LO.a: Describe objectives and core attributes of an effective corporate governance system and evaluate whether a company's corporate governance has those attributes.

1. The *least likely* objective of corporate governance is:
   A. to eliminate or mitigate conflicts of interest, especially between managers and shareholders.
   B. to have well defined manager and director governance responsibilities.
   C. to ensure that the company's assets are used efficiently and productively and in the best interests of its investors and other stakeholders.

2. Which of the following statements is *least accurate*?
   A. One system of corporate governance applies to all firms.
   B. A corporate governance system requires a comprehensive collection of principles and procedures.
   C. Different industries, cultures, economic system and legal environments may influence a company's corporate governance system.

3. Which of the following is not a core attribute of an effective corporate governance system?
   A. Clearly defined guidelines for how company assets must be utilized.
   B. Clearly defined governance responsibilities of managers and directors.
   C. Transparent and accurate disclosures regarding operations, financial position, performance and risk.

LO.b: Compare major business forms and describe the conflicts of interest associated with each.

4. Owner expertise is *least* important for which business form?
   A. Sole proprietorship.
   B. Partnership.
   C. Corporation.

5. The disadvantage in a corporation especially from a corporate governance perspective is:
   A. that corporate investors may not be experts in the business of the corporation.
   B. the difficulty owners face in supervising the firm's management.
   C. that corporations have unlimited life because of transferability of stock ownership.

LO.c: Explain conflicts that arise in agency relationships, including manager-shareholder conflicts and director-shareholder conflicts.

6. Which of the following decisions by management will *least likely* result in a conflict of interest with the shareholders? Managers use funds to
   A. expand business size to increase their control and job security.
   B. invest in high risk projects to increase the value of executive stock options.
   C. invest in projects with positive expected net present value.

7. Which of the following situations will *most likely* cause a conflict between directors and shareholders?
   A. An independent board.
   B. The board members do not have consulting agreements with the company.
   C. Generous remuneration paid to directors irrespective of firm's performance.

LO.d: Describe responsibilities of the board of directors and explain qualifications and core competencies that an investment analyst should look for in the board of directors.

8. All of the following are responsibilities of board members *except*:
   A. to set up clear lines of responsibility and a sound system of accountability.
   B. to ensure that a company's monthly targets are met.
   C. to establish corporate values and governance structures for the company such that business is run ethically and professionally.

9. The *most likely* factor that indicates a lack of independence of Firm A's board is that:
   A. no board member has any personal relationships or affiliations with the firm.
   B. one of the board members of Firm A is the CEO of Firm B and the CEO of Firm A is on the board of Firm B.
   C. no board member has ever been a former employee of the company.

10. In assessing the skill and experience of the board of C&G Corp., a large consumer goods company, it is:
    A. essential that some members of the board have relevant experience in the consumer goods industry.
    B. essential all some members of the board have relevant experience in the consumer goods industry
    C. not necessary that any member of the board have industry experience because management has this expertise.

LO.e: Explain effective corporate governance practice as it relates to the board of directors and evaluate strengths and weaknesses of a company's corporate governance practice.

11. Company Y supports election of its board members on a staggered basis. Corporate governance *best* practice is that the board of directors be elected on a(n):
    A. annual basis.
    B. staggered basis.
    C. quarterly basis.

12. The corporate counsel of Shezin plc. a food and beverage company has the added responsibility of advising the board on matters pertaining to the company's compliance with regulatory requirements. As per effective corporate governance practices, Shezin should:
    A. hire an outside legal counsel for advising the board.
    B. continue with the existing corporate counsel for advising the board.
    C. have one of the directors assume the role of the legal counsel.

13. The compensation committee of Melon Inc., a publicly listed fashion apparel company, grants stock options as performance-based compensation to its senior management. This practice will *least likely* align the interests of managers with those of shareholders if:
    A. appropriate accounting of the expense of stock options, with assumed conversion to stock in the earnings-per-share calculation is done.
    B. grants of stock options are awarded to executives after seeking shareholder approval.
    C. there is a provision allowing "repricing" of stock options, with a downward adjustment of the option exercise price relative to current stock price.

LO.f: Describe elements of a company's statement of corporate governance policies that investment analysts should assess.

14. A statement of corporate governance policies of a company should include all of the following *except*:
    A. statements of management's responsibilities to provide complete and timely information to the board members before board meetings.
    B. statements of management's responsibilities regarding meetings with analysts'.
    C. statements of directors' responsibilities regarding monitoring, and review, covering internal control, risk management, audit and accounting disclosures and other responsibilities.

15. In evaluating the extent of disclosures provided to investors, indicators of *good* quality financial reporting are:
    A. aggressive assumptions used for employee benefit plans.
    B. conservative estimates regarding revenue and expense recognition.
    C. maximum capitalization of interest and overhead costs.

16. The regulatory filings of the company should also have clear and complete information regarding the following items *except*:
    A. governance procedures and policies followed by the company.
    B. compensation policies and amounts awarded, including perquisites, for important senior managers and directors.
    C. organizational culture and supplier contracts.

17. To analyze related-party or insider transactions involving senior employees or directors of the company, an analyst should research the:
    A. company website.
    B. financial disclosures and regulatory filings.
    C. company announcements.

LO.g: Describe environmental, social, and governance risk exposures.

18. The risk not related to a company's exposure to ESG factors is:
    A. operating risk.
    B. legal risk.
    C. credit downgrade risk.

19. The risk of a decline in market value of a company relative to other companies because of the management's lack of concern for managing ESG factors and mitigating risk exposures is *best* known as:
    A. operating risk.
    B. reputational risk.
    C. legal risk.

LO.h: Explain the valuation implications of corporate governance.

20. Strategic policy risk is:
    A. the risk that the financial statement recognition and related disclosures of a firm, are incomplete or misleading.
    B. the risk that the firm's assets will be misused by managers or directors giving themselves excessive remuneration and or perquisites.
    C. the risk that managers of a firm may enter into transactions, or incur business risks which are not beneficial for shareholders, but lead to large payoffs for management or directors.

Solutions

1. B is correct. Choices A & C are the two major objectives of the corporate governance system. B represents a core attribute of an effective corporate governance system. Section 2.

2. A is correct. A single system of effective corporate governance does not apply to all firms in all industries worldwide. Section 2.

3. A is correct. Options B and C represent core attributes of an effective corporate governance system. Option A does not. Section 2.

4. C is correct. Owner expertise is unnecessary for a corporation but essential for sole proprietorship and partnership. Section 3.3.

5. B is correct. The disadvantage with a corporation is the difficulty that shareholders have in monitoring management and the firm's operations. A sole proprietor directly oversees day-to-day business. However, a shareholder of a large corporation cannot possibly monitor business activities and personnel, and exert any control over the firm. Section 3.3.

6. C is correct. Managers making business decisions, such as investing in highly risky ventures, or increasing business size that benefit them but do not increase the wealth of the company's investors result in a conflict of interest with the shareholders. However, investments in positive net present value projects that are beneficial for a firm will not cause a manager-shareholder agency problem. Section 4.1.

7. C is correct. Generous compensation paid to directors can create director-shareholder conflict. Excessive compensation may cause directors to align their interests with the management instead of the investors. Section 4.2.

8. B is correct. Board members are generally concerned with the long term interests of shareholders. Ensuring that short-term targets are met is the responsibility of the management team. Options A and C reflect responsibilities of board members. Section 5.1.

9. B is correct. Interlocking directorships as described in Option B show a lack of independence. Section 5.1.1.

10. A is correct. The board should have some members with expertise in the consumer goods industry. Section 5.1.3.

11. A is correct. Corporate governance best practice generally supports the annual election of directors because this makes it easier for investors to change the slate of directors. Section 5.1.4.

12. A is correct. To hire an outside counsel is important since the board of directors oversees the management on behalf of the shareholders. If the corporate counsel is from within the firm,

he cannot be wholly independent with regard to the advice provided to the directors as he is on Shezin's payroll. Section 5.1.10.

13. C is correct. Repricing of stock options is when the company with the board's approval adjusts downward the exercise price of option grants relative to current price of the stock. This typically happens when the stock price has dropped making the options out-of-the-money. After repricing managers may have at-the-money options, but investors are left with losses. Section 5.1.9.

14. B is correct. Meeting with the firm's analysts is not part of the statement of corporate governance policies. Section 5.1.11.

15. B is correct. Section 5.1.12.

16. C is correct. Reporting organizational structure should be mentioned in the regulatory filings and not organizational culture or supplier contracts. Section 5.1.12.

17. B is correct. Financial disclosures and related notes in regulatory filings are a source for analysts for assessing insider or related-party transactions involving the company's executives and/or directors. Section 5.1.13.

18. C is correct. Section 6.

19. B is correct. Reputational risk is the risk that companies whose managers have shown a lack of concern for managing ESG factors in the past, so as to mitigate risk exposures, will suffer a decline in market value relative to other companies in the same industry. Section 6.

20. C is correct. Strategic policy risk is the risk that managers might enter into transactions, such as mergers and acquisitions, or incur other business risks which are not in the best long-term interest of shareholders, but benefit management or directors in terms of large payoffs. Section 7.