City Colleges' ***'Night Before Notes'*** for ACCA P1 Dec 2014

Owen O'Reilly owen.oreilly@citycolleges.ie

Everyone loves 'tips' – but you have got to be careful! There is a grain of truth in the following... handy as a checklist also – 3 or 4 points on each:

Paper P1 BPP
• Public sector governance.
• Integrated reporting.
• Ethical and CSR theories – applied to scenarios.

Paper P1 LSBF
• Governance:
– Role of Board. – Unitary/two tier.
– Chair role/CEO chair split.
– Induction/performance appraisal. – Reward systems.
– Family based structure.
– Global standards in governance.
– Stakeholder classifications.
• Control:
– Objectives of a sound system.
– COSO failures. – Reasons for internal audit.
– Internal control disclosure.
• Risk management:
– Risk committee or risk manager. – Strategic/op/static and dynamic risk.
– Risk diversification.
– ALARP.
• Ethics:
– Absolute/relative, consequential. – Grey, Owen and Adams.
– Professionalism.
– AAA model or Tucker.

Paper P1 Becker
• Corporate governance (CG) concepts, underlying fundamentals and arrangements.
• CG in other organisations (e.g. public sector, NGOs).
• Types and forms of CG (e.g. rules based, principles based, insider, outsider systems, UK Corporate Governance Code, SoX).
• Agency theory, stakeholders, Mendelow.
• Board structures, CEO/chairman, directors, NEDs, committees.
• Internal control and business risk, Turnbull.
• Ethical theories and business codes – Kohlberg, Gray, Owen and Adams, Tucker, AAA.
• Professions and the public interest.
• Corporate social responsibility, corporate citizen, footprints and sustainability.
• Integrated reporting, social and environmental auditing.

Paper P1 Kaplan
• Corporate governance comparison of approaches – public v private sector.
• Conflict of interest and independence.
• Stakeholders and stakeholder claims.
• Function and importance of internal audit.
• Risk correlation and strategies for management of such risks.
• Corporate codes of ethics critique and improvements.
• Tucker's ethical decision making model.
• CSR – comparison of approach (profit and not for profit organisations). • Integrated reporting.

Exam technique improvement by:

USA [**U**nderstanding the actual requirement is the hardest part of P1... *'fools rush in'* (thanks Elvis!) ... then you need to...
Structure an answer – based on the PARTS of the requirement and MARKS and maybe one of your mnemonics [RORCS!]

And then **A**pply using the *key phrase* from question... to APPLY to scenario's industry (chemicals, banking, public sector).

Then **PEAT** for each point:
Point – every paragraph has only ONE point/purpose
Explain – keep short!
Apply – to key phrase in requirement / & scenario's INDUSTRY!
Time – Got to be careful with time!

- Indent a support point to try to score a related point (skip lines and plenty of 'white space')
  Use '**This Means**...' **However**, *Because*, **eg**, How? Why? (These 6 tools set up your second mark!)

Adopt the role of your mentor... gives tone and authority, dress for work... professional accountant.
Deliver **peak performance** by visualising the day and how you are going to do the exam – rehearse this a lot.
OK? Got it?! Great – following the above exam technique will boost your mark over 15%. I guarantee this.

Summary of Examiner's advice:

The professional marks in part (d) were for presenting the answers in the form of a press release. ... It was frustrating to see some candidates setting out their answer as a memo or a letter when this was clearly not what was being asked in the requirement. It was also important to present the answer as a press release and not just as an exam answer. In a press release, for example, it would be unusual to see terms like deontological or consequentialist.... [OK – so normal language – simple punchy paragraphs]

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[Rem Memo has line under it!... Report – prepared by! Letter structure.....]
[Rem our STRUCTURE for this... **1. Intro** (what you're going to say – We would like to (thank you) take the opportunity to...), **2. Content** (short punchy paragraphs based on each requirement), **3. Outro** (thank you for the opportunity to clarify our position... etc), **4. Sign off**]

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The most common answer to this was a brief discussion of the general importance of internal controls and this was **clearly not what the question was asking**. [oh oh! No marks!!]

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Only candidates who were **able to see** what this question was asking scored marks. [He means business!!]

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This task required candidates to consider the roles of internal audit in **a specific industry situation**.

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Stronger answers were able to place the idea of embedding risk **into the context of the case....**[makes sense...]

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Summary of key slides from the Revision Course:

A fiduciary duty is an often onerous *duty of care and trust that one party owes to another...*

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OLAND (12/12) How sound corporate governance addresses company failure.
1. alignment of board interests with those of shareholders.
2. a sound system of corporate governance helps to identify and manage the wide range of risks that a company can face,
3. 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
4. effective codes encourage reliable and complete external reporting of financial data and other voluntary disclosures.

Fifth, compliance with a code underpins investor confidence
Finally, sound corporate governance will encourage and attract new investment of share capital

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RDC (12/12) Importance of recognising all stakeholders.
Stakeholder recognition is necessary to gain an understanding of the sources of potential risk and disruption....
Stakeholder recognition is important in terms of assessing the sources of influence over the objectives and outcomes
Stakeholder recognition is necessary in order to identify potential areas of conflict and tension between stakeholders,....
There is an ethical and reputational case for knowledge of how decisions affect stakeholders,

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There are a number of differences between the governance arrangements for a **privately-owned family** business like Lum Co and a public company which Lum Co (6/12) became after its flotation.
Governance arrangements are much more formal for public companies than for family businesses. This is because ...
Linked larger companies, and public companies in particular, are more highly regulated and have many more stakeholders concerned with maintaining public confidence in their governance and to seek to reassure their shareholders.
Such measures include additional reporting requirements that do not apply to family firms.

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Rules vrs principles [rules = unambiguous, standardised, comparable] [No leeway... Loopholes...]

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Underlying principles of all good governance: **TAPS principle** [transparency, accountability, probity, sustainability]

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Two principal conclusions were drawn by the Financial Reporting Council [FRC] from its review of the code.

1. Much more attention needed to be paid to following the **spirit** of the Code as well as its letter.
2. Impact of **shareholders in monitoring** the Code could and should be enhanced **by better interaction** between the boards of listed companies and their shareholders.

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To follow the spirit of the Code [cue song...] to good effect, boards must think

- **deeply**,
- **thoroughly** and on a
- **continuing basis**,
- about their overall tasks and the implications of these for the roles of their individual members.

Absolutely key in this endeavour are the **leadership** of the **chairman** of a board,
The **support given to and by the CEO**, and the **frankness and openness of mind** with which issues are discussed and tackled by all directors.

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The **main Sections/principles** of UK CG code: [**LEARS**]

- **L**eadership **collectively responsible** for the long-term success of the company.... There should be a **clear division of responsibilities**
- **E**ffectiveness The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.
- **A**ccountability The board should establish formal and transparent arrangements for considering how they should apply the **corporate reporting** and **risk management** and **internal control** principles and for maintaining an appropriate relationship with the company's auditor.
- **R**emuneration link rewards to corporate and individual performance. There should be a formal and transparent procedure for developing **policy** on executive remuneration
- **S**hareholders - Relations with.... use the AGM to communicate with investors encourage participation

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BOOM Co. (6/13) **The purposes of such codes** are as follows.

- First, they guide and specify behaviour in matters of governance, internal control and risk management
- Second, they aim to encourage best practice
- Third, codes aim to underpin investor confidence
- Fourth, codes aim to reduce fraud, waste or inefficiency.....
- Fifth, in principles-based reducing the chances of governmental legislation being implemented

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Benefits... of 'maintaining a system of IC over FR [SOx 404]

1. Aids Mgt Decision Making thru accurate info
2. Provides Audit trail to prove compliance
3. Provides Assurance to shareholders
4. Where Mandatory – avoid penalties

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Board appraisal = must review itself AND All directors have individual appraisal. [**PI CPD**]
• **Preparedness** – knows key staff, organisation and industry
• **Independence** – free thinking, avoids conflicts of interest
• **Committee work** – understands process of committee work, exhibits ideas and enthusiasm
• **Participates actively** - questioning, insists on obtaining information, undertakes professional education
• Aides **Development** of the organisation – contributes to this e.g. re innovation, strategic direction and planning
NEDs appraise performance of the Chairman and the CEO

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Role of **Remuneration Comm**

- Role to set Remuneration '**policy**' of co
- Role of complying with codes of best practice – eg staffed by Neds & meet regularly
- Role of **reporting** to shareholders of their decisions
- **Set pay** of Execs – within 'best practice'
  - Goal congruence/Align interests of each party /Motivate/Must ARM

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Role of **Nominations Comm** Dec 13
All of which are concerned with the recommendation of appointments to the board of directors.

1. Establish the appropriate **balance** between executive and non-executive directors (NEDs). (50% in UK)
2. Role is to ensure that the board contains the **requisite skills**, knowledge and experience to effectively lead the co and provide leadership. Any identified gaps in these requirements should be filled by new appointments.
3. **Continuity** of required skills, the retention of directors and succession planning.
4. **Board size** given the skill needs, cost constraints and strategies of the company.
5. Committee is likely to be concerned with issues of **diversity** and to ensure that the company's board is adequately representative of the society in which it operates.

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Annual reports must **convey a fair and balanced view** of the organisation.
Should ***state*** whether the organisation has **complied with governance regulations and codes**.
Best practice to give specific disclosures about:

- Board composition [directors/NEDs], evaluation of performance
- Committee reports
- Relations with auditors and shareholders
- Review of internal control
- Going concern status and
- Business Review

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PART 2 Internal Controls and Risk

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Objectives of IC

- **R**isk Management objectives...
- **O**perations – E&E
- **R**eporting – Ensure reliability of Int & Ext
- **C**ompliance – with laws and regs
- **S**afeguard shareholder investment

[see Hayho (6/12) Q1c]

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Characteristics of SOUND IC [**CREW**] [characteristics = 'qualities that distinguish something – i.e. Sound from unsound IC]
The Turnbull Report discusses a 'sound' system of internal control - characteristics:

(a) Part of the **c**ulture
(b) Be capable of **r**esponding quickly to evolving risks
(c) Be **e**mbedded in operations
(d) **w**histle blower provisions.

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Turnbull Internal Control reporting [RrEF!]

1. Mgt must state they have <u>responsibility</u> for establishing and maintaining ICs
2. Statement that mgt <u>have **r**eviewed</u> the adequacy and effectiveness of ICs
3. Statement that the ICs exist to manage <u>not **e**liminate</u> risk
4. Should <u>identify **f**ramework</u> used to assess ICs [eg Turnbull Report]

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SOX (Section 302)

- CEO and CFO prepare a statement certifying the appropriateness of the financial statements.

Section 404

- Annual report contains an internal control report that:
  - States management's responsibility for maintaining ICs
  - Verifies the directors' assertions re ICs
  - Includes an assessment of the effectiveness of the FINANCIAL ICs
  - Auditors audit this. (Attestation report)
  - Identify framework used to assess the ICs (COSO).

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Hoppo (06/13)
Internal controls can be at the strategic or operational level. At the strategic level, [LONG TERM!!] controls are aimed at ensuring that the organisation 'does the right things';
at the operational level, controls are aimed at ensuring that the organisation 'does things right'.

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Yaya (12/12)
Well designed IC systems can be ineffective for # of reasons.
<u>Costs outweighing benefits</u>.
<u>Failures in human judgement</u> when assessing a control,
or <u>fraud in measuring or reporting</u> a control.
<u>Collusion</u> between employees
<u>Non-routine</u> or unforeseen events can render controls ineffective
Controls can become <u>obsolete</u> because they are not updated to meet changed conditions.

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Blurp (06/13)
Discuss how effective IC can provide assurance on the integrity of financial reporting
First, they are more <u>likely to **create systems** capable of generating accurate and reliable information</u>. A lack of IC systems may allow for subjective and 'best guess' figures to be fed into the reporting process,...
Second, <u>to **identify specific people and functions responsible** for operating a particular control</u>. A robust IC system will not expect reporting information to 'just happen', but rather, a certain control and/or named person can be made accountable for the delivery of a specific input or set of inputs into the reporting process.
Third, <u>**makes the process visible and amenable to scrutiny**</u> by either internal or external auditors. By having a clear allocation of controls over each stage of the reporting process, an auditor can analyse the quality of control and the information it has produced, at any stage. Or, in the case of an error, the auditor can easily trace back to find how and where the error was introduced.

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COSO keen on risk <u>**OWNERSHIP**</u>
Risk Management must be owned for it to be effective = accountability

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S116 Xaxa (06/14) **Examiner's Risk Audit Steps:**

1. Identification
2. Assessment
3. Review of controls
4. Report to management

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Xaxa (06/14) **Advantages of external risk audit**
<u>**avoid familiarity**</u> threats by the auditor. The company's internal auditors are likely to be working within the company's culture and perhaps 'contaminated' or at least 'affected' by it....
Second, will be neutral and <u>**independent**</u> in its approach.... A '<u>fresh pair of eyes</u>'
Third, will <u>**enhance investor confidence**</u> in the process
Finally, <u>**best practice can be more effectively transferred**</u>

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Role of **risk Mgt Function**

- Helping determine risk management strategies
- <u>**Champion**</u>s of risk management
- Establishing <u>**risk awareness culture**</u>, policy and structures
- Developing and reviewing risk management processes
- Co-ordinating functional responses
- Preparing report for board / shareholders

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Zogs (06/12)
There are five general roles of a risk committee.
1. Agrees the <u>organisation's risk management strategy</u>,
2. <u>Reviews reports on key risks</u> prepared by depts on operational risks.
3. <u>Monitors overall risk exposure</u> and ensures it remains within the limits
4. Risk committee <u>assesses the effectiveness of risk management systems and policies</u>.
5. <u>Approves statements /disclosures</u> made to internal or external audiences

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COSO categorises 4 objectives:

1. **Strategic Objs** – high level goals, support mission
2. **Operational** Objs – effectiveness and efficiency
3. **Reporting Objs** – reliability
4. **Compliance Objs** – with applicable laws

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Changing risk culture: [itick]

- **Involvement** in risk identification
- **T**raining
- **I**ncentives
- **C**ommunications programme
- **K**ey personnel persuasion

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Embedding Risk [sac]
Risk should be embedded in the company's:
- Systems and procedures
- All levels
- Culture and values

Embedding risk awareness
- Consistent activity embedded across all processes
- Consistent action-orientated risk assessment

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Event Identification
- Types (Entrepreneurial, market, political etc)
- Categories (strategic/operational)
- Risk register

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Risk assessment (= analysis)

- Process (Who? How? How often?)
- Profiling (likelihood/impact)
- Quantification
- Consolidation

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Risk response
- TARA [Transfer, Accept, Reduce, Avoid]

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Types of risk = NB!!! [rem to pick up both marks available – make an indented second point!!]

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Market risk concerns potential losses on capital markets from changes in the value or volatility of a share price or other security [property assets devaluing, raw material].

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Business risks - which **can threaten the survival of the business as a whole** and they can arise from many sources. Essentially though, they arise because of the business model which an organisation operates and the strategies it pursues.

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Financial risk -from **the way a business is financially structured**, its management of working capital and its management of short and long-term debt financing. **Cash flow** ...how it manages its **working capital** and its ability to control payables, receivables, cash and inventories. **poor collection of receivables, excessive borrowing, increased borrowing rates**,

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Embedding financial risk management Dubland (6/13)
This means that it is **not a 'stand alone' activity** but becomes **normal behaviour**. The value of managing and controlling the risk becomes widely accepted and made a **part of many people's roles**, as a part of their normal behaviour.
First, because financial risks are technical in nature **to inform and educate a wide range of employees to understand and recognise risk factors.**
Second, **technical accounting and monitoring systems need to be implemented that measure and report (to management) on agreed targets**, measures and compliance with those.
Third, human resource systems can be designed to provide **incentives for monitoring and alerting management about the risks.** Rather than encouraging risk taking in BigBank, staff appraisals and the reward structures could be designed to reward behaviour more likely to control and mitigate the financial risks.
4th, **awareness of financial risks**, & those things that can increase them, can be **normalised as a part of BigBank's culture**.

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Embedding financial risk mgt:
1. Educate
2. Systems
3. Incentives
4. Culture

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- Who is managing the risks? [responsible/*owner*ship]
- When do they do it? [Embed/systems/continuous process]
- Where are the events from? [ext/internal]
- How do they do it? [Brainstorm/inspect...]
- What is Status of the risk? [Changed? Trend?]
- What controls are in place?

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Risk Assessment
1. Process(a) - **Who** should do it? (b) **How** (c) **How often**?
2. Profile – Probability and Impact!
3. Quantification - sensitivity analysis & accounting ratios!
4. Consolidation

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ALARP (as low as reasonably practicable) principle...risk management is partly a **trade-off between the cost of control and level of perceived risk**. We operate to a principle known as ALARP or that risks should be 'as low as reasonably practicable'.

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Examiner's Risk Audit Steps:
1. Identification
2. Assessment
3. Review of controls
4. Report to management

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Duties of audit committee [4 reviews.ie]
- **Review of financial statements** including changes in policies, judgemental areas, compliance
- **Review of internal audit**: standards, scope, resources, reporting, work plans, liaison with external auditors, results
- **Review of internal control:** systems adequacy, legal compliance, fraud risk, auditors' reports, disclosures
- **Review of risk management**
- **Investigations** into areas of concern
- **Relationship with external auditors**: appointment / removal, independence, scope, liaison

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See HEC (12/13)
Internal audit functions, such as envisaged for HEC, have traditionally had **four general roles**:

to **address** and **assure** **the quality and effectiveness**
1. of **risk** management systems,
2. of **internal control systems**,
3. of technical and legal **compliance** issues
4. of the **value for money** returned to our shareholders and others.

I personally ***see these roles as interconnected*** says the Examiner.

In summary... IA..... Must address and **assure** The quality and effectiveness of [**RIC-V**]

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Factors determining IA existence [ccPRUN]
Company does not have to have IA But **must review annually the need** for it! Depends on:
- **Cost** – benefit considerations
- **Complexity** of activities
- **Problems** with IC
- State of **risk** management
- **Unexplained** items up
- Employee **numbers**

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PART 3 Professionalism and Ethics

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Threats to independence of action and conflicts of interest include: [**FASSi**]
1. Familiarity
2. Advocacy
3. Self-interest
4. Self-review
5. Intimidation

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The IFAC Code states that firms should have established policies to resolve conflict and should consider: **FE PEA**
1. The **f**acts
2. The **e**thical issues involved
3. Related fundamental **p**rinciples
4. **E**stablished internal procedures
5. **A**lternative courses of action, considering the consequences of each

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AAA Model - ames the ethical decision as a series of questions: **FEN ABCD**
1. What are the **f**acts of the case?
2. What are the **e**thical issues in the case?
3. What are the **n**orms, principles and values related to the case?
4. What are the **a**lternative courses of action?
5. What is the **b**est course of action that is consistent with the norms, principles and values identified?
6. What are the **c**onsequences of each course of action?
7. What is the **d**ecision?

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Tucker's 5 question model is a benchmark against which to test the ethicality of a decision. **PL FRS**
Ask yourself, is the decision:
1. Profitable?
2. Legal?
3. Fair and equitable?
4. Right/ethical? [prone to subjective judgement]
5. Sustainable or environmentally sound?

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Kohlberg describes the development of individuals' ethical reasoning through three stages or levels.
1. **Pre-conventional:** reward/punishment and self-interest [*Self oriented – avoid trouble!*]
2. **Conventional:** "good boy/girl" and legal or social conventions [*Most people - obligation*]
3. **Post-conventional:** concern for others and principled conscience [*Rare! Concern for impact on others*]
   - 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.
   - 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.

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Typical features of a corporate ethical code[**EMS BS**]
1. Specific examples of company **expectations**
2. Links to the organisation's **mission** and objectives
3. **Standards** for the ethical treatment of suppliers, customers, employees
4. Guidance on acceptable and unacceptable **behaviour**
5. Clear guidance on consequences and **sanctions**

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S247 Lobo 12/13
All professionals are required to act in the public interest. Because the status of a professional in society is accorded a special privilege, the requirement to act in the public interest at all times *is an expectation of society*. This applies to professional engineers as well as to professional accountants.

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- The public interest is one of the key themes in professionalism, including in accountancy. To act in the public interest means to act for the benefit of the <u>**collective wellbeing of society as a whole**</u>. This means that accountants should serve the interest of clients, shareholders, governments and other stakeholders. In accounting services, accountants need to be aware that when conducting an audit, they need to be impartial and unbiased <u>because they are acting in the interests of shareholders</u>.
- Society relies upon the premise that accounting reports are true and fair, and useful for decision-making. Anything which might erode that premise <u>is against the interests of stability in society and therefore against the public interest</u>.[note logic]

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Ann Koo (06/11) ethical threats:
a) <u>**Self-interest threats**</u>, which may occur as a result of the financial or other interests of a professional accountant or of an immediate family member;
(b) <u>**Self-review threats**</u>, which may occur when a previous judgement needs to be re-evaluated by the professional accountant responsible for that judgement;
(c) <u>**Advocacy threats**</u>, which may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised;
(d) <u>**Familiarity threats**</u>, which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others; and
(e) <u>**Intimidation threats**</u>, which may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived

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Ethical safeguard

- An ethical safeguard is a constraint or control placed upon a professional person or an organisation <u>to prevent the occurrence of any of the ethical threats</u> mentioned above.
- Safeguards are imposed from two sources:
  - those created by the profession, legislation or regulation,
  - and those created from within a given firm's own systems and procedures.
- The external regulation of audit includes several provisions intended to ensure the independence of an external auditor, whilst some organisations also have their own rules for ensuring that employees or contractors are not compromised in their ability to act independently and without acceding to any vested interests.
- Benefits of ethical safeguards
- The primary benefit is <u>**to protect an individual or an organisation from the effects**</u> of an ethical threat.
- The provision of both audit and non-audit services by Hum and Hoo <u>raises several potential ethical threats</u>, particularly to independence. By instituting effective safeguards, these hazards can be avoided. It is important that, <u>**as a professional organisation,** the appearance of ethical threats is avoided as well as the actual avoidance itself</u>. The fact that staff can work on both audit and non-audit work and that the lines between the two are blurred, represents a challenge to the imposition of effective safeguards at Hum and Hoo.
- The <u>**presence of effective ethical safeguards underpins public trust and the confidence of shareholders**</u>.
- The <u>reputation</u> of accountants in society is a crucial component in their professionalism. Ethical threats, unchecked by effective ethical safeguards, undermine the professional reputation and introduce unhelpful factors which make it difficult for accountants to operate normally. Professionals such as auditors, and accountants performing non-audit services, are only helpful to shareholders (in the case of external audit) or service clients (in the case of non-audit services) <u>**precisely because their independence cannot be questioned**</u>.
- A third benefit of ethical safeguards is that they enable the effective delivery of both audit and non-audit services without the frustrating factors (ethical threats) which might render some services ineffective. An external auditor, for example, must have the full confidence of shareholders, <u>**and safeguards limiting interactions**</u> between them and their clients mean that they <u>**can be, and be seen to be, independent of them.**</u>

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Range of possible ethical stances:

- Short-term shareholder interest
- Long-term shareholder interest
- Multiple stakeholder obligations
- Shaper of society

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CSR is a term used to include a series of measures concerned with an <u>**organisation's stance towards ethical issues**</u>.
<u>**Behaviour in all of these areas is largely discretionary**</u>
recent times, <u>the idea has emerged that CSR can be integrated into an organisation's strategy</u>.
Org's <u>ethical reputation may be viewed as a strategic asset and a key part of its competitive positioning</u>. [Cadbury!!]

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Gray, Owen and Adams Bobo (6/11) **[Pristine Capitalist** (theft!), **Expedients** (link to LT shareholder ethical stance), **Social Contract** (agreement), **Social ecologists** (orgs socially responsible),
Socialists (equality)**, Radical Feminists** (feminine values/sharing/nurturing)**, Deep Ecologists** (man has no greater right...)**]**

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Contents of environmental Audit:

1. Agreed <u>metrics</u> (what should be measured and how)
2. Performance <u>measured</u> against those Metrics
3. Reporting compliance/<u>variance</u>

The problem, however, is:

- <u>what</u> to measure and
- <u>how</u> to measure it.

As an environmental audit isn't compulsory, there are no mandatory audit standards
and no compulsory auditable activities

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Requirements for EMAS registration:

1. An environmental policy containing commitments to comply with legislation and achieve continuous improvement
2. An on-site environmental review
3. An environmental management system that is based on the review and the company's environmental policy
4. Environmental audits at sites at least every three years
5. Audit results to form basis of setting environmental objectives and the revision of the environmental policy to achieve those objectives
6. A **public environmental statement** validated by accredited environmental verifiers containing detailed disclosures about: [**PSP**] Policy, Systems, performance in areas[**NEW**...]

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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.

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SUMMARY OF RECENT ARTICLE ON PUBLIC SECTOR *Relevant to P1 from the December 2014 exam session*

There is a new section of the Paper P1 on public sector governance. But how will this be examined?

a) Describe, compare and contrast public sector, private sector, charitable status and non-governmental forms of organisation, including purposes and objectives, performance, ownership & stakeholders (including lobby groups).

AGENCY IN THE PUBLIC SECTOR One of the key concepts in corporate governance in the private sector is agency. ... [OK YOU KNOW THIS = PRINCIPLES AND AGENTS ...] ...It is slightly different for public sector organisations. Whereas private and public companies have shareholders, public sector organisations carry out their important roles on behalf of those that fund the activity (mainly taxpayers) ***and*** those use the services [use this!] (perhaps pupils in a school). Funders (ie taxpayers) and service users are sometimes the same people (for instance, taxpayers placing their children in state school) but sometimes they are not, and this can give rise to disagreements on how much is spent and on what particular provisions. Part of the nature of political debate is about how much state funding should be allocated to which public sector organisation and how the money should be spent.

In general, however, public sector organisations emphasise different types of objectives to the private sector. Whereas private companies tend to seek to optimise their competitive positions, public sector organisations tend to be concerned with social purposes and delivering their services efficiently, effectively and with good **value for money.** [use this!]

A common way of understanding the general objectives of public sector organisations is the **three Es: *economy*, *efficiency* and *effectiveness*.** [use this!]

FORMS OF ORGANISATION The entry in the *Study Guide* contrasts 'public sector, private sector, charitable status and non-governmental (NGO and quasi-NGOs) forms of organisation'. The term 'third sector' [use this!] is sometimes used to refer to charitable and non-governmental organisations.

In such cases, NGOs and charities may have an executive and non-executive board, but these are subject to a higher board of trustees [use this!] whose role it is to ensure that the NGO or charity operates in line with its stated purpose or terms of reference. In these cases, the agency relationship is between the NGO or charity, and its donors. When donors give to NGOs or charities, it is important for them to be reassured that their donation will be responsibly used [use this!] for its intended purpose and the board of trustees help to ensure that this is what happens.

LOBBYING AND LOBBY GROUPS In a democratic society.... external interests seek to influence public policy...such interests sometimes 'lobby' politicians to try to get them to vote in the legislature in favour of their particular interest. These 'lobby groups' may attempt to influence in favour or against a wide range of issues and, although their activities are legal, some argue that they are not always helpful because it is thought by some that those that are the best funded will be the most likely to be heard. This can act against the public interest and in favour of sectional interests and this is thought to not always be helpful to the democratic process. [THINK ALCOHOL new minimum pricing bill for Scotland, 2011] [use this!]

STAKEHOLDERS IN THE PUBLIC SECTOR Public sector organisations have, in many cases, an even more complex set [use this!] of stakeholder relationships than some private sector businesses. Because most public sector activities are funded through taxation, public sector bodies have a complicated model of how they add value. For a private business, revenues all come from customers who have willingly engaged with the business and gained some utility for themselves in the form of benefit from goods or services.

With a government, however, taxation is mandatory and may be paid against the wishes of the taxpayer. Citizens of a country might disagree with the levels of taxation taken by a government, esp when a taxpayer sees most of his or her tax being spent on causes or services that mainly benefit others (and not themselves) and with which they may disagree.

Political theorists discussed the importance of a social contract between the government and the governed [use this!] In this arrangement, those who pay for and those who use public services must all feel that they are being fairly treated and not being over-exploited nor badly served. Because there are so many claims to balance, then, the stakeholder pressures on a government are often very difficult to understand. [use this!]

Furthermore, the claims of some stakeholders are assessed differently by different people according to their particular political stance. This means that some stakeholder claims are recognised by some but not by others, and this can make for a very complex situation indeed when it comes to deciding which stakeholder claims to recognise and which to reduce in weight or ignore. Some stakeholders have a very weak voice, [use this!] [homeless people – weak voice – tend not to vote... mental health weak voice... = no money available. Bird Flu outbreak = money would be found immediately for measures because it threatens the poultry industry/jobs/voters = powerful voice]... while others have no effective voice at all in order to express their claim. Part of the debate in politics is the extent to which these weaker stakeholders are represented and how their assumed needs are met.

b) Describe, compare and contrast the different types of public sector organisations at subnational, national and supranational level. [See this yourselves - *does not feel likely to me* – famous last words] [don't use this!]

c) Assess and evaluate the strategic objectives, leadership and governance arrangements specific to public sector organisations as contrasted with private sector.

STRATEGIC OBJECTIVES While most private sector organisations are independent in that they are 'stand alone' companies answerable to their shareholders, most public sector organisations are part of a larger public sector structure. A defence force, such as an army, cannot act alone and as it sees fit. Rather, it is funded by government and is tightly controlled in what it is asked to do and how it achieves its aims.... the public sector organisation is helping to achieve and implement a set of higher government policy objectives**.** The 'three Es' framework **[use this!]** encountered in the previous article is of help in understanding this. Each public sector organisation must be strategically effective in that it must achieve the objectives established for it in carrying out government policy. Because they are funded by public money, they must also be efficient and make the most of whatever resources they are provided with. Finally, they must also be economical in that they must work within specified budget and deliver desired outputs within that budget. Accordingly, there is an emphasis on value for money and service delivery. When public sector organisations are occasionally criticised in the media, it is usually because they have either overspent, underperformed, or both. [use this!]

GOVERNANCE ARRANGEMENTS Accountability is gained in part by having a system or reporting and oversight of one body over others. Because there is no market mechanism of monitoring performance (as there is with listed companies, for example), other ways must be found to ensure that organisations achieve the objectives and service delivery targets established for them.

In some cases, then, a head of service or a board of directors must report to an external body of oversight. The oversight body may be a board of governors, a council of reference, a board of trustees, an oversight board or similar. In each case, its role is to hold the management of the service to account for the delivery of the public service and to ensure that the organisation is run for the benefit of the service users. Because public sector organisations are not held to account by shareholders as with business companies, the oversight body is often put in place as a means of holding the management to account. In this respect, oversight bodies are acting in the interests of service funders (usually taxpayers) in making public sector organisations accountable. [use this!]

1. Firstly, they BOARD OF GOVs there to c**omply** with government rules on whichever public sector gov applies.
2. Ensure the organisation **is well-run and meets the performance targets** THREE Es
3. The oversight body may be **involved in budget negotiations**
4. Involved in making senior appointments to the public sector body and in monitoring the performance

There is an increasing move in some situations to run some public services along similar lines to private companies. This means they may have an executive board and also some non-executive membership on the board also.

d) Discuss and assess the nature of democratic control, political influence and policy implementation in public sector organisations including the contestable nature of public sector policy'

As governments change, some public sector organisations grow in size and become more important, and others become small and less important.

The debate is often intense and enduring. In the case of health services, for example, some believe that health should always be entirely within the public sector and entirely funded by the taxpayer. This means that, for the service user (the patient), everything is free at the point of use. Others strongly believe that this is a misuse of public funds and that people should pay for health services in other ways, such as through an insurance or subscription scheme. Likewise with university education: some believe it should be paid for by the state and others believe that students should pay. In each case, debates are complicated. [use this!]

One of the ways in which some countries have restructured their economies in recent years, is through the process of privatisation. This means taking a service that was previously delivered through public sector organisations and then allowing it to be provided by private sector organisations. ...Those in favour of privatisation tend to argue that services can be delivered more efficiently in the private sector where management have a profit motive and competition. This, in turn, delivers better value to the customer. This process is not without its critics, however. [use this!] Opponents of privatisation sometimes argue that some strategic services, such as utilities, water, etc, are too important to be subject to the market forces of private enterprise.

Privatised businesses, once transferred from the state sector, are often subject to a great deal of internal change including changes in culture, structure, and governance. [use this!] Some Paper P1 questions have used privatised businesses as a case study, focusing in particular on issues of changing governance. In any event, however, we can see that changes in opinion influence public sector organisations [use this!] in many ways.

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SUMMARY of Integrated reporting articles on ACCA site:

IR is the culmination of much work undertaken since the mid-1970s around trying to make financial reporting more complete, transparent, coherent and relevant, and such initiatives were variously described in terms of environmental or green accounting, sustainability reporting, or triple bottom-line accounting. CONCLUSIONS Integrated reporting is gaining support around the world as a practical and useful reporting framework to enhance the quality and relevance of corporate reporting. ...around what the benefits to stakeholders are of preparing IR and how this relates to the agency concept and how it is defined.

The future of corporate reporting

The future of corporate reporting is currently the subject of considerable debate. Financial reporting has been criticised for over-complexity and requiring more disclosures, sparking accusations that corporate and financial reports are too long and not relevant, especially for the needs of investors. So could integrated reporting provide the answer? [use this! = yes!!]

In the UK, the Companies Act 2006 changed the required information to be included in the Directors' Report, making a business review part of the required reporting for companies other than small companies. Quoted companies were also required to include additional information 'about environmental matters including the impact of the company's business on the environment'.

This was a step towards a more modern look at corporate reporting, **but does it need to evolve and develop further**? ACCA believes that it does... [use this!] **THE NEED TO EVOLVE** It has become clear that the current corporate reporting framework needs to evolve to reflect the wide range of factors that affect corporate performance. Stakeholders want to know the value of the organisation they are interested in, and the current focus on an organisation's financial statements is insufficient to answer the question. Financial reporting and risk are, and will remain, important aspects of corporate reporting. However, high quality decision-making can only be possible when additional information is available.

INTEGRATED REPORTING

Integrated reporting (IR) has developed from the growing realisation that traditional financial reporting provides insufficient information for integrated thinking and investment decision-making. The true value of an organisation will depend in part on tangible or financial factors that will traditionally show on a balance sheet, and are perhaps fairly straightforward to account for. But the value will also depend on a wide range of other factors that are less easy to measure.

Factors such as people, energy security, natural resources and intellectual property all also have a bearing on the value of an organisation. [use this!]

IIRC FORMED

As a result the International Integrated Reporting Council (IIRC) was formed. ACCA is a member of IIRC, which is a global coalition of regulators, investors, companies, standard setters and the accounting profession. This coalition shares the view that communication about businesses' value creation should be the next step in the evolution of corporate reporting. Integrated reporting is the domain of accountants more than any other professional because we deal in information....**The purpose of the IIRC is to formulate a globally accepted and recognised international IR framework**. This framework will underpin and accelerate the evolution of corporate reporting, reflecting developments in financial governance, management commentary and sustainability reporting. **It will require that organisations supply material information about their strategy, governance, performance and prospects in a clear, concise and comparable format.** However, any new regime will lose some value if it is too inflexible and restrictive [**NOT RULES**!!]. The IIRC has been very clear during the consultation process that examples given are for guidance purposes. Entities are encouraged to think for themselves about which categories are most relevant to an explanation of the resources and relationships which are most material to an understanding of how they each go about their business.

Financial reporting currently relies largely on historic information, but **IR aims to give a holistic view** [use this!]**of the organisation by putting its performance and strategy in the context of its relevant social and environmental issues**.

Importantly, integrated reporting includes forward-looking information [use this!]to allow stakeholders to make a more informed assessment of the future of a company, as well as of how the organisation is dealing with its sustainability risks and opportunities.

REDEFINING THE BUSINESS MODEL

A particularly important concept in the IIRC model is the business model, and how this is embedded in the reporting process. To create value, any organisation will make use of a range of capitals, which lead to outputs (products and services) and outcomes (wider benefits to investors and society). The **capitals** [use this!] include traditional areas, such as financial and manufactured capitals, but also place ***equal emphasis*** [use this!] on other capitals: human, intellectual, natural and social.

It is clear that financial reporting, needs to adapt [use this!] to a new investment landscape. If the destination is **improved transparency, credibility, reliability and trust,** Aim to make reporting more user friendly. [use this!]

OK – that's it!

Let me know how these notes and the course could be improved and good luck in your exams!

'it is time to 'Lock and load'
.... Bring it on...'

Enjoy it... you are ready.

Be confident! You can do it!

Owen.oreilly@citycolleges.ie