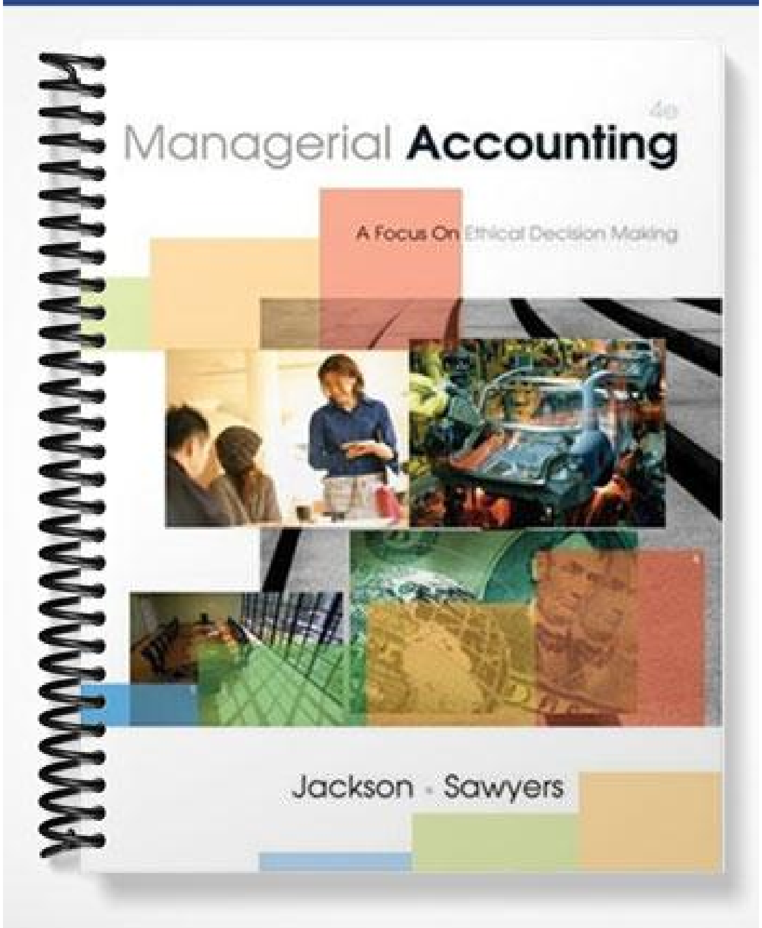
TEST BANK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Managerial Accounting
A Focus On Ethical Decision Making
Jackson · Sawyers

Chapter 2--Corporate Governance and Ethics

Student: ____

1. The main objective of *corporate governance* is to:
A. make sure employees are working as efficiently as possible.
B. make management more accountable to employees, stockholders, and others interested in the company.
C. make sure the a company's stock price is not overvalued.
D. reduce the use of internal controls throughout the organization.

2. Individuals who serve on a company's *audit committee* should be:
A. internal auditors of the company.
B. external auditors of the company.
C. either employees, managers, or stockholders of the company.
D. individuals who have no significant business relationship with the company.

3. Which of the following statements is *true* regarding internal control?
A. Some companies may eliminate internal control policies if their costs outweigh their benefits.
B. Effective internal control policies guarantee that a company's goals and objectives will be achieved.
C. Internal control is comprised of two elements - risk assessment and monitoring.
D. All companies are required to following the same set of internal control procedures.

4. The most widely used internal control framework in the United States was developed in 1992 by:
A. the Securities and Exchange Commission (SEC).
B. the Internal Revenue Service (IRS).
C. the New York Stock Exchange (NYSE).
D. the Committee of Sponsoring Organizations (COSO).

5. Which of the following factors is *least* likely to contribute to the internal control environment within a company?
A. Attitude and general philosophy of the board of directors towards internal control.
B. Attitude and general philosophy of stockholders towards internal control.
C. Attitude and general philosophy of management towards internal control.
D. Attitude and general philosophy of customers towards internal control.

6. What occurred in 2002 to significantly increase the oversight role of a company’s board of directors with respect to internal controls?
A. The creation of the Securities and Exchange Commission (SEC).
B. The passage of the Sarbanes-Oxley Act.
C. The creation of an internal control framework by the Committee of Sponsoring Organizations (COSO).
D. The creation of the Financial Accounting Standards Board (FASB).

7. Which of the following items is *not* required by the Sarbanes-Oxley Act of 2002?
A. A company’s external financial statement auditor is responsible for determining the internal control procedures the company must have in place.
B. Management must provide certifications about internal controls over financial reporting.
C. Management must make an assessment regarding the effectiveness of their internal controls.
D. Companies must allow employees to make complaints about accounting and auditing matters directly to members of the audit committee.

8. Which of the following statements is *true* regarding the Sarbanes-Oxley Act of 2002?
A. Due to the lack of possible criminal penalties, companies have little incentive to follow the requirements of the act.
B. Only employees classified as upper-level management may take complaints to the company’s audit committee.
C. The external financial statement auditor bears all responsibility for creating the internal control policies the company should follow.
D. It requires management to make an assessment regarding the effectiveness of their internal controls.

9. Which of the following statements is *false* regarding board of directors for public companies?
A. Board of directors should ascertain whether management is looking out for the best interests of the company as a whole rather than their own best interests.
B. Board of directors serve as a liaison between a company’s management and its stockholders.
C. Board of director members should be employees of the company.
D. Board of directors have seen their role become more important since the passage of the Sarbanes-Oxley Act.

10. Which of the following statements is *true* regarding risk assessment?
A. Risk assessment is not normally part of internal control.
B. Management should focus primarily on assessing risks that might occur by lower-level employees.
C. Management is required to only assess risk every three years.
D. Management is required to evaluate the potential impact and likelihood of risks that affect the company.

11. Which of the following is *not* one of the general internal control activities that companies often use?
A. Safeguarding of assets
B. Transaction authorization
C. Segregation of duties
D. Gaining a competitive advantage over the competition

12. Ideally, segregation of duties requires which duties to be segregated?
A. Managerial and financial accounting duties
B. Manufacturing and selling and administrative duties
C. Computerized recordkeeping and manual recordkeeping duties
D. Recordkeeping, custody, and authorization duties

13. Which of the following is *not* an example of an internal control procedure?
A. Timely bank reconciliations
B. The use of sequentially numbered sales tickets
C. Manager bonuses associated with high levels of sales
D. Bar coding of inventory

14. Which of the following internal controls would *not* reduce the likelihood of unauthorized data access in a technology-intensive environment?
A. Keeping computers on 24 hours per day.
B. Using passwords to gain access to sensitive data.
C. Using a firewall to limit access to computer network systems.
D. Moving critical data to a separate server that is not connected to the internet.

15. Which of the following statements is *true* regarding the impact that information technology has had on internal controls?
A. It has introduced new risks.
B. It has reduced the likelihood of internal control failure.
C. Internal control procedures that were used before information technology became prevalent no longer need to be followed.
D. It has not altered the way management approaches internal control.

16. Who sets the tone for ethical behavior in an organization?
A. Internal auditors
B. Audit committee
C. Upper management
D. Stockholders

17. Stakeholder analysis normally includes all of the following steps *except*:
A. Understanding the nature of each stakeholder’s interests.
B. Developing strategies to address the demands of stakeholders.
C. Assessing each stakeholder’s power and influence.
D. Assessing the ethical values of each stakeholder.

18. All of the following statements about stakeholder analysis are true *except*:
A. Stakeholder analysis can be used by a company to identify how a particular action or decision might affect employees, customers, suppliers, and owners.
B. Stakeholder analysis is a framework for analyzing ethical dilemmas.
C. Stakeholder analysis is a type of financial statement analysis and can be used to analyze company profitability.
D. Stakeholder analysis can be used by a company to determine its responsibility to employees and owners.

19. The portion of a company’s ethics program which lays out specific rules or standards of behavior for various business situations is called:
A. the mission statement.
B. the corporate philosophy statement.
C. the code of conduct.
D. the articles of incorporation.

20. Where do most companies assert their commitment to key stakeholders?
A. In their mission statement.
B. In their code of conduct.
C. In their articles of incorporation.
D. In their financial statements.

21. Which of the following statements regarding fraud is *false*?
A. Fraud perpetrated by higher-level management is harder to detect than that of lower-level employees.
B. Fraud is often committed unknowingly by employees.
C. The most common type of fraudulent financial reporting involves the overstating of revenues and assets and the understating of liabilities.
D. Adequate internal control systems can usually detect or prevent most types of employee fraud.

22. Which of the following statements is the *best* description of fraudulent financial reporting?
A. Fraudulent financial reporting involves the misappropriation of assets.
B. Fraudulent financial reporting only involves the intentional misstatement of amounts owed to the Internal Revenue Service.
C. Fraudulent financial reporting is brought about by the misuse of a company’s assets.
D. Fraudulent financial reporting often involves the intentional misstatement of or omission of significant information from a company’s financial statements.

23. The most common types of fraudulent financial reporting involve overstating:
A. liabilities and expenses.
B. direct materials and overhead.
C. revenues and assets.
D. liabilities and revenues.

24. If a company has decided to issue fraudulent financial statements, which type of account is *most* likely to be understated?
A. Assets
B. Revenues
C. Expenses
D. Owner’s equity

25. Fraud involving upper-level management:
A. is less likely to harm the company than fraud by lower-level employees.
B. usually results in revenues and assets being understated on the financial statements.
C. is much more difficult to detect than fraud by lower-level employees.
D. is more likely to happen when a company has internal control procedures in place.

26. Fraudulent financial reporting involves the active involvement of a company’s:
A. creditors.
B. stockholders.
C. customers.
D. management.

27. Which of the following is *not* an example of fraudulent financial reporting?
A. Net income on the income statement is intentionally overstated.
B. The company's annual report omits required disclosures required by generally accepted accounting principles.
C. The company controller allowed herself to receive additional compensation that had not been approved by the Board of Directors.
D. Liabilities on the balance sheet are intentionally understated.

28. Which of the following is more of an example of fraudulent financial reporting rather than misappropriation of assets?
A. Kiting
B. Lapping
C. Overstatement of revenues
D. Embezzlement of funds

29. Which of the following situations is the *best* example of fraud being committed?
A. During the year, management over-applied manufacturing overhead to products.
B. The manager in charge of purchasing materials did not try to get the best price on those materials from suppliers.
C. A cashier inadvertently gave too much change back to a customer from their purchase.
D. Without proper authorization, an employee uses a company vehicle for personal reasons.

30. Which of the following situations is *not* an example of fraud?
A. During the year, management estimated total overhead costs of $50,000 for purposes of the overhead application rate, but at the end of the year, total overhead costs were actually computed to be $58,000.
B. Without permission, an employee with access to company materials took home less than $10 worth of company materials.
C. A district manager intentionally reported $50 too much on his expense report for reimbursement of travel expenditures.
D. Management intentionally recorded the sale of a product in 2005 instead of 2006 in order to overstate net income.

31. ____ occurs when two or more people work together to commit fraud.
A. Embezzlement
B. Kiting
C. Lapping
D. Collusion

32. Which of the following controls would be best for reducing the incidence of **lapping**?
A. Securing of assets
B. Segregation of duties
C. Computer encryption of sensitive data
D. Setting up a firewall for network access

33. Which of the following would be best for reducing the incidence of employee theft of merchandise?
A. Transaction authorization
B. Timely bank reconciliations
C. Safeguarding of assets
D. Supervisor review of timecards

34. Which of the following is *not* one of the three general categories of forces that make up the **fraud triangle**?
A. Internal control procedures
B. Opportunities
C. Situational pressures
D. Personal characteristics

35. The most common financial motivation for fraud is:
A. opportunity.
B. greed.
C. a poor credit rating.
D. inflation.

36. Which of the following is *least* likely to be in place when a company has fraud committed by its employees?
A. Collusion between employees and a third party.
B. Inadequate internal controls.
C. Management override of internal controls.
D. Aggressive antifraud programs and policies.

37. Which of the following strategies would be best for combating fraud?
A. Allowing the same employee who approves transactions to also record those transactions and maintain custody of any assets involved.
B. Trusting only top-level employees.
C. Conducting background checks for employees.
D. Performing independent reviews of employees’ work as infrequently as possible.

38. Why is corporate governance important? List some of the internal and external forces that shape a company's corporate governance system.

39. Define corporate governance. Why would one set of corporate governance processes not be appropriate for every company?

40. List three specific ways that assets can be safeguarded from misappropriation.

41. List two specific and unique risks that a business operating in a technology-intensive environment would be more likely to be exposed to than a company that does not operate in that environment.

42. What are the five related elements of internal control?

43. How can risk assessment and control activities help to reduce fraud within a company?

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47. Stakeholder analysis can be used to evaluate ethical dilemmas. List the 5 steps a company would follow when performing a stakeholder analysis.

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49. What are the three primary types of codes of ethics?

50. What are the three crucial ways a company should respond to ethics violations?

51. What are the two critical elements in the legal definition of fraud?

52. What precipitated the passage of the Sarbanes-Oxley Act of 2002 and what are some of its provisions?

53. How does employee fraud differ from management fraud?

54. List and describe the two general types of fraud that companies and their stakeholders should be concerned about?

55. What is "lapping" and how can it be prevented?

56. What is a possible cause of fraudulent activity by management?

57. List and briefly describe the three forces (often depicted as the fraud triangle) that cause fraudulent activity to occur?

58. Describe a situation where an employee might feel justified in committing fraud against a company.

59. How can a company reduce the risk of employee fraud?

60. How can the management of a company help to reduce fraud within the company?

61. J.R. works as a cashier for a large discount retail store. J.R.'s good friend, Eva, has approached J.R. with a scheme whereby Eva will pretend to purchase and pay for an item in J.R.'s cashier lane, but will really take the item home without paying for it. Later, J.R. and Eva can sell the item on an online auction site for cash. Eva has assured J.R. that her scheme is "foolproof".

Required:

What internal controls would you suggest to assist management in eliminating this opportunity for theft?

62. Pamela works as a cashier for a large discount retail store. Pamela has recently run up a lot of credit card debt and is now desperate to obtain enough cash to pay off the debt. Pamela's friend, Maurice, has suggested that Pamela steal inventory from her store and then allow Maurice to return the stolen inventory back to the store for a refund.

Required:

What internal controls would you suggest to assist management in eliminating this opportunity for theft?

63. Ed F. is a store manager for a local consumer electronics chain. At the end of each year, Ed is eligible to receive a bonus contingent upon his store's sales performance. In the current year, mainly due to the local economy, Ed's store has experienced a decrease in sales. Ed is fearful that his year-end bonus will not be large enough and, as a result, he has decided to record fictitious credit sales at the end of the year in order to boost his store's profits.

Required:

What internal controls would you suggest to assist upper-level management in eliminating this opportunity for fraudulent financial reporting?

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B. Trusting only top-level employees.
C. Conducting background checks for employees.
D. Performing independent reviews of employees' work as infrequently as possible.

38. Why is corporate governance important? List some of the internal and external forces that shape a company’s corporate governance system.

Corporate governance is important because it makes management more accountable to employees, stockholders, and others interested in the company. Both internal and external forces shape a company’s system of corporate governance.

Internal forces include: the board of directors, various committee on the board (ex. audit committee), internal audit department, compensation and incentive programs, corporate codes of conduct, and conflict of interest policies.

External forces include: local, state, and federal laws and regulations, generally accepted accounting principles, creditors, and stockholders.

39. Define corporate governance. Why would one set of corporate governance processes not be appropriate for every company?

Corporate governance includes the processes used by a company to promote fairness, complete and accurate financial disclosures, and management accountability.

Companies face different internal and external forces. These forces help shape the corporate governance process. Companies differ in many ways. They have different management structures, differences sizes, different complexity of operations, different stakeholders, and they face different business risks. Corporate governance processes should be tailored to fit the circumstances of the company.

40. List three specific ways that assets can be safeguarded from misappropriation.

Examples may include: (*pick three*)

- Locked vaults and safes.
- Locked doors and windows.
- Password-protected computer equipment.
- Security systems.
- Inventory anti-theft tags.
- Inventory bar codes.
- Limit cash on hand. Timely bank deposits.
- Timely bank reconciliations.

41. List two specific and unique risks that a business operating in a technology-intensive environment would be more likely to be exposed to than a company that does not operate in that environment.

Examples may include: (*pick two*)

- Customer impersonation.
- Denial-of-service attacks.
- Unauthorized access to data.
- Sabotage by former employees.
- Threats by current employees.

42. What are the five related elements of internal control?

The five related elements of internal control are: ***the control environment***, ***risk assessmen***t, ***control activities***, ***information and communication***, and ***monitoring***.

43. How can risk assessment and control activities help to reduce fraud within a company?

Risk assessment and control activities involve identifying potential risks to the organization and ways to minimize or manage those risks. Internal risks can be minimized with the cooperation of upper management and affected employees. Minimizing external risks requires understanding competitive pressures facing a company and its managers, and the impact of new products, technology changes, and changes in laws and regulations on a company. Risk assessment helps a company to focus on high risk areas so that the company is less vulnerable to the occurrence of fraud and other irregularities.

44. Provide two examples of internal control procedures.

Answers may include: (*pick two*)

- Reviewing financial reports that compare actual results to budgeted amounts.
- Checking the accuracy of recorded transactions.
- Segregation of duties between employees so that people who authorize transactions do not also record them and have access to related assets.
- Securing assets such as cash, inventory, and property, plant and equipment.
- Comparing financial data with other supporting data such as sales documents and shipping documents.

45. For segregation of duties to be most effective, what duties should be segregated?

Companies should segregate duties related to recordkeeping, custody, and authorization. For example, employees who authorize transactions should not also record or have access to them.

46. List two internal control procedures unique to a company engaged in a technology-intensive environment.

Examples may include: (*pick two*)

- Passwords to limit access to computer systems.
- Firewalls to limit access to computer networks.
- Encryption of sensitive data.
- Moving critical data to a server not connected to the internet.
- Shutting off computers during nonbusiness hours.
- Staying up-to-date with technology.

47. Stakeholder analysis can be used to evaluate ethical dilemmas. List the 5 steps a company would follow when performing a stakeholder analysis.

1. Identify stakeholders.
2. Understand the nature of each stakeholder’s interests.
3. Assess each stakeholder’s power and influence.
4. Assess the social, legal, ethical and economic responsibilities to the various stakeholders.
5. Develop strategies to address the demands of stakeholders.

48. List two specific ethics programs that companies use to promote and maintain an ethical business environment?

Common ethics programs include: (*pick two*)

- Written codes of ethics.
- Employee hotlines and ethics call centers.
- Ethics training.
- Process to register anonymous complaints about wrongdoing.
- Ethics offices.

49. What are the three primary types of codes of ethics?

The three primary types of codes of ethics are: ***code of conduct***, ***credo or mission statement***, and ***corporate philosophy statement***.

50. What are the three crucial ways a company should respond to ethics violations?

The three crucial ways a company should respond to ethics violations are:

- Carefully and thoroughly monitor the apparent violation.
- React in a timely manner to the possible or actual violation.
- Administer sanctions appropriate for the violation.

51. What are the two critical elements in the legal definition of fraud?

The two critical elements are ***knowledge*** and ***intent***. Fraud is generally defined as a knowingly false representation of a material fact made by a party with the intent to deceive and induce another party to justifiably rely on the representation to his or her detriment.

52. What precipitated the passage of the Sarbanes-Oxley Act of 2002 and what are some of its provisions?

The Sarbanes-Oxley Act was passed in 2002 as a result of corporate scandal - specifically, the scandal related to Enron in late 2001. The scandal involved not only Enron but their external auditors, Arthur Andersen, as well.

Sarbanes-Oxley includes several significant provisions, including:

- Requiring management to provide certification regarding the internal controls over their financial reporting.
- Requiring management to make an assessment about the effectiveness of their internal controls.
- Requiring the company’s external auditors to attest to the company’s internal controls and their effectiveness.
- Increasing the criminal penalties associated with financial statement fraud.
- Allowing company employees to make complaints about accounting and auditing matters without the fear of harassment or discrimination.

53. How does employee fraud differ from management fraud?

Employee fraud typically involves the theft of cash or other assets of an organization. It is often carried out for the personal benefit of the employee. It may involve large or small amounts. The likelihood of the fraud being detected will be greatly determined by the amount involved and the level of the employee. For example, small amounts are less likely to be discovered than large amounts, and fraud by upper-level management is less likely to be discovered, at least in a timely manner, than fraud by lower-level employees.

Management fraud typically results from pressure on management to report good operating results. This pressure may come from stockholders to meet earnings expectations but may also be a result of unrealistic sales goals or other budgets set internally or compensation plans that are tied directly to the financial results of the organization. The most common type of fraudulent financial reporting involves overstating revenues and assets and understating liabilities.

54. List and describe the two general types of fraud that companies and their stakeholders should be concerned about?

Companies and their stakeholders are concerned about ***fraudulent financial reporting*** and ***misappropriation of assets***.

Fraudulent financial reporting in the intentional misstatement or omission of material and significant information from a company's financial statements. It often requires management involvement. It may involve misstated amounts or inadequate or missing disclosures.

Misappropriation of assets involves the theft of a company's assets. It may involve lower-level or high-level employees and involve large or very small amounts.

55. What is "lapping" and how can it be prevented?

Lapping is a technique to cover up the misappropriation of cash. It involves having an employee (or employees if there is collusion) having access to both cash receipts and the recording of those receipts. Lapping is accomplished when the cash received from a customer is stolen, and to cover up the fact, cash received from a different customer is applied towards the first customer's account. The scheme will continue as long as sufficient cash is being received from customers to cover up the stolen cash. It can be prevented by segregation of duties whereby the employee in charge of collecting cash from customers does not have access to the accounting records where those collections are recorded.

56. What is a possible cause of fraudulent activity by management?

Management fraud typically results from pressure on management to report good operating results. This pressure may come from stockholders expectations with regard to earnings or it may come from unrealistic sales goals or budgets set internally or compensation plans that are tied directly to the financial results of the organization.

57. List and briefly describe the three forces (often depicted as the fraud triangle) that cause fraudulent activity to occur?

The three forces are ***situational pressures and incentives, opportunities, and personal characteristics and attitudes***.

Situational pressures and incentives often provide the motivation for employees to commit fraud. The most common example is greed.

Opportunities are the conditions or circumstances that allow employees to commit fraud - usually a result of weak or missing internal controls.

Personal characteristics and attitudes influence the psychological mind-set that employees rely on to justify fraud.

58. Describe a situation where an employee might feel justified in committing fraud against a company.

Answers will vary. Employees may convince themselves that are “entitled” to the asset they have misappropriated because of feeling underappreciated, or not received an anticipated promotion. They may feel that “no one is really getting hurt.” They may even think they are simply “borrowing” the misappropriated asset because they have the intention of paying it back.

59. How can a company reduce the risk of employee fraud?

Individuals engage in fraudulent activity as a result of an interaction of situational pressures, opportunities, and personal characteristics. Although personal characteristics of employees and managers are difficult to control, situational pressures and certainly opportunities for fraudulent behavior can be controlled to a certain extent through policies and procedures known as <u>internal control</u>. Internal control is comprised of five elements: the control environment, risk assessment, control activities, information and communication, and monitoring. In addition, fraudulent activity can be combated by establishing <u>employee hotlines</u>, <u>conducting background checks of employees</u>, <u>fraud awareness training programs</u>, and <u>establishing a code of conduct</u>.

60. How can the management of a company help to reduce fraud within the company?

Answers will vary, but may include: set a tone of highly ethical behavior, rewarding ethical behavior, establishing an internal audit department, and establishing a corporate code of ethics.

61. J.R. works as a cashier for a large discount retail store. J.R.'s good friend, Eva, has approached J.R. with a scheme whereby Eva will pretend to purchase and pay for an item in J.R.'s cashier lane, but will really take the item home without paying for it. Later, J.R. and Eva can sell the item on an online auction site for cash. Eva has assured J.R. that her scheme is "foolproof".

Required:

What internal controls would you suggest to assist management in eliminating this opportunity for theft?

Answers will vary. Possible internal controls would include:

- Random inspections by managers to ensure that all items are properly rung up. This could be accomplished by comparing the customer's receipt with the items that are in the customer's bag.
- Video monitoring of cashier stations to ensure that items are properly rung up.
- Attaching computer chips or security tags to inventory items that can only be deactivated if the inventory is scanned and rung up by the cashier. If the chip/tag is not deactivated, an alarm will go off when the customer walks out of the store.
- Audible beeps that can be heard when inventory is scanned.
- Offering incentives to employees to report violations that they see occur.

62. Pamela works as a cashier for a large discount retail store. Pamela has recently run up a lot of credit card debt and is now desperate to obtain enough cash to pay off the debt. Pamela's friend, Maurice, has suggested that Pamela steal inventory from her store and then allow Maurice to return the stolen inventory back to the store for a refund.

Required:

What internal controls would you suggest to assist management in eliminating this opportunity for theft?

Answers will vary. Possible internal controls would include:

- Inspections by managers of all employee bags to make sure that any inventory held or taken by an employee has a sales receipt.
- Limiting access to inventory receiving departments by employees.
- Attaching computer chips or security tags to inventory items that can only be deactivated if the inventory is scanned and rung up by the cashier. If the chip/tag is not deactivated, an alarm will go off when the customer/employee walks out of the store.
- Audible beeps that can be heard when inventory is scanned.
- Offering incentives to employees to report violations that they see occur.
- Allowing only managers to accept returned merchandise and requiring a receipt or proof of purchase for all returned merchandise.

63. Ed F. is a store manager for a local consumer electronics chain. At the end of each year, Ed is eligible to receive a bonus contingent upon his store's sales performance. In the current year, mainly due to the local economy, Ed's store has experienced a decrease in sales. Ed is fearful that his year-end bonus will not be large enough and, as a result, he has decided to record fictitious credit sales at the end of the year in order to boost his store's profits.

Required:

What internal controls would you suggest to assist upper-level management in eliminating this opportunity for fraudulent financial reporting?

Answers will vary. Possible internal controls would include:

- Monitor and investigate sudden increases in credit sales.
- Randomly sample documentation to support credit sales.
- Pay cash bonuses several months after sales have been recorded and cash collected from those sales.
- Determine a different bonus plan not dependent on store sales.
- Offering incentives to employees to report violations that they see occur.