

Chapter 2 Ethics & Governance Scandals

Multiple Choice Questions

1. As a result of the spectacular stock market crash in 1929, the government implemented the *Securities Act of 1933*, the *Securities Act of 1934*, as well as which of the following acts:
 - a. *Glass-Steagall Act*
 - b. *Investment Advisers Act*
 - c. *Gramm-Leach-Bliley Act*
 - d. All of the above
 - e. Only a and b

ANSWER: e

2. In 1984, Edward Freeman published an article on stakeholder theory. Which of the following is not true?
 - a. A firm needs the support of its stakeholders to enhance the firm's reputation.
 - b. Stakeholder theory took years to mature.
 - c. Stakeholder theory is not a useful framework for those interested in governance.
 - d. Firms need stakeholders to achieve their corporate objectives.
 - e. Stakeholder theory occurred at the same time as the rise in social and corporate activism.

ANSWER: c

3. Which of the following is not covered under the *Sarbanes-Oxley Act of 2002 (SOX)*?
 - a. The responsibilities of shareholders
 - b. The responsibilities of the board of directors
 - c. The responsibilities of management
 - d. The responsibilities of auditors
 - e. Conflicts of interest

ANSWER: a

4. The overall requirement of the Internal Revenue Service *Circular 230* is to ensure that tax professionals:
 - a. Know their clients
 - b. Always develop tax plans for their clients
 - c. Make tax planning suggestions that, even if they don't have a chance of success, will save the client some money in the short-term
 - d. Never develop tax shelters
 - e. Only be professional accountants

ANSWER: a

5. A collateralized debt obligation (CDO):
- Is an insurance policy that any investor can purchase
 - Is a bond that is secured by a portfolio of mortgages
 - Protects an investor in the event that the issuer of the mortgage defaults on the contract
 - Acts as a hedge against changes in interest rates
 - Were outlawed with the passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

ANSWER: b

6. Which of the following is not a sign of an ethical collapse within an organization, according to Marianne Jennings?
- Pressure to meet financial goals
 - Hubris
 - Neptotism, favoritism and hiring sycophants
 - An open and candid organizational culture
 - Weak boards of directors

ANSWER: d

7. The *U.S. Federal Sentencing Guidelines* were introduced in 1991 to:
- Help judges formulate sentences.
 - Avoid sentences that are too light.
 - Signal potential sentences to executives and directors.
 - Encourage executives and directors to avoid environmental damage.
 - All of the above.

ANSWER: e

8. Due diligence programs developed to reduce penalties levied under the *U.S. Federal Sentencing Guidelines* for environmental harm did not include:
- Awareness programs for employees.
 - Guidelines for employees.
 - Compliance oversight by corporate officials.
 - Rewards for non-compliance.
 - Encouragement for whistleblowers.

ANSWER: d

9. Which of the following financial crises or fiascos were not related to the Subprime Lending Crisis?
- Bear Stearns

- b. Lehman Brothers
- c. Bernie Madoff
- d. AIG
- e. Galleon Group

ANSWER: c and e

10. Which was the largest fraud or bankruptcy leading to the crisis of investor confidence in 2002?
- a. Enron
 - b. Global Crossing
 - c. WorldCom
 - d. HIH Insurance
 - e. Xerox

ANSWER: WorldCom

11. The crisis in investor confidence in 2002 was caused by:
- a. Lack of integrity of business leaders.
 - b. Manipulation of financial results.
 - c. Boards of Directors that did not provide proper oversight.
 - d. Findings of alert auditors
 - e. All of the above.

ANSWER: a, b, and c.

12. SOX contained sections with regard to the audit and/or audit committee that were designed to:
- a. Increase the independence of management.
 - b. Increase the financial literacy of audit committee members.
 - c. Limit the conflicts of interest related to the services an auditor can perform.
 - d. Restrict the ability of auditors to serve on the audit committee.
 - e. All of the above.

ANSWER: b and c

13. The U.S. Internal Revenue Service (IRS) implemented *Circular 230* to remedy problems found with regard to the marketing of tax shelters thought to:
- a. Have no other purpose except to reduce taxes.
 - b. Have lower than 50% chance of success if challenged by the IRS.
 - c. Not be in accordance with client's needs.
 - d. Create fictitious losses.
 - e. All of the above

ANSWER: e

14. Why didn't investors caught in the Subprime Lending Crisis take earlier note of the risks inherent in investments known as collateralized debt obligations (CDOs)?
- Greed and the desire for high returns.
 - Banks were selling and buying them.
 - Risks were buried in complex, jargon-oriented documents.
 - Risks were diversified over many mortgages.
 - Only three of the above.

ANSWER: a, b, c, and d

15. The U.S. Government created the *Troubled Asset Relief Program* (TARP) to:
- Bail out investors in U.S. financial firms and institutions.
 - Avoid a worldwide financial crisis.
 - Stimulate the U.S. economy
 - Resolve the financial crisis in Iceland.
 - Make a profit on the ultimate sale assets bought at a low value.

ANSWER: a, b, and c

16. The *Dodd-Frank Wall Street Reform and Consumer Protection Act* was created after the Subprime Lending fiasco to protect consumers from deceptive practices related to:
- Mortgages
 - Credit cards
 - Cars
 - Financial derivatives
 - All of the above

ANSWER: a, b, and d

17. A *Ponzi* scheme, such as Bernie Madoff ran, is:
- A card game
 - A sound investment scheme
 - A scheme to improve the environment
 - Hard to hide forever
 - None of the above.

ANSWER: d

18. Ralph Nadar contributed to the lack of credibility of corporations by exposing their:
- Excessive bonus schemes
 - Greed
 - Poor car safety
 - Poor environmental record
 - "Seller beware" attitude of toy manufacturers.

ANSWER: c and d Note Ch. 2 discusses only c

19. Freddie Mac and Fannie Mae:

- a. Were created to support the U.S. housing market.
- b. Stimulated the U.S. Housing Bubble.
- c. Provided bailout funds to the U.S. Government
- d. Acted in the best interest of consumers
- e. Acted in the best interest of lenders

ANSWER: a and b

20. Which of the following demonstrated extraordinary hubris?

- a. Kenneth Lay
- b. Bernie Ebbers
- c. Arthur Andersen
- d. Scott Sullivan
- e. All of the above.

ANSWER: a and b