (or competence) is present throughout the organisation and is woven into the *normal routines, rituals, ways of thinking and is taken-for-granted* in all parts of the company and in all employees.

Assessment
Risks can arise in any part of the organisation and at any level. Not all risks are at the strategic level and can be captured by a risk assessment. A culture of risk awareness will help ensure that all employees are capable of identifying risks as and when they arise.

Risks are dynamic and rise and fall with changes in the business environment and with changes in the company's activities. With changes to the company's risk profile occurring all the time, it cannot be assumed that the risks present at the most recent risk assessment will remain the same. Being prepared to adapt to changes is a key advantage of a culture of risk awareness.

A lack of risk awareness is often *evidence of a lack of risk management strategy* in the organisation. This, in turn, can be dangerous as the company could be more exposed to risk than it need be because of the lack of attentiveness by staff. A lack of effectiveness of risk management strategy leaves the company vulnerable to unrecognised or wrongly assessed risks.

3 (a) Charities and public listed companies

Differences
Firstly, the two types of organisation are different in terms of *regulation*. Listed companies are subject to all the provisions of company law plus any listing rules that apply. Listing rules, such as the need to adopt the Combined Code in the UK, impose a number of obligations upon listed companies such as non-executive directors, committee structures, a range of reporting requirements, etc. Charities, in contrast, must receive recognition by a country's charity authority to operate and they then

receive the concessions that charitable status confers. This often involves favourable tax treatment and different reporting requirements. Because charities are not public companies they are not subject to listing rules although, depending upon the country's rules, they may be subject to audit and have some reporting requirements.

The second difference is in the *strategic purpose* of the organisation. Listed companies exist primarily to make a financial return for their investors (shareholders). This means that they employ and incentivise people, including directors, to maximise long-term cash flows. Value is added by the creation of shareholder wealth and this is measured in terms of profits, cash flows, share price movements and price/earnings. For a charity, the strategic purpose is to support the charitable cause for which the organisation was set up. It is likely to be a social or benevolent cause and funds are donated specifically to support that cause and this expectation places a different emphasis on the purpose of governance.

Thirdly, the two are different in terms of stakeholders and societal expectations. Society typically expects a business to be efficient in order to be profitable so that, in turn, it can create jobs, wealth and value for shareholders. Society expresses its support for a business by participating in its resource or product markets, i.e. by supplying its inputs (including working for it) or buying its products. A charity's social legitimacy is tied up with the charity's achievement of benevolent aims. Stakeholders in a business often have an economic incentive to engage with the organisation whereas most stakeholders in a charity have claims more concerned with its benevolent aims.

Governance arrangements
There can be a number of substantive differences between the governance structures of public companies and charities. In a public company, a board consisting of executive and non-executive directors is accountable to the shareholders of the company. The principals are able to hold the board accountable through AGMs (annual general meetings) and EGMs (extraordinary general meetings) at which they can vote on resolutions and other issues to convey their collective will to the board. In a charity, the operating board is usually accountable to a board of trustees. It is the trustees who act as the interpreters and guarantors of the fiduciary duty of the charity (because the beneficiaries of the charity may be unable to speak for themselves). The trustees ensure that the board is acting according to the charity's stated purposes and that all management policy, including salaries and benefits, are consistent with those purposes.

[**Tutorial note:** *allow latitude and 'cross marking' between these points*]

(b) Transparency

Define transparency
Transparency is usually defined in terms of openness and adopting a default position of information provision rather than concealment. This means that unless there is an overwhelming reason not to disclose information of any kind (perhaps for reasons of commercial sensitivity) then information should be disclosed or made available upon request to any interested stakeholder.

The case for greater transparency at HHO
Transparency is an important principle in corporate governance, including at HHO, for a number of reasons.

In general, transparency has the effect of *reassuring investors* that their funds are being responsibly stewarded and used for worthwhile investments. In the case of a charity, such as HHO, without shareholders in the conventional sense, donors give money to support the charity's stated aims and purposes. With the relief of suffering to animals being a prominent reason any donors give to HHO, the amount of money diverted for other purposes, such as salaries, would be information of considerable interest.

Transparency would *inform and placate HHO's critics*, including the journalists who are investigating it. Public commentators like journalists are capable of causing damage to HHO's reputation and this in turn can affect donations and support for the organisation.

There are a number of potentially *damaging allegations* made against Mr Hoi including the likelihood of large payments to himself and some profligacy in the purchase of the private jet. These allegations could be rebutted if the organisation were to make the accounts public and explain the case for the purchase of the jet. For a charity receiving money from 'well-meaning individuals that care greatly about animal suffering', the allegations have the potential to do much reputational damage to the charity.

The *publication of the financial data is an inadequate expression of transparency* and appears to be a poor attempt to give the appearance of providing information whilst providing no useful detail at all. This would not meet any stakeholder's information needs and fails to address any of the concerns raised about HHO. It does not give any absolute financial figures, for example, in terms of income and costs. Such a truncated summary actually gives the impression, to any informed observer, of an attempt at concealment and this provides a strong reason to provide a full financial statement.

(c) Audit committee and internal controls

There are a number of apparent internal control deficiencies, although the case does not permit definite and specific allegations of IC deficiencies to be made or to conclude that a complete lack of governance structure exists at HHO. However, any such organisation would benefit from having an audit committee with wide-ranging powers and responsibilities when reviewing internal controls. With regard to the situation at HHO, the most important areas for audit committee attention are monitoring the adequacy of internal controls, checks for compliance with relevant regulation and codes, checking for fraud and reviewing existing IC statements for accuracy.

Monitoring the adequacy of internal controls involves analysing the controls already in place to establish whether they are capable of mitigating risks. In the case of HHO, there are internal risks that the controls need to be capable of controlling. The risk of fraud and the risk of compliance failure are relevant internal risks.

To check for compliance with relevant regulation and codes refers to HHO's compliance with its legal and other regulatory constraints. It is likely that HHO has a number of regulatory constraints as a result of its charitable status. It may also have voluntary codes it seeks to abide by, perhaps made public through its marketing or reporting literature, and the audit committee could also test for compliance with these.

Checking for fraud is also within the remit of an audit committee and this would, at first glance, be a priority at HHO. There are grounds for believing that inadequate remuneration policies exist at HHO and grounds for suspecting some financial dishonesty. There also seems to be a lack of accountability for the behaviour and actions of Horace Hoi, especially if the claims about his lavish lifestyle are accurate. The misuse of donations for personal enrichment would be outside of what is allowed under his charitable status and this could be reviewed by the audit committee.

Finally, an audit committee could play a more supervisory role if necessary, for example reviewing major expenses and transactions for reasonableness. This might include measuring transactions against its regulatory regime and the reasonable expectations of its trustees and donors.

4 (a) Ethical threats

The five generally accepted types of ethical threat under the IFAC and ACCA codes of ethics and conduct are:

(a) Self-interest threats, which may occur as a result of the financial or other interests of a professional accountant or of an immediate family member;
(b) Self-review threats, which may occur when a previous judgement needs to be re-evaluated by the professional accountant responsible for that judgement;
(c) Advocacy threats, which may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised;
(d) Familiarity threats, which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others; and
(e) Intimidation threats, which may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

The IFAC code highlights self-interest threats and intimidation threats as relevant in accepting gifts or hospitality.

260.1. 'Self-interest threats to objectivity may be created if a gift from a client is accepted; intimidation threats to objectivity may result from the possibility of such offers being made public.'

A self-interest threat is one in which a person's interests in him or herself obscures objectivity and the need to act with integrity. Clearly the promise of personal gain can be a threat to ethical behaviour, especially if, as in the case of Ann, it can be a large amount of money.

An intimidation threat can arise when the party who has given the inducement seeks to exercise power over the recipient in the belief that further advantage can be taken. In the case of a bribe, the recipient can be induced to take further unethical actions with the threat that their first bribe will be exposed if they do not comply. Ann may be induced to award other contracts to the contractor, for example, and this could act against the interests of the company, its shareholders and other contract providers.

There may also be an advocacy threat in addition to the self-interest and intimidation threats. An advocacy threat occurs when objectivity is impaired because of a person's advocacy for a certain interest (e.g. client, bidder, person, etc). In this case, the fact that Ann awarded the contract seemingly on the basis of a bribe, means she will have to defend (act as an advocate for) the successful bidder against her own management if the contract does not go well. In so doing, she may well be acting against the interests of her employer and the company's shareholders.

(b) Criticise Ann Koo

First, she did not allow the contract to be bid for by all competing parties equally. This is a failure of her duty to the public interest, to her employers and, as an accountant, to her professional body. Her employers and other stakeholders expect to gain the best value for money and this requires a fair tendering process giving all potential contractors an equal chance of winning the contract.

Second, she accepted a bribe to award the contract. This undermines the contract bidding system and offers poor value to the organisation's principals, which in the case of a public company are the shareholders.

Third, she exposed herself to ethical threats that may result in more unethical behaviour in the future. Safeguards are put in place to ensure that ethical threats are not incurred. Her family's personal financial misfortunes are of no direct concern to her employers and should have had no bearing on her management of the contract process.

Fourth, her belief that she deserves a 'higher personal return' suggests she is seeking more than just the career opportunities that come with being a qualified accountant. This belief or expectation may apply to most qualified professionals but acceptance of additional rewards in the manner that this case describes is totally unacceptable and is not a generalisable

ethic in terms of Kant's deontological understanding of ethics. What if everybody sought to make a 'higher personal return' on their training through abusing their responsible position in this way?

Public interest

Ann Koo owes a duty to the public interest *both as an accountant and as a company director*. This means that it is her duty to behave in such a way as to *maximise the public good* and not act in terms of pursuing personal interests only. Accounting and other professionals are bound to recognise this duty and to comply with it regardless of the temptation or inducement to act otherwise.

(c) Insider trading

Insider dealing/trading

Insider dealing (also called insider trading) is the buying or selling of company shares *based on knowledge not publicly available*. Directors are often in possession of market-sensitive information ahead of its publication and they would therefore *know if the current share price is under or over-valued* given what they know about forthcoming events. If, for example, they are made aware of a higher than expected performance, it would be classed as insider dealing to buy company shares before that information was published. Similarly, selling shares in advance of results publication indicating previous over-valuation, would also be considered as insider dealing.

Why is insider trading unethical and often illegal?

By accepting a directorship, each director *agrees to act primarily in the interests of shareholders*. This means that decisions taken must *always be for the best long-term value for shareholders*. If insider dealing is allowed, then it is *likely that some decisions would have a short-term effect* which would not be of the best long-term value for shareholders. For example, businesses which are about to be taken-over often see a significant rise in their share price. In this situation directors might purchase shares in their own companies, seek potential buyers for the company and recommend the sale to shareholders, in order to make a profit on their own share investments. For this reason, a blanket ban on insider dealing ensures that such short-term measures are not taken.

There is also the potential damage that insider trading does to the reputation and integrity of the capital markets in general which could put off investors who would have no such access to privileged information and who would perceive that such market distortions might increase the risk and variability of returns beyond what they should be.

1 **(a)** 2 marks for each cause identified and described to a maximum of 8 marks.
2 marks for each IC measure identified and described to a maximum of 6 marks.
(Maximum 12 marks)

(b) 2 marks for each Kohlberg level explained to a maximum of 6 marks.
2 marks for each level correctly assigned to a person with evidence (½ for correct recognition only).
(Total 12 marks)

(c) 2 marks for distinguish between.
1 mark for purpose of AGMs.
1 mark for purpose of EGMs.
1 mark for each relevant point for advantages to a maximum of 4 marks.
(Total 8 marks)

(d) **(i)** 1 for each role identified and 1 for placing in context to a maximum of 8.
Or
1 for each role identified and briefly explained, in context, to a maximum of 8.
(Total 8 marks)

(ii) 2 marks for each point of defence identified and developed.
(Total 6 marks)

Professional marks for clarity, logical flow, persuasiveness and appropriate structure.
(Total 4 marks)

2 **(a)** 2 marks for each evaluation point made to a maximum of 4 marks.
2 marks for each point identified and explained on dynamic to a maximum of 4 marks.
(Total 8 marks)

(b) Half mark for correct strategy selection for each risk. 1 mark for each risk strategy correctly explained and justified.
(Total 6 marks)

(c) 2 marks for explanation of related and correlated risks.
2 marks for each description of why correlated to a maximum of 4 marks.
(Maximum 5 marks)

(d) 2 marks for explanation.
2 marks for each relevant point for assessment.
(Total 6 marks)

3 **(a)** 2 marks for each area of difference identified and explained to a maximum of 6 marks. Half mark for identification only.
3 marks for differences in governance structures.
(Total 9 marks)

(b) 2 marks for definition of transparency.
2 marks for each point made for greater transparency.
(Total 8 marks)

(c) 2 marks for each relevant area of internal control explained.
(Total 8 marks)

4 **(a)** 1 mark for each threat identified and briefly described (half for identification only).
2 marks for each relevant ethical threat discussed to a maximum of 4 marks.
(Total 9 marks)

(b) 2 marks for each criticism identified and developed to a maximum of 8 marks.
2 marks for evidence of understanding of public interests (in any part of the answer).
(Total 10 marks)

(c) 3 marks for evidence of understanding of insider dealing/trading.
3 marks for explanation of why it is unethical.
(Total 6 marks)