Ethics and Governance – Module 3 Quiz

Here are some easy questions just to test you have understood the main points within this module.

Questions

Question 1

Which of the following statements regarding institutional shareholders is correct?

A These shareholders have extensive power to monitor the activities of the company.

B Institutional shareholders prefer to exert their power privately rather than publicly.

C These shareholders often aim to improve outcomes rather than sell their shareholding.

D Institutional shareholders are known to publicly use their voting power to encourage sound corporate governance.

Question 2

Which of the following regarding corporate governance is correct?

A Corporate governance can temper growth.

B Good corporate governance can result in excessive risk-taking.

C Corporate governance often result in prompt and effective decision-making.

D The aim of corporate governance is to protect the interests of shareholders and the local economies.

Question 3

In terms of the ASX Principles, which of the following regarding the composition of the nomination committee of a listed company is most correct?

A A minimum of three members chaired by an executive director.

B A majority of independent directors chaired by an independent director.

C A majority of three members of whom most are independent directors.

D A minimum of one independent director who also chairs the committee.

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Question 4

Which of the following regarding agency theory is correct?

A Agency theory only applies to large entities.

B Agents act in the best interest of the principal.

C Agents are assumed to be in a position of power.

D Agency theory defines the relationship between agents and directors.

Question 5

Which of the following is not an agency cost?

A Residual loss.

B Bonding costs.

C Congruency loss.

D Monitoring costs.

Question 6

Which of the following regarding residual loss is correct?

A Bonding costs do not have an effect on residual loss.

B Residual loss is incurred by the agent because an agency relationship exists.

C Under agency theory, residual loss can be reduced to zero by good governance.

D A reduction in residual loss is likely to be the result of an increase in monitoring costs.

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Question 7

ABC Ltd is a mining company listed on the Australia stock exchange. It has an audit committee comprising four members. Two members are independent non-executive directors with engineering and mining qualifications. The nomination committee is currently looking to appoint an additional member to the audit committee.

In terms of the ASX principles, which of the following would most likely be the best candidate for appointment?

A An independent non-executive director with a qualification in finance.

B An executive director with a qualification in accounting.

C A non-independent non-executive director with qualifications in accounting and auditing.

D A non-executive director who was previously the CFO of ABC Ltd a year ago.

Question 8

Which of the following is not an example of a duty or responsibility of directors?

A Having a conflict of interest but declaring it to the board of directors.

B Continuing to transact with creditors when the company's liabilities exceed the assets.

C Researching and asking questions relating to the company's operations so as to be informed.

D Choosing to personally carry out instructions from the board rather than requesting subordinates to do so.

Question 9

Consider the following recommendations:

- a minimum of three members;
- chaired by an independent director;
- a majority of independent directors;
- can comprise executive directors.

In terms of the ASX Principles, the above requirements relate to the composition of which committees?

A The nomination and risk committees.

B The audit and remuneration committees.

C The remuneration, audit, risk and nomination committees.

D The remuneration, risk and nomination committees but not the audit committee.

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Question 10

Which of the following descriptions applicable to different types of directors and their independence is incorrect?

A Independent executive director.

B Independent non-executive director.

C Non-independent executive director.

D Non-independent non-executive director.

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Solutions

Question 1: Correct answer is B

Explanation
According to page 174 of the study guide, institutional shareholders prefer to express their power privately because they try to not publicly embarrass the board since they realise that they would need their cooperation.

Institutional shareholders have power in terms of their voting rights but they do not have power to monitor the activities of the company.

Institutional shareholders often prefer to sell rather than maintain their shareholding and trying to improve outcomes.

Institutional shareholders often do not publicly use their voting power and this is actually one of the criticisms of institutional shareholders.

Question 2: Correct answer is A

Explanation
According to page 149 of the study guide, having very stringent corporate governance policies can sometimes mean that there are too many steps and processes to follow before final decisions are made. This causes decisions to take longer to be resolved and can thus temper growth.

Excessive risk taking is incorrect as this is more likely to result from poor governance.

Prompt and effective decision-making is incorrect because having very stringent corporate governance policies can sometimes mean that there are too many steps and processes to follow before final decisions are made. This causes decisions to take longer to be resolved and can thus temper growth.

The aim of corporate governance is broader than just protecting the interests of shareholders and the local economy, so this is incorrect, because it also considers other stakeholders and the international economy.

Question 3: Correct answer is B

Explanation
'As discussed on page 195, Recommendation 2.1 of the ASX Principles and Recommendations states:

The board of a listed entity should have a nomination committee which:

(1) has at least three members, a majority of whom are independent directors; and

(2) is chaired by an independent director.'

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Question 4: Correct answer is C

Explanation

Option A — This is incorrect because agency theory does not just apply to large entities. It applies to all entities, wherever there is separation of ownership and control, irrespective of their size.

Option B — This is incorrect because agents do not naturally act in the best interest of the principal, rather they are likely to act in their own self-interest.

Option C — This is correct because agents are assumed to be in a position of power because one of the two key assumptions that underlie this theory is that agents have the power to make decisions. This is because they have information which gives them this power and the second assumption is that they will use this power to serve their own self-interests.

Option D — This is incorrect because the relationship is not between agents and directors, but between agents and principals. Usually the agents are the directors who are acting for the principals (the shareholders).

Question 5: Correct answer is C

Explanation

Congruency loss is not one of the 3 main agency costs. The three agency costs are monitoring costs, bonding costs and residual loss.

Question 6: Correct answer is D

Explanation

Residual loss is likely to be reduced with increased monitoring because monitoring costs will increase goal congruency as the supervised agent attempts to avoid disciplinary action. There is an inverse relationship between monitoring and bonding costs and residual loss.

Bonding costs do affect residual loss. Higher bonding costs will reduce residual loss while lower bonding costs are likely to increase residual loss.

Residual loss is incurred by the principal not the agent, because if the agent does not perform as expected, then the loss suffered would be borne by the principal.

Residual loss cannot be reduced to zero because the agent will always act in their own self-interest. As such, there will always be a residual loss to some extent.

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Question 7: Correct answer is A

Explanation
As discussed on page 195, Recommendation 4.1 of the ASX Principles and Recommendations states:
The board of a listed entity should have an audit committee which:
(1) has at least three members, all of whom are non-executive directors and a majority of whom are independent directors.'
The requirement is to have a majority of independent non-executive directors.

Currently only two of the four members are independent non-executive and so this requirement is not satisfied.

An additional independent non-executive director needs to be appointed to make it a majority of independent non-executive directors. Therefore, option A is correct as it is the only one that is independent non-executive director.

Question 8: Correct answer is B

Explanation

Option A	As discussed on page 161, continuing to transact with creditors is not an example of a duty or responsibility because directors have a duty to not trade when the company is insolvent. All of the other options are examples of a duty or responsibility of directors.
Option B	Directors should declare their conflicts of interests because it is sometimes unavoidable that a director may have a conflict of interest but it is a duty or responsibility of that director to then disclose the conflict and manage it appropriately.
Option C	Directors should research and ask questions because they are required to have an understanding and know about the company's operations.
Option D	Directors should avoid requesting subordinates to carry out board instructions because they should avoid delegating their responsibilities.

Question 9: Correct answer is D

Explanation
This is discussed on page 195. Also refer to ASX Principles and Recommendations 2.1(a), 4.1(a), 7.1(a) and 8.1(a)

Question 10: Correct answer is A

Explanation
Independent executive director is incorrect because all independent directors must be non-executive directors. Executive means that they are employed in the organisation and thus by definition can never be independent.

All of the other options are correct descriptions of types of directors (independent non-executive, non-independent executive, non-independent non-executive).