

Chapter 13

Governance, Accountability, and Compliance

CHAPTER SUMMARY

The modern corporation is a remarkable form of economic organization that enables everyone in society to interact for mutual gain. Ideally, everyone should benefit from the wealth-creating power of business corporations. For corporations to function and provide their benefits, several problems must be solved. First, corporations must be controlled so that investors, employees, customers, suppliers, and other groups that participate in productive activity are protected. This is the task of corporate governance. Second, there must be a control environment within the corporation to detect and deter employee misconduct. This is the task of corporate ethics. Third, corporations must be held accountable so that corporate executives do not engage in fraud or other wrongdoing. In addition to corporate governance, this task is addressed by accounting and auditing, a corporation's board of directors, and the criminal law. When an economic system combines all of these elements together—corporate governance, corporate ethics, and corporate accountability—the results can be a prosperous society. Where one or more of the elements is absent, the corporation cannot achieve its full potential.

CHAPTER OBJECTIVES

- 13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders
- 13.2: Critique how financial reporting, corporate management roles, and the law function to prevent fraud and other kinds of corporate misconduct, and the flaws in the system that have allowed major scandals
- 13.3: Evaluate the components of corporate ethics programs, the federal guidelines designed to punish and prevent misconduct, and how adopting a code of ethics benefits companies

SUGGESTED DISCUSSION PROMPTS

- 1. Is a corporation's charitable giving a corporate function, or is it something extra?
- 2. Do corporations exist merely to facilitate transactions, or is there some other reason for their being?
- 3. What advantages does the stakeholder theory of corporate control have over the shareholder theory?
- 4. What should corporations emphasize and incorporate in their ethics programs?
- 5. What is the role of federal sentencing guidelines in enhancing fairness?

ASSESSMENT FOR IN-CLASS USE

Multiple Choice Questions

Choose the BEST possible answer for each of the following.

1. Shareholders have governance over a company in return for _____.
 - A. influence
 - B. capital
 - C. prestige
 - D. advertising

Correct Answer: B

13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders

Topic/Concept: Corporate Governance

Difficulty Level: Easy

Skill Level: Understanding

2. The property rights theory of corporations has it that incorporation _____.
 - A. is a general aspect of ownership
 - B. is a matter of owning enough capital
 - C. should be accompanied by rules
 - D. is anyone's right

Correct Answer: A

13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders

Topic/Concept: Corporate Governance

Difficulty Level: Easy

Skill Level: Understanding

3. Although Electronics, Inc. has a code of ethics for its subcontractors, it has experienced issues with its government contracts. Several subcontractors have been embroiled in scandals involving unethical conduct. Most recently, a subcontractor falsified thousands of dollars in work orders. If Electronics, Inc. wants to show the government that it is serious about preventing unethical conduct, it should _____.
 - A. educate subcontractors about its expectations and monitor them for compliance
 - B. emphasize that it bears little responsibility for the subcontractor's behavior because the subcontractor is not an employee by law
 - C. warn subcontractors about the perils of getting caught
 - D. provide proof of its code of ethics which prohibits unethical conduct

Correct Answer: A

13.3: Evaluate the components of corporate ethics programs, the federal guidelines designed to punish and prevent misconduct, and how adopting a code of ethics benefits companies

Topic/Concept: Corporate Compliance

Difficulty Level: Moderate

Skill Level: Evaluate

4. Accountants, Inc. wishes to expand its accounting practice to include both consulting and auditing services. Which aspect of its strategy should be examined more closely?
- A. The accounting firm has failed to take into account that auditing is more lucrative than consulting.
 - B. Hiring an accounting firm for consultation can be problematic because it is not a widely accepted business practice.
 - C. CPAs are not qualified to give advice beyond accounting and financial matters.
 - D. Conflicts of interest are likely to arise from offering both services to one client.

Correct Answer: D

13.2: Critique how financial reporting, corporate management roles, and the law function to prevent fraud and other kinds of corporate misconduct, and the flaws in the system that have allowed major scandals

Topic/Concept: Corporate Accountability

Difficulty Level: Moderate

Skill Level: Analyze

5. Adolf Berle argued against public responsibility of a corporation on the basis of _____.
- A. the rights of stakeholders
 - B. limiting the power of shareholders
 - C. excessive managerial power
 - D. corporations' impact on society

Correct Answer: C

13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders

Topic/Concept: Corporate Governance

Difficulty Level: Easy

Skill Level: Understanding

6. Although ABC Corporation has a comprehensive ethics program, several of its employees have been charged with financial fraud. If ABC is subsequently convicted of the crime and sentenced under the Federal Sentencing Guidelines, it

can expect _____.

- A. strict sanctions without the possibility of leniency
- B. lenient sanctions because it has a comprehensive ethics program
- C. standard sanctions regardless of its comprehensive ethics program
- D. reassurance of no sanctions because it has a comprehensive ethics program

Correct Answer: B

13.3: Evaluate the components of corporate ethics programs, the federal guidelines designed to punish and prevent misconduct, and how adopting a code of ethics benefits companies

Topic/Concept: Corporate Compliance

Difficulty Level: Moderate

Skill Level: Evaluate

7. The central argument for shareholder control of a company states that _____.
- A. companies without shareholders are not likely to be profitable
 - B. shareholders have the most to lose in their company involvement
 - C. shareholders are more likely than management to operate a company profitably
 - D. management can only control a company insofar as they are paid by it

Correct Answer: B

13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders

Topic/Concept: Corporate Governance

Difficulty Level: Easy

Skill Level: Understanding

8. According to stakeholder theory, _____.
- A. stakeholders invest the most capital in a corporation
 - B. a company ought to be run to the benefit of everyone involved in it
 - C. everyone involved in a company should be treated as shareholders
 - D. ownership of a company should be divided among all stakeholders

Correct Answer: B

13.1: Identify the moral arguments and legal rules for shareholders' control of publicly held corporations, and the additional considerations for protecting the interests of other stakeholders

Topic/Concept: Corporate Governance

Difficulty Level: Easy

Skill Level: Understanding

9. Unethical business conduct usually arises from _____.
- A. ignorance of the law
 - B. unscrupulous individuals acting alone

- C. attempts to cheat shareholders of their dividends
- D. the way that an organization as a whole operates

Correct Answer: D

13.2: Critique how financial reporting, corporate management roles, and the law function to prevent fraud and other kinds of corporate misconduct, and the flaws in the system that have allowed major scandals

Topic/Concept: Corporate Accountability

Difficulty Level: Moderate

Skill Level: Analyze

10. An effective corporate ethics program should include _____.
- A. standards that have been communicated to all levels
 - B. oversight given to a few individuals
 - C. training in all of the relevant laws
 - D. reporting of all procedures to the public

Correct Answer: A

13.2: Critique how financial reporting, corporate management roles, and the law function to prevent fraud and other kinds of corporate misconduct, and the flaws in the system that have allowed major scandals

Topic/Concept: Corporate Accountability

Difficulty Level: Moderate

Skill Level: Analyze

Essay Questions

1. Evaluate some key components of corporate ethics programs and how they promote ethical conduct.

13.3: Evaluate the components of corporate ethics programs, the federal guidelines designed to punish and prevent misconduct, and how adopting a code of ethics benefits companies

Topic/Concept: Corporate Compliance

Difficulty Level: Moderate

Skill Level: Evaluate

2. Examine the reasoning behind the Sarbanes-Oxley Act and the ways in which it prevents accounting fraud.

13.2: Critique how financial reporting, corporate management roles, and the law function to prevent fraud and other kinds of corporate misconduct, and the flaws in the system that have allowed major scandals

Topic/Concept: Corporate Accountability

Difficulty Level: Moderate
Skill Level: Analyze

3. Explain the reasons why shareholder theory of control better accounts for interest protection than stakeholder theory.

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Difficulty Level: Moderate

Skill Level: Analyze