
CHAPTER 2
Ethics and the Law

TRUE FALSE QUESTIONS

1. Compliance with the law is the baseline for effective and responsible managerial action.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

2. Boycotting is a way in which customers show displeasure with unethical corporate activity.

ANSWER: True

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

3. Employment-at-will is mandated by federal law.

ANSWER: False

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

4. Ethics and law are unrelated.

ANSWER: False

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

5. The chief executive officer plays the most significant role in instilling a sense of ethics throughout the organization.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

6. Nobel Prize winner in economics Milton Friedman asserts that the only guiding criterion for the corporation should be profitability within the confines of the law.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

7. Employees are not stakeholders of a corporation.

ANSWER: False

SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

8. Although high ethical standards are admirable, it is an accepted fact that ethical behavior reduces corporate performance.

ANSWER: False
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

9. Managers should remember that there is usually only one ethically correct way to look at a situation.

ANSWER: False
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

10. The two main schools of ethical thought are teleological and deontological.

ANSWER: True
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

11. Under the Teleological theory, the ethical good of an action is judged by the effect of the action on others.

ANSWER: True
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

12. The Deontological theory focuses on the consequences of an action rather than on the motivation of the individual.

ANSWER: False
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

13. Utilitarianism is a major deontological system that operates under the proposition that the ideal is to focus on motivation rather than on consequences.

ANSWER: False
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

14. Utilitarianism seeks to equalize the benefit to everyone.

ANSWER: False
SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

15. Utilitarianism operates under the proposition that the ideal is to maximize the total benefit for everyone involved.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

16. Kantian theory considers universalizability and reversibility.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

17. Rawlsian moral theory seeks to develop principles behind a “veil of information.”

ANSWER: False

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

18. Rawlsian moral theory seeks to maximize the condition of the worst off person in society.

ANSWER: True

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

19. Companies may post audits of foreign factories on the Fair Labor Association website.

ANSWER: True

SKILL LEVEL: AACSB Diversity

OBJECTIVE: AICPA Legal

20. Most automakers are members of the Alliance of Automobile Manufacturers, the trade group leading the fight for tougher fuel and emission standards.

ANSWER: False

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

MULTIPLE CHOICE QUESTIONS

1. Which of the following is a federal law passed in 2002 in an attempt to reduce corporate wrongdoing?
- A. The Jones-Whaley Act
 - B. The Glover-Laughlin Act
 - C. The Sarbanes-Oxley Act
 - D. The Corporate Reduction and Ethics Act

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

2. Which of the following is true regarding the relationship between law and ethics?
- A. The law attempts to prohibit all “bad” behavior.
 - B. An action that is unethical is also considered illegal in the U.S.
 - C. Both that the law attempts to prohibit all “bad” behavior and that an action that is unethical is also considered illegal in the U.S..
 - D. An action that is unethical may nonetheless be legal.

ANSWER: D

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

3. What was the result in the case of *Bammert v. Don’s Super Valu, Inc.* discussed in the text involving the firing of the wife of a police officer after the officer had arrested the wife of the owner of Don’s Super Valu store?
- A. That the firing was prohibited because of the at-will employment principle.
 - B. That the firing was legal because of the at-will employment principle.
 - C. That the firing was prohibited because of a public policy exception to the at-will principle.
 - D. That the firing was legal because of the employment contract involved.

ANSWER: B

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

4. As discussed in the text, which of the following is true regarding whether juror’s care about a corporation’s ethical reputation?
- A. Studies have shown that white males are not overly concerned about a corporation’s ethical reputation so long as no actual laws are violated.
 - B. Studies have shown that jurors as a whole are not overly concerned about a corporation’s ethical reputation so long as no actual laws are violated.
 - C. Jurors are concerned about a corporation’s ethical reputation.
 - D. Jurors are concerned about a corporation’s ethical reputation only in the employment arena.

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

5. Which of the following is true regarding the amount in 2005 that the average CEO took home in pay?
- A. The average CEO took home more than 400 times the pay of the average worker.
 - B. The average CEO took home more than 300 times the pay of the average worker.
 - C. The average CEO took home more than 200 times the pay of the average worker.
 - D. The average CEO took home more than 100 times the pay of the average worker.

ANSWER: A

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

6. Which of the following is a term for a psychological disorder by which a person lacks empathy and fails to recognize boundaries and which is discussed in the text as a possible problem within the corporate world?
- A. Prevalent personality disorder
 - B. Narcissistic personality disorder
 - C. Corporate phenomena disorder
 - D. Trial disorder

ANSWER: B

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

7. Which of the following is true regarding the penalties that may be imposed upon corporate executives who defraud investors?
- A. They may be fined but may not be sentenced to jail.
 - B. They may be fined and sentenced to jail.
 - C. They may be fined and sentenced to jail, but for no longer than 1 year.
 - D. They may be fined and sentenced to jail, but for no longer than 6 months.

ANSWER: B

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

8. Which of the following is a company discussed in the text that suffered from corporate wrongdoing by company officials?
- A. Adelphia Communications Corporation
 - B. Tyco International
 - C. Mallicoat Enterprises
 - D. Both Adelphia Communications Corporation and Tyco International, but not Mallicoat Enterprises

ANSWER: D

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

9. Which of the following is a term for a stock option that has a strike price less than the underlying stock's fair market value on the date of the grant?
- A. A price saver option
 - B. An accepted option
 - C. An in the money option
 - D. A true option

ANSWER: C

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

10. Which of the following is the first question managers should ask themselves when determining whether a proposed action is ethical?
- A. Whether it will result in a loss of profits
 - B. Whether stockholders would approve

- C. Whether the CEO would approve
- D. Whether it is legal

ANSWER: D

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

11. Which of the following is the group given the ultimate legal authority to change management?
- A. Shareholders
 - B. Human resource managers
 - C. The mayor in the applicable jurisdiction
 - D. The city council in the applicable jurisdiction

ANSWER: A

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

12. Which of the following is a term for the maximization of shareholder value?
- A. Shareholder importance
 - B. Shareholder primacy
 - C. Value of shares maximization
 - D. Corporate allocation

ANSWER: B

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

13. Which of the following is a term for a statute authorizing boards of corporations to take into account all stakeholders and constituencies even when a change in control or breakup of the corporation has become inevitable?
- A. Corporate control
 - B. Break-up
 - C. Constituency
 - D. Protection

ANSWER: C

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

14. In which of the following are a majority of Fortune 500 companies incorporated?
- A. New York
 - B. California
 - C. Delaware
 - D. Connecticut

ANSWER: C

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

15. Which of the following is a stakeholder of a corporation?

- A. Customers
- B. Employees
- C. Managers
- D. All of the responses are correct

ANSWER: D

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

16. Which of the following is true regarding shareholder primacy?
- A. It is never legally mandated.
 - B. It is always legally mandated.
 - C. It is legally mandated only in very narrow circumstances.
 - D. There is no such thing.

ANSWER: C

SKILL LEVEL: AACSB Analytic

OBJECTIVE: AICPA Legal

17. Which of the following is recognized as the primary obligation of directors of a corporation?
- A. That the obligation of the directors is to manage the corporation for the best interest of the corporation.
 - B. That the obligation of the directors is to manage the corporation for the best interest of the shareholders.
 - C. That the obligation of the directors is to manage the corporation for the best interest of the employees.
 - D. That the obligation of the directors is to manage the corporation for the best interest of the community.

ANSWER: A

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

18. Nobel prize winner Milton Friedman asserts that “social responsibility” is a fundamentally _____ doctrine.
- A. positive
 - B. risky
 - C. good
 - D. subversive

ANSWER: D

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

19. Nobel prize winner Milton Friedman asserts that a corporation is an “artificial person” and therefore has no true responsibilities to any constituent other than
- A. the government.
 - B. its owners.
 - C. its business associates.
 - D. society.

ANSWER: B
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

20. Which of the following statements regarding the teleological theory is false?
- A. Teleological theory is concerned with consequences.
 - B. Teleological theory judges the ethical good of an action by the effect of the action on others.
 - C. Teleological theory focuses more on the motivation and principle behind an action.
 - D. Both that teleological theory is concerned with consequences and that teleological theory judges the ethical good of an action by the effect of the action on others.

ANSWER: C
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

21. Rawls believed that social policies developed behind the veil of ignorance would create a system that most benefits the
- A. Majority
 - B. Minority
 - C. Least well off
 - D. Most well off

ANSWER: C
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

22. According to the Kantian theory of universalizability, the ethical worth of an act is determined by whether one
- A. would want such a rule applied to one's self
 - B. would want everyone to perform in this manner
 - C. could get away with such an action
 - D. could live with the results of such an action

ANSWER: B
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

23. Which of the following is part of Kant's categorical imperative?
- A. The form of an action rather than the intended result determines the ethical worth.
 - B. No one person's interest is given more weight than another.
 - C. Distribution favors the person getting the worst share.
 - D. Both that no one person's interest is given more weight than another and that distribution favors the person getting the worst share.

ANSWER: A
SKILL LEVEL: AACSB Ethics
OBJECTIVE: AICPA Legal

24. Which of the following is not an example of St. Thomas Aquinas' requirements for a law to be just?

- A. Within the power of individuals to fulfill.
- B. Consonant with a reasoned determination of the universal good.
- C. Formed to promote private benefit of the majority.
- D. Widely promulgated.

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

25. According to St. Thomas Aquinas, in order to be just, a human law must be
- A. within the power of individuals to fulfill.
 - B. a law of nature.
 - C. approved by the church.
 - D. written.

ANSWER: A

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

26. According to St. Thomas Aquinas, the only true laws were those that followed _____.
- A. reasoned law
 - B. customary law
 - C. eternal law
 - D. localized law

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

27. Which of the following is true regarding the Organization of Economic Cooperation and Development (OECD)?
- A. It is comprised of nations from North America, Europe, and Asia-Pacific.
 - B. It is a subsidiary of the European Union.
 - C. It is comprised of nations who entered into the North American Free Trade Agreement.
 - D. It is comprised of states inside the U.S.

ANSWER: A

SKILL LEVEL: AACSB Diversity

OBJECTIVE: AICPA Legal

28. Which of the following is true regarding the Organization of Economic Cooperation and Development's code of business conduct?
- A. It requires multinational corporations to act in accordance with the economic, commercial, and social goals and priorities of the host country.
 - B. It requires multinational countries to pay the same wages in the host country as is paid in the home country.
 - C. It requires multinational corporations to borrow only from the host country.
 - D. All of the responses are correct.

ANSWER: A

SKILL LEVEL: AACSB Diversity
OBJECTIVE: AICPA Legal

Fact Pattern 2-1 (questions 29-30 apply)

Susan is an accountant who works in a company owned by Richard. Richard is concerned about the amount of taxes he will owe for the year and asks Susan to falsify his income tax return. Susan refuses. Richard fires her. Susan asks you for advice telling you that Richard is unethical and that she is certain that the law prohibits all unethical conduct.

29. Refer to fact pattern 2-1. Which of the following is the theory on which Richard will most likely rely?
- A. The employer-freedom principle
 - B. The employment-at-will principle
 - C. The free-country theory
 - D. The free-market theory

ANSWER: B

SKILL LEVEL: AACSB Reflective Thinking
OBJECTIVE: AICPA Critical Thinking

30. Refer to fact pattern 2-1. Which of the following is a theory on which Susan may be able to prevail?
- A. Public policy
 - B. Reflective policy
 - C. Implied protection
 - D. No justification

ANSWER: A

SKILL LEVEL: AACSB Reflective Thinking
OBJECTIVE: AICPA Critical Thinking

Fact Pattern 2-2 (questions 31-32 apply)

Wally who has been hired as the human resource manager for a company that has recently formed and started operation comes to you for advice regarding the need for an ethics policy. He tells you that he believes that appointing a lower-level person to address any ethical concerns is sufficient because higher levels in the company do not need to be concerned about anything that does not directly involve a violation of the law.

31. Refer to fact pattern 2-2. What would you tell Wally regarding the relationship between law and ethics?
- A. That law seldom reflects society's consensus about what constitutes appropriate behavior.
 - B. That patterns of unethical behavior tend to result in illegal behavior over time.
 - C. That patterns of unethical behavior tend to result in more onerous business regulation.
 - D. Both that patterns of unethical behavior tend to result in illegal behavior over time and that patterns of unethical behavior tend to result in more onerous business regulation.

ANSWER: D

SKILL LEVEL: AACSB Reflective Thinking
OBJECTIVE: AICPA Critical Thinking

32. Refer to fact pattern 2-2. What would you advise Wally regarding his plan to only have a lower level employee in charge of addressing all ethical issues?
- A. That his idea is a good one and that he should proceed with his plan.
 - B. That his plan is not a good idea because the ethical tone for a company should be set by the head of the company.
 - C. That Wally, as the human resource manager, should set the ethical tone for the company.
 - D. That no one should address ethics because doing so is a waste of corporate funds and that the only concern of the company is compliance with the law.

ANSWER: B

SKILL LEVEL: AACSB Reflective Thinking

OBJECTIVE: AICPA Critical Thinking

Fact Pattern 2-3 (questions 33-34 apply)

Wally and Janice are both managers in a small corporation set up to manufacture sporting goods. They both receive bonuses for any ideas that benefit the company although Janice's bonus is computed at a lower rate than that of Wally because she has been at the company a shorter amount of time. Janice has a great marketing idea that would result in her receiving a bonus of \$1,000. She has it all worked out on her computer. Unknown to her, one evening after business hours, Wally obtains the information from her computer and submits it himself the next day. He is immediately awarded a bonus of \$2,000 for the information. Fortunately for Janice, Sally, a custodian, saw Wally in Janice's office and heard him calling his wife while he was there to brag about his misdoings. Sally informed Blaire, the CEO, of Wally's actions.

33. Refer to fact pattern 2-3. Which of the following types of justice is involved if Blaire requires that Wally give Janice \$1,000?
- A. Compensatory
 - B. Retributive
 - C. Fair
 - D. Justifiable

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Critical Thinking

34. Refer to fact pattern 2-3. Which of the following types of justice is involved if Blaire requires that Wally give Janice the entire \$2,000 bonus he received?
- A. Compensatory
 - B. Retributive
 - C. Fair
 - D. Justifiable

ANSWER: B

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Critical Thinking

35. Monica tells all her employees that she expects them to treat others as they would like to be treated. Which of following is a descriptive term for Monica's requirement?
- A. The Required Rule
 - B. The Accepted Rule
 - C. The Golden Rule
 - D. The Advanced Rule

ANSWER: C

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Critical Thinking

ESSAY QUESTIONS

1. Art, the sole shareholder of ABC Company, got a ticket for reckless driving because he was speeding through a school zone at 85 miles per hour. Sue, the wife of the officer who gave Art the ticket, was an employee of ABC Company. Art asked her if she could get the ticket "fixed" for him. Sue indeed talked to her husband, but he was unwilling to tear up the ticket. Art was incensed and fired Sue on the spot saying that she could not be counted upon to do anything the right way. Discuss the pros and cons of whether Sue should prevail in an action against ABC Company alleging a violation of public policy.

ANSWER: The facts are similar to those in *Bammert v. Don's Super Value, Inc.* discussed in the text. Students should discuss fairness in employment versus the employment-at-will doctrine.

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

2. Discuss and explain the ethical business leader's decision tree referenced in the text.

ANSWER: Students should discuss the questions presented in the decision tree such as whether a proposed action is legal, whether it maximizes shareholder value, and whether the action is ethical.

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

3. You have been promoted to an executive position in your company. You have just learned that your boss in a publicly traded company is involved in securities fraud, not only to keep his job but also to increase his annual bonus. What should you do about this? Explain your reasons.

ANSWER: The action should be reported. Whistle-blowing would be involved, and the Sarbanes-Oxley Act makes it illegal to fire, demote or harass employees of publicly traded companies who report, for example, federal securities fraud.

SKILL LEVEL: AACSB Reflective Thinking

OBJECTIVE: AICPA Critical Thinking

4. You are the owner of a small Internet company. You are planning a public offering in 12 months. You ask your accountant to prepare an optimistic business model that shows a greater profitability potential than a conservative estimate would produce. When the accountant questions your profitability assumptions, you remind him that he has been given 10,000 shares of the company stock at a low price. A public offering would dramatically increase the value of those shares. Discuss the ethical issues faced by the owner and the accountant. How should they be resolved?

ANSWER: The ethical business leader's decision tree should be consulted. An action that is illegal should not be performed. Assuming illegality is not involved, other considerations are whether shareholder value is maximized; and, if not, whether it is ethical to perform the action. It appears that bribery may be involved. If the optimistic business model would be inaccurate, the owner should withdraw the request; and the accountant should refuse to provide an inaccurate model.

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

5. Your company has asked you to write a code of ethics. What should you include and why?

ANSWER: Many examples are reported in the text of situations in which companies encountered difficulties due to unethical conduct. Students should set forth rules guarding against unethical as well as illegal conduct.

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal

6. Your company has grown from a national to a multi-national entity. How have your ethical responsibilities changed? To whom do you owe these responsibilities?

ANSWER: As the text makes clear in the section titled "When Ethics Travel," practices regarded as ethically unacceptable in the United States may be common practice in foreign countries. Students should discuss the fact that ethical responsibilities are owed to all affected including citizens and employees of a host country.

SKILL LEVEL: AACSB Reflective Thinking

OBJECTIVE: AICPA Critical Thinking

7. You are the CEO of a multi-billion dollar company. Your company employs over 75,000 people. The company is being sued for \$100 million dollars as the result of racial discrimination against your customers. Your investigation reveals that some of your managers are actively violating the law. Discuss the steps you would take to ensure your company's compliance with ethical norms and legal requirements.

ANSWER: Students should discuss the need for an ethical code of conduct and the need to take immediate action to end the discrimination, including discharge of those responsible if needed.

SKILL LEVEL: AACSB Reflective Thinking

OBJECTIVE: AICPA Critical Thinking

8. Discuss why Enron failed and who should be held responsible for the failure.

ISSUES: Students should discuss improper accounting practices, questionable information provided to Wall Street investors and the public; wrongful actions by managers; the wrongful use of partnerships; and issues involving Enron's investment banking partners.

SKILL LEVEL: AACSB Reflective Thinking

OBJECTIVE: AICPA Critical Thinking

9. Discuss the position of critics of outsourcing jobs overseas as well as the position taken by proponents of outsourcing.

Answer: Critics of outsourcing claim that companies who outsource are shipping valuable jobs overseas and often simultaneously laying off loyal Americans. Proponents of the practice maintain that better jobs will be created in the United States with the money saved by outsourcing.

SKILL LEVEL: AACSB Ethics

OBJECTIVE: AICPA Legal