YJ Oil & Gas

Scenario and requirement

Game 2 – Ethical Dilemma
Industry background

Oil is a naturally formed liquid found in the Earth’s crust and preserved there for many millions of years. Oil is being extracted in increasing volumes and is vital to many industries for maintaining industrial growth and for all forms of transportation.

Natural gas is used in a wide variety of industrial processes, for electricity generation, as well as for domestic heating. Natural gas is described as the “cleanest” of all fossil fuels, as it generates the lowest levels of carbon emissions of all of the fossil fuels. Almost all off-shore oil fields also contain reserves of natural gas. Therefore, drilling and production of oil also provides the opportunity to produce and sell natural gas from these reserves.

This case study material concerns only the “upstream operations” which is defined as the exploration, drilling of exploratory wells, subsequent drilling and production of crude oil and natural gas. This is referred to as the “exploration and production” (E & P) business sector.
Licences
All companies operating in the exploration and production (E & P) sector need to have a licence to operate each oil and gas field. Each country around the world owns the mineral rights to all gas and oil below ground or under the sea within its territorial waters. This generates enormous revenues for the countries which owns the mineral rights. The government of the country which owns the onshore or off-shore land will issue a licence based on a set of criteria concerning its technical ability to bring the potential oil and gas fields into production, its awareness and track record in respect of environmental issues and the company’s financial capacity in respect of the investment required to bring the oil and gas field into production.

Some of the smaller E & P companies apply initially for a licence to drill to identify the size of the reserves at the oil and gas field and subsequently enter into a Joint Venture, known in the industry as a “Farm-out” agreement, in order to raise the required finance to bring oil and gas fields into production, due to the huge amount of capital expenditure required.

Independent oil and gas exploration and production (E & P) companies
Independent oil and gas E & P companies are an important feature in the liberalised global energy market. The UK and some other European countries have a substantial and growing oil and gas exploration and production business sector which comprises a range of small listed companies.

YJ Ltd (YJ) is a UK company which is listed on the AIM with an initial public offering (IPO) of US$ 60 million. Its main shareholders are 12 large institutional shareholders which together own 96% of the shares. The principal activity of YJ is the exploration and production of oil and gas fields. The company’s strategy is to explore, appraise and develop into production its licensed oil and gas fields both safely and responsibly.

To date, YJ has been successful in identifying and bringing into production three oil and gas fields. This involved obtaining the required licences, test drilling and then proceeding through to production drilling at these three locations. It has therefore been successful in achieving its investors’ expectations. The oil and gas exploration industry is hugely capital intensive before any oil or gas can be brought into production and sold.

Even though YJ is listed in the UK, it prepares its accounts in US Dollars, as is usual in the oil and gas industry. All revenues from the sale of oil and gas are priced in US Dollars.
Drilling for oil and gas
All of the drilling operations that YJ undertakes are off-shore. YJ’s geologists and surveys teams are experts at studying and scanning potential areas for oil and gas reserves. YJ’s team undertakes extensive survey work over potential oil and gas fields including 2D and 3D seismic surveys and controlled source electromagnetic mapping to try to establish the size and depth of possible oil and gas reserves, before licence applications and test drilling commences. Oil and gas fields can be classified according to the reasons for drilling and the type of well that is established, as follows:

- “Test wells” are defined as wells which are drilled purely for information gathering purposes in a new area to establish whether survey information is accurate.
- “Production wells” are defined as wells which are drilled primarily for the production of oil or gas, once the oil or gas reserve has been assessed and the size of the oil or gas reserve proved.

Health, Safety and Environmental issues
Health, Safety and Environmental (HSE) issues are firmly placed at the top of YJ’s objectives. YJ wishes to ensure that it actively prepares for and manages the risks it faces in the hostile and difficult environments in which it operates.

Future potential oil and gas fields
YJ’s geologists and survey teams are currently investigating 12 further potential oil and gas fields. This includes four oil and gas fields in Asia and Africa for which YJ has applied for licences to drill. The outcome of the application for these four licences should be known over the next six months. The Director of Exploration has worked closely to meet all of the requirements of the licence applications for the four identified potential oil and gas fields.

However, his team find dealing with some members of the government of the African and Asian countries, which own the on-shore and off-shore land, difficult and at times ethically challenging.

Some of these Asian and African government officials have requested payment of fees, which the Director of Exploration considers to be bribes. He has clearly stated that this is not how YJ conducts business and he has taken a clear ethical stance with the full support of the Chairman of YJ.
Payments made

Last week, when the Finance Director was authorising the automated bank payments for YJ’s normal weekly supplier payments, he identified an invoice that looked unusual. He did not authorise this bank payment to be made and asked you, as Management Accountant, to investigate it.

The invoice stated it was for “Geological consultancy services”. Your investigation showed that it was the fifth invoice from this supplier over the past six months and each invoice was for the same value of US$ 50,000. Your investigation showed that you, as Management Accountant, had authorised the automated bank payment for this supplier for two of the previous four invoices and that the Chief Executive Officer (CEO) had authorised all of the invoices. It is not uncommon for YJ to use a range of external consultants to help with geological surveys. However, what was unusual was that all of the invoices had been personally authorised by the CEO and that payment was to a Swiss bank account, despite the consultancy company being located in an African country, X.

You, as Management Accountant, met with the CEO to discuss this and he told you to arrange payment without delay and to not discuss this payment with anyone. The CEO further stated that he considered that you were a person that he could trust. However, you are very concerned, as the African country, Country X, where the invoice address was located, is the same African country from which YJ is currently waiting to hear about a recent licence application for a new oil and gas field. You are unsure what you should do.

Requirement

You are required to draft an email to YJ’s Finance Director covering the following:

- What the ethical dilemmas are.
- Why you consider these to have ethical dimensions.
- Your recommendations on what actions should be taken to address the ethical dilemmas.
- Your justification of why you have made these recommendations.

Your email should contain no more than 10 short sentences.

N.B. You will be presenting in teams the email that you have put together.
Consultancy advice for
YJ Oil & Gas

What the ethical issue is:
1.
2.

Why I consider this problem to have an ethical dimension:
3.
4.
5.

Recommendations for this ethical issue:
6.
7.
8.

Justification of why I am making these recommendations:
9.
10.