CORPORATE GOVERNANCE COURSE: QUIZZES AND EXERCISES

February 4, 2009

This publication was produced for review by the United States Agency for International Development. It was prepared by Demir Yener / Bearing Point Inc.

CORPORATE GOVERNANCE COURSE AND EXERCISES

USAID JORDAN ECONOMIC DEVELOPMENT PROGRAM

CONTRACT NUMBER: 278-C-00-06-00332-00

BEARINGPOINT, INC.

USAID/ECONOMIC GROWTH OFFICE (EG)

29 DECEMBER, 2009

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TASK NO: 1.14.1.14.3.1

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Module 1 Exercises

Module 1: Introduction to Corporate Governance

1- We discussed how Carly Fiorina of Hewlett-Packard went against the wishes of the large shareholders by exerting control over the Board. Find another example of how management went against shareholders wishes and describe what happened.

2- Do some research and explain how US corporations became as important and as large as they are today. Some academics have discussed the "theory of the firm" or the "nature of the firm." To what extent and how do these theories explain US corporations today. How do agency problems play a role in these theories?

3- There are many interlinking relationships among business participants (stakeholders). Create a figure showing the interlinkages among business participants in Jordan. Explain the interlinkages.

4- How severe is the agency problem in Jordan? Explain. Also, provide real examples.

5- In Jordan, which is the prevailing ideology used in resolving agency conflicts, such that:

   a. It will provide incentives to executives for good behavior

   b. It will closely monitor the executives

   c. Apply sanctions to executives for their self centered behavior.

   Do you think it is working in Jordan? Explain.

Module 1 Test Questions

The Definition of and Rationale for Good Corporate Governance

1. What is corporate governance?

a) A set of rules and procedures aimed at expanding the company's markets

b) A series of structures and processes for the direction and control of a company

c) A series of rules and procedures for monitoring competitors' governance processes

d) A series of rules and procedures for production management

2. What is *not* corporate governance?

a) Relations between shareholders and stock market advisors

b) Relations between shareholders and the Board of Directors

c) Relations between shareholders and the General Manager

d) Relations between shareholders, the Board of Directors and management bodies

3. Global corporate governance standards are based on:

a) Sarbanes-Oxley Act
b) Egyptian Company Law 159

c) OECD Principles of Corporate Governance

d) ISO standards

4. Corporate governance does not foster:

a) Higher shareholder earnings

b) Higher earnings for directors and managers

c) Growth of national economy

d) Higher earnings for competitors

5. The costs which are not associated with the principle-agent problem are:

a) Divergence costs
b) Monitoring costs
c) Operating costs
d) Replacement costs

6. One of the four pillars of corporate governance is:

a) Accountability
b) Synergy
c) Leadership
d) Continuous improvement

7. A synonymous term of corporate governance is:

a) Public governance
b) Corporate management
c) Business ethics
d) None

8. Corporate governance is regulated by:

a) The government
b) The society
c) Internal/external frameworks
d) Corporate rules

9. Priorities and values among the various stakeholders may cause conflicts due to:

a) Conflicts between employees and shareholders or a firm
b) Conflicts between the community at large and the government
c) Conflicts between the environmentalists and the management of a firm.
d) All of the above

10. Corporate governance may help:

a) Increase the cost of capital
b) Hinders operational efficiency
c) Reduce vulnerability to crisis
d) A and c

11. There are several forms of business ownership. These are:

a) Sole proprietorship
b) Corporation
c) Partnership
d) All of the above.

12. Principal-Agent Dilemma is the basis for corporate governance, and results from the separation of control between:

a) Management and the stakeholders of a firm
b) Shareholders and stakeholders of a firm
c) Government and private sector firms.
d) Management and the shareholders of a firm.

13. Corporate governance is an intricately linked web of distinct fields including the following:

a) Finance, accounting, economics, law, corporate culture, risk, control and strategy
b) Economics, law, culture, risk management and public administration
c) Strategic management, economics and international trade.
d) Politics, economics and society

14. Legal frameworks seem to have a significant impact on the ways in which good corporate governance has developed in various countries. As a result, we could reference a number of systems of corporate governance such as:

a) Outsider system in common law type countries versus insider systems of corporate governance that are prevalent in the continental law countries.
b) Shareholder versus stakeholders model of corporate governance
c) External versus internal frameworks
d) A and B.

Module 2 Exercises and Test

Module 2

Module 2 Exercises:

The Jordanian and International Environment for Corporate Governance

1. Discuss some of the critical issues Jordanian companies are facing in attracting new domestic and foreign investors, and in terms of sustained growth and new job creation.

2. Obtain the model corporate charter developed by IFC and compare it to a ASE 10 Jordanian company's corporate charter. Discuss similarities and key issues, and provide the rationale for any differences.

3. Discuss the main issues relative to corporate governance for family owned or small Jordanian enterprises.

4. Compare and contrast the Jordanian Code of Corporate Governance with a Country Code of your choice.

Model 2 Test

The Jordanian and International Environment for Corporate Governance

1. There are many players in the international arena involved in disseminating corporate governance knowledge to the world. These include:
   a) The Global Corporate Finance Forum by IFC and OECD
   b) IMF, The World Bank Group, Financial Stability Forum
   c) Basel II, Governments and Bank Regulators around the world
   d) All of the Above

2. The two basic models of corporate governance that result from legal frameworks are:
   a) Government versus private sector
   b) One tiered versus two tiered board system
   c) Anglo-Saxon *Outsider System* vs. Continental European-Japanese *Insider System*
   d) None of the above.

3. The external frameworks for corporate governance environment is about:
   a) International codes such as the OECD Principles of CG
   b) Individual country codes and guides for private and public sector firms
   c) A and B
   d) Public and civil laws.

4. The internal frameworks for firm level corporate governance environment is about:
   a) General and specific governance frameworks such as the corporate charter, bylaws on management and policies on disclosure, risk and dividends.
   b) Anti-trust regulations
   c) Capital markets supervision authority rules for disclosure
   d) Banking laws and procedures.

5. What are some of the reasons for the increased attention on corporate governance by policy makers?
   a) Corporate scandals and failures,
   b) Short termism and executive greed,
   c) Economic stagnation and the lack of investment capital
   d) All of the above

6. Corporate governance frameworks are gradually converging due to:
    a) Regional initiatives and alliances through economic zones
    b) Cross border investments, globalization and local reach
    c) Standardization that affects accounting, auditing, board independence, and CG codes.
    d) All of the above.

7. New US regulation on corporate governance Sarbanes-Oxley was passed in 2002 for what purposes?
    a) To regulate corporate executive behavior in favor of shareholders
    b) To put pressure on the private sector to improve disclosure requirements
    c) To ban corporate loans to executives, which had become detrimentally controversial and had the tendency to corrupt the health of a corporation
    d) All of the above

8. The OECD Principles of Corporate Governance provides an international framework for countries to use in developing their Codes of Corporate Governance. In this context, the OECD Principles emphasize:
    a) The rights of shareholders and key ownership functions and the equitable treatment of all shareholders.
    b) The “whistle blower” protection.
    c) The basis for an effective CG framework must be ensured.
    d) A, b and C

9. The Jordanian Code of Corporate Governance:
    a) Was developed in 2008 and it places the Board of Directors as the representative of the shareholder body, emphasizes the independence of the board members, and internal and external auditors.
    b) It is mandatory for all firms.
    c) Regulates all listed Jordanian corporate entities.
    d) Only a and c.

10. The Jordanian capital markets consist of a number of governmental and self-regulatory, quasi governmental agencies and includes the:
    a) Jordanian trade commission
    b) Ministry of Higher Education
    c) Jordan Securities Commission, the Amman Stock Exchange, and Securities Clearance Corp
    d) Only the Central Bank of Jordan.

Module 3 Exercises and Test

Module 3 Exercises

The Board of Directors

1. Do Boards play a role in Jordan? Please explain why or why not. What are the regulations pertaining to boards, if any, in Jordan? Do you think these regulations are appropriate?

2. Following the presentations on US corporate scandals please discuss the role of the Board in these scandals and the lessons for Jordanian companies**?**

3. The companies governing bodies consist of the general manager, board of directors and the GSM. The Board consists of seven directors, five of which are the company's executives. The Board meeting made a unanimous decision to pay a bonus to the general director. The amount of the bonus was extremely high.

   One of the shareholders on learning about this sued the Board.

   NOTE TO INSTRUCTORS: Two groups: One group to defend the decision of the Board. Another – in defense of the shareholders.

   Each group makes a presentation with arguments in favor of their position.

4. Should there be regulations pertaining to board composition and structure? If you think so, then what kind of regulations?

5. In 2005, Walt Disney Shareholders lost their long running law suit against their board's hiring, firing and compensating of Michael Ovitz, former president of Walt Disney. Describe the surrounding details and circumstances.
   NOTE TO INSTRUCTORS: Please distribute the mini-case, "Disney's Board During the 1990s" prior to this exercise. Allow 10 minutes of reading and discussion time to 4 teams of students.

Module 3 Test

The Board of Directors

1. The purpose of the Board of Directors is to:

a) Manage the day-to-day activities of the company;

b) Execute the managing director's instructions;

c) Set the strategy and effectively monitor management;

d) Represent the company in front of the media?

2. Which of the following statements is NOT true:

a) The Board of directors approves the distribution of dividends to shareholders;

b) The Board of directors oversees risk management and internal control plans;

c) The Board of directors appoints the CEO;

d) The Board of directors approves all new staff recruitment?

3. The optimal board in terms of involvedness is:

a) The passive Board

b) The certifying Board;

c) The engaged Board;

d) The intervening Board?

4. The main duties of the board members are:

a) To facilitate the paper work of the company with regulators;

b) To act in good faith and be accountable;

c) To protect the confidentiality of related-party transactions;

d) To avoid conflict with management?

5. The business judgment rule means that

a) Reasonable decision made by the Board of Directors based on available information shall not give rise to the Board members liability even if it resulted in negative or catastrophic consequences for the company;

b) Reasonable decision made by the Board of Directors based on available information shall give rise to the Board members liability if it resulted in negative or catastrophic consequences for the company;

c) Reasonable decision made by the Board of Directors based on available information shall give rise to the Board members liability in any case;

d) Reasonable decision made by the Board of Directors based on available information shall in no case give rise to the Board members liability?

6. Under the duty of loyalty, board members will:

a) Use assets and facilities of the company for personal use so long as they report the fact to shareholders;

b) Refrain from using information received in their personal capacity for personal gains;

c) Accept gifts from parties having certain interests in the company during social events;

d) Participate in media campaigns to improve the environment?

7. To be able to perform their functions properly, board members must:

a) Be able to watch the daily news;

b) Have access to information in a timely manner;

c) Have periodic meetings with the regulators;

d) Participate in various tournaments?

8. The reasons for underdeveloped boards are:

a) Strong management, who are simultaneously majority shareholders;

b) Lack of experienced directors familiar with their rights & responsibilities;

c) Failures in succession planning for the function of the CEO;

d) a&b?

9. Please select the case that may NOT create a conflict of interest from the following:

a) Mr. Ali is an attorney at law of **Ali & Ahmed** and is a board member of High Hopes Company. High Hopes intends to acquire some fixed assets from Great Expectations Company of which Ali & Ahmed are their legal advisers;

b) Dr. Fadel is an accounting professor and sits on the board of Wind Mills Company. Wind Mills intends to merge with Air Supply Company, of which Dr. Fadel owns 10% of total issued capital;

c) Mr. Khaled is a media guru. He sits on the board of a company that manufactures spare parts for cars. His cousin sits on the board of a competitor spare parts company;

d) Mr. Hamed sits on the board of **Evergreen**, a food processing company. He is about to acquire a farm that supplies 35% of the vegetables that Evergreen needs?

10. Under the Jordanian law, Board of Directors members are liable for:

a) Inaccurate or mispresented financial information even if it was unintended;

b) Divulging sensitive information that someone can use to make abnormal gains from dealing in the company shares;

c) Making a press release on behalf of the company;

d) Authorizing dividend distribution when the company has made losses?

11. Number of directors on the Board:

a). Is determined by the GMS.

b). Is determined by the decision of the Board.

c). Is determined by the companies law.

d). Depends on the legal and organizational form of the company (closed or open).

12. Board of Directors may not consist:

a). Only of members of executive board.

b). Only of the company's executives.

c). Only shareholders.

d). Only persons who are not executives or employees of the company.

13. Member of the Board of Directors may be:

a). Only a person with university degree.
b). Only a person that has professional training.
c). Any person with the necessary qualifications and experience.
d). Only a person below retirement age.

14. In accordance with the good practice of corporate governance, executive directors are:

a). Company's officers acting as interim CEOs.
b). Members of the Board of Directors who are at the same time employees of the company.
c). Company's executives.
d). Employees of the company.

15. An independent director is:

a). Member of the Board of Directors who is not a CEO.
b). Member of the Board of Directors who is not an executive of another company.
c). Member of the Board of Directors who is not a shareholder of the company.
d). Member of the Board of Directors who meets the criteria of independence.

16. An independent director is important because:

a) S/he prepares financial statements consistent with applicable laws.

b) S/he controls internal communications.

c) S/he scrutinizes the management performance.

d) S/he relieves the full board of its responsibilities.

17. Company is in severe risk if it failed to find:

a) The right number of directors.

b) The right mix of skills.

c) The right mix of categories.

d) Answers a, b, c and d.

18. Finding the right number of the board depends on:

a) Finding the right personal characteristics.

b) Finding the right balance and trade off between competence, cost and efficiency.

c) Fulfilling the role of succession planning.

d) Finding the right competencies only.

19. The role of the chairman of the board and the CEO are:

a) Joining the roles of CEO and the Board's Chairman.

b) The projects management.

c) The chairman of the board runs the board, and CEO runs the company.

d) The company's financial position.

20. The most important point of Jordanian Code of Corporate Governance is:

a) Compliance with the code is not an end in itself.

b) Always follow instruction of the CEO.

c) Board committees should not only be comprised of Board members.

d) Majority shareholders rights include selection of directors.

Module 4 Exercises and Test

Module 4 Exercises

Shareholders and Shareholder Activism

1. In your opinion do you think shareholder activism works, in the US, Europe, Asia, or Jordan? Why or why not?
2. Who are the largest shareholders in Jordan? How do they control the firms that they own? Do you think having these large shareholder types (e.g. family or the state) is good or bad for minority shareholders? Explain.
3. Do small investors have any significant power in Jordan? Why or why not? If not, then do you foresee improvements in this regard in the future? Why or why not?
4. Are pension funds and mutual funds significant shareholders in Jordan?
5. Do some research and describe what is involved in submitting shareholder proposal.
6. Describe corporate governance objectives of institutional investor activist CalPERS (or TIAA-CREF).
7. Go to the Council of Institutional Investors web site (www.cii.org). What shareholder initiatives are they following?
8. Pick two firms from the same industry in ASE and identify the largest shareholders. If their ownership structure is similar or different, try to identify why this might be.
9. Pick two firms in different industries and identify their largest shareholders. Find out if their ownership structures are similar or different, and try to identify why this might be.
10. Do some research, and identify and describe the current (Jordanian CMA) regulations that mutual funds must adhere to. Discuss regulations that might hinder their ability to be more active shareholders.

Module 4 Test

Shareholders and Shareholder Activism

1. **Shareholder activism can be useful:**
   a) When minority share owners organize to exert pressure on firms for more transparency and equitable treatment
   b) If corporate governance infrastructure is poor
   c) Where large shareholders are prevalent
   d) All of the above

2. **Executive Directors**
   a) Do not hold an operational position in the firm
   b) Do hold an operational position in the firm
   c) Are independent
   d) Have no material relationship with the firm.

3. **Independent Directors**
   a) Do not hold an operational position in the firm
   b) Have no material relationship with the firm
   c) Are individuals who can effectively exercise objective judgment
   d) All of the above

4. **Non-executive, Independent directors**
   a) Scrutinize managerial performance and ensure financial information is accurate and risk management systems are robust
   b) Are responsible for managing the firm with the CEO
   c) Have a prime role in appointing senior management and determine their remuneration.
   d) A and c.

5. **Shareholder activism**:
   a) Happens anytime shareholders express their opinions to affect changes in the ways a firm is governed.
   b) Occurs when individual, large and institutional shareholders act to influence the firm, and they are not mutually exclusive.
   c) May occur even by writing a letter to management demanding changes in their social policies.
   d) Any one of the above

6. **Vocal shareholders may include:**
   a) Hedge funds
   b) Pension funds
   c) Individual investors
   d) All of the above
7. **Individual Shareholders may not always be successful in affecting changes:**
   a) Due to the expense of communicating with all the shareholder classes at GSM
   b) Because many shareholders prefer to remain passive at GSM
   c) As there may be a conflict between the individual and large shareholders interests
   d) Any one of the above points**.**
8. **"Free rider" problem is said to exist:**
   a) Due to lack of adequate incentives to pursue a cause to affect a change in the governance of the firm for minority shareholders.
   b) When the majority of shareholders own less than 5 percent of a firm there are not enough incentives to monitor management.
   c) When the minority shareholders can take a free ride on the vehicles provided by the company to attend the GSM.
   d) A and b.
9. **The statement: "Institutional shareholder activism works"**
   a) Is a valid statement.
   b) Is inconclusive because it is still under debate whether shareholder activism works or not since good subsequent firm performance can not be directly linked to increased activism.
   c) Is true, because shareholder activism results in better firm performance.
   d) Is not true, because shareholder proposal submissions did not necessarily lead to any obvious improvements in the firm performance.

10. Effective shareholder activism has met roadblocks due to:
   a) The short term views of some institutional investors limiting their motivation to be activists
   b) Private pension advisors face major conflicts of interest because they are employed by these firms
   c) The regulatory and political environment also hinder large institutional shareholders from being activists.
   d) All of the above.

Module 5 Exercises and Test

Module 5 Exercises

Executive Compensation and Incentives

1. How would you design an executive compensation contract to ensure managers have the right incentives? Do you think managers will like it?
2. Do you think executive options should be expensed? Why or why not?
3. What do you think CEO compensation will be like in the near future?
4. Maybe it will be more conservative, but then do you think this will help or harm the future growth of corporate Egypt? Discuss the cost-benefit trade-offs.
5. Do you think firms should force executives to own the firm's stock? This might create a near-perfect alignment between managers and shareholders, but do not forget that executives already have their entire personal wealth (i.e. their salaries) staked to the firm.

Module 4 Test

Executive Compensation and Incentives

1. **What of the following principles is not a key principle of director remuneration:**
   a). Accountability;

   b). Trust?

   c). Transparency;

   d). Fairness;

2. **What could be part of a remuneration structure for a non-executive director:**
   a). Chairman/Committee fee;

   b). Fees per meeting;

   c). Annual fee;

   d) Answers a, b, c?

3. **Which internal factor does not affect the level of executive compensation:**
   a). Financial position of the company;
   b). Risk level;
   c). Holiday scheme;
   d). Existing practices and other employees pay level?

4. **What is not an external factor affecting the level of executive compensation:**
   a). Local markets;
   b). Age;
   c). Industry;
   d). Country risk level?

5. **What type of long-term plan is not in existence:**
   a). Appreciation plan;
   b). Goal-based plan;
   c). Grant-plan;
   d). Evaluation plan?

6. **What are current trends in executive compensation?**

   a) More pay being put at risk;

   b) More layers of incentives to cover other managers;

   c) Less scrutiny from the board;

   d) A&B?

7. **Which of the following arguments is one used <u>in favor of</u> stock options: Stock options**

   a) Improve operational efficiency and performance;

   b) Provide better access to finance;

   c) Bring together owner and management interest;

   d) Increase the number of shares?

8. **Which of the following arguments is normally one used <u>against</u> stock options: Stock options**

   a) Make directors focus on short term performance only;

   b) Prevent employees from earning more;

   c) Spoil the relationship between CEO and Chairman;

   d) Hinder the formation of a remuneration committee?

9. **Why are option programs uncommon in Jordan:**

   a) The stock market is underdeveloped;

   b) The majority of owners are not prepared to offer managers stock in the company;

   c) The companies show in general bad financial positions;

   d) a & b;

   e) a & c?

10. **What is <u>not</u> a task of the remuneration committee?**

   a) To develop employment contract terms;

   b) To search for potential successors of the CEO;

   c) To set principles and criteria for determining the size of remuneration, including Key Performance Indicators;

   d) To develop the company's policy on remuneration?

Module 6 Exercises and Test

Model 6 Participant Worksheet 1

What Every Director Needs to Know

About Accounting and Finance

Discussion 4:
Perform a quick analysis of financial statements of **Aqaba National Engineering Company**

Notes
ROA =
ROE =
Gross Margin =
A/Cs Receivable Turnover =
Financial Leverage =
Current Ratio =

Model 6 Participant Worksheet 2

Financial Statement Analysis for Directors

Discussion 2:
Students are divided into 5 groups and each group is assigned homework to perform a financial ratio analysis of a ASE 20 listed company belonging to a different industry sector. These industry sectors are: (1) Banking; (2) Telecom; (3) Textiles; (4) Food and Beverages; (5) Pharmaceuticals. Students should enter the relevant data to an Excel Spreadsheet and perform an analysis to calculate the following 12 Performance ratios: Perform a quick analysis of financial statements of **your select firm from one of the above sectors.**

Notes

1- Performance Ratio:

(1) ROE (Net Income/Equity) and, (2) ROA (Net Income/Total Assets)

2- Profitability Ratios:

(3) Gross Margin (Gross Profit/Revenues) and, (4) Expense Ratio (Expenses/Revenues)

3- Resource Management Ratios:

(5) Average Age of Inventory (Inventory/Average Daily Cost of Goods Sold) and,

(6) Average Age of Receivables (Accounts Receivable/Average Daily Sales);

(7) Age of Payables (Accounts Payable/Average Daily Purchases)

- Use 360 days for the year.

4- Liquidity Ratios

(8) Current Ratio (Current Assets/Current Liabilities) and,

(9) Acid Test Ratio (Cash + Accounts Receivables/Current Liabilities)

5- Leverage Ratios

(10) Debt to Equity Ratio (Total Debt/Equity);

(11) Long term debt to Total Capital (Long Term Debt/LTD + Equity);

(12) Interest coverage (EBIT/Interest Expense for the year)

Comment on each ratio.

Module 6: Exercises

Financial Controls, Auditing & Disclosure

DISCUSSION QUESTIONS AND EXERCISES

Review Questions

1. What is the role of management accounting, financial accounting, internal auditing, and external auditing?
2. What has weakened the ability of external auditors to conduct objective audits?
3. Who regulates accounting and auditing?
4. What is meant by "managing earnings?"
5. Give examples of how firms can manipulate earnings. Give examples of how firms commit accounting fraud.

Discussion Questions

1. Smoothing accounting earnings, from year to year, could make the stock price less volatile (i.e. less risky). So is smoothing, or managing, earnings good or bad for shareholders? Compare and contrast the advantages versus disadvantages of smoothing earnings.
2. How would you improve the system of external auditing in the U.S.? Make sure you weigh the costs and benefits to your ideas. Also make sure you describe how your ideas are feasible.
3. Do you think that Jordan should adopt the International Accounting Standards that IASB has created? Do you think the rest of the world should adopt U.S. GAAP or IASB? For the latter question, first argue "no" and then argue "yes."

Exercises

1. Find a firm that has exhibited smooth earnings growth for the past decade or so. How do you think this firm was able to have such smooth earnings? Find another firm that exhibited erratic earnings. Why do you think this firm was unable to show smooth earnings? Do some research and try to figure out what the repercussions have been to the latter firm for having erratic earnings.
2. When firms report their income to their shareholders, they want to show high income. When firms report their income to the tax authorities, they want to report low income. Find and describe three legal ways in which accountants are able to report different incomes to shareholders and to the tax authorities in Jordan.
3. Periodically a firm might decide that its recent past financial statements did not accurately reflect its financial condition. When the firm provides a new revised financial statement, it is said to have restated. The number of earnings restatements has dramatically changed over the past decade. Do some research and try to figure out how and why the number has changed.
4. WorldCom disclosed that roughly $3.8 billion had been improperly booked as capital investments instead of operating expenses. Describe how this affected its financial statements, stock price, and credit rating.
5. Do some research and try to identify some key differences between International Accounting Standards and U.S. GAAP. Describe the application of IFRS accounting principles in Jordan. How are they different from U.S. GAAP?
6. Describe some details of the external auditing system used in Jordan. Is there a designation similar to a CPA Jordan? Does Jordan have similar problems with external auditing that the U.S. has? Whether you answer "yes" or "no" to this last question, describe and explain why.
7. To what extent are financial statements important in Jordan? Who uses financial statements the most? Investors? Lenders? Government?
8. To what extent does accounting manipulation occur in Jordan? Do you trust the accuracy of financial statements in Jordan? Elaborate on your answer.
9. How is accounting and auditing regulated in Jordan? Describe the regulatory body and its composition and describe its powers.
10. How would you improve the auditing environment? Make sure you weigh the costs and benefits to your ideas. Also make sure you describe how your ideas are feasible.

Module 6: Self Test

Module 6: Self Test

Financial Controls, Auditing & Disclosure

1- **Accounting is the process by which information about a business is:**

a) collected and archived,

b) collected, recorded and communicated to the shareholders,

c) recorded, classified, summarized, interpreted and communicated,

d) none of the above?

2- **The "matching principle" requires:**

a) to assume the company will continue to operate in the foreseeable future,

b) that expenses should match the revenues and be recorded in the period when they occur,

c) that monetary units should be used in recording all the company's transactions,

d) all of the above?

3- **Under the "accrual basis":**

a) revenues and expenses are recorded when cash is received,

b) assets are recorded at book value,

c) depreciation is calculated on straight-line basis,

d) revenues are recognized when the service is rendered with high probability of payment?

4- **The following are examples of material events that should be reported in the financial statements:**

a) a foreign exchange loss of JD 1,000 for a 500 million capital bank,

b) a potential tax claim of JD100,000 pending settlement of a legal dispute,

c) write-off of JD 20,000 of interest in a bank's loan portfolio,

d) all the above?

5- **The following can be classified as a current asset:**

a) the car of the CEO,

b) the inventory of scaffolds for a construction company,

c) the total of checks paid by clients for the receipt of products,

d) none of the above?

6- Retained earnings are usually formed of the following:

a) cash received in advance of service contracts,

b) end-of-year profits paid to shareholders,

c) end-of-year profits not paid to shareholders,

d) cash received from bank loans?

7- The following transaction adds to operating cash flow:

a) collection of accounts receivable,

b) building up of inventory,

c) acquisition of shares of other companies,
d) none of the above?

8- Financial statement analysis is an:

a) analysis of each item of the financial statements over one time period,
b) analysis of income statement items only to come up with income drivers,
c) analysis of operating cash flows to improve cash flow position,
d) analysis of all items of financial statements, line-by-line, comparatively over several periods?

9- Internal auditors:

a) oversee the firm's financial and operating procedures internally
b) check the accuracy of the financial record keeping,
c) implement improvements with internal control an detect fraud
d) all of the above

10- The following is not a function of the audit committee:

a) ensuring company's compliance with all regulations and tax codes,
b) cooperating with external auditors to obtain answers from management of any areas of doubt,
c) Evaluating current internal control systems to ensure proper oversight over management,
d) None of the above?

Module 7 Exercises and Test

Module 7: Exercises

Corporate Takeovers: Mergers and Acquisitions

Review Questions

1. What are the two broad rationales for takeovers? What are some of the specific rationales?

2. Discuss how takeovers can be viewed as a governance mechanism.

3- List and describe various takeover defenses.

4. Discuss why takeover defenses might be bad for shareholders.

Discussion Questions

1. In your opinion, who benefits when firms have takeover defenses? Who is hurt when firms have takeover defenses? In sum, which is greater, the benefits or the costs?

2. Do you believe that takeovers can effectively contribute to the corporate governance system? Why or why not?

3. What are horizontal, vertical, congeneric and conglomerate mergers? Are they all legal?

4. What is synergy? What are some of the factors that might lead to synergy? How is the amount of synergy in a proposed merger measured, and how is it allocated between the two firms stockholders?

5. Are mergers and acquisitions really good for all shareholders?

Exercises

1. Daimler Benz was adamant that its takeover of Chrysler was really a "merger between equals." From Daimler's viewpoint, why was it important that Chrysler shareholders believed this? Do some background research.

2. Find a recent hostile takeover attempt. Was it successful? How did it eventually get resolved? Regardless of the outcome, do you think the target firm is now better off? Explain your answer.

3. Conduct some research and discuss the costs and benefits of state anti-takeover laws and are they beneficial?

4. Find a firm with a poison pill and describe it. Find another firm from the same industry that does not have a poison pill and try to identify why one firm has a poison pill and the other does not.

5. This lecture suggests that hostile takeovers might be good for corporate institutions. Do some research and try to argue that hostile takeovers are bad for corporations.

6. Compare and contrast the M&A market in Jordan to the U.S. Also, do some research to work out what led to the differences between the two countries (e.g. if you find that M&A activity is low in Jordan, then what might be the cause; is it historical, economic, social, political, ownership related, etc.?).

7. In this lecture, we did not discuss foreign acquisitions in detail. Does Jordan have foreign ownership restrictions? Do you think having a more active international acquisition market can improve the corporate governance environment in Jordan and worldwide?

8. Do you think hostile acquisitions are going to occur more often in Jordan? Do you think there should be more hostile acquisitions? Support your contentions.

Module 7: Test

Corporate Takeovers: Mergers and Acquisitions

1. **Mergers and acquisitions are relevant to corporate governance because:**
   a) "Bad" firms are acquired by investors who impose dramatic changes on the target firms management to improve shareholder value.
   b) Target firms' management usually resist acquisitions because of fear of losing their jobs.
   c) Synergies among the merged firms have a potential to benefit shareholders
   d) All of the above.

2. **The board has the authority to accept or reject a merger only within specific parameters as:**
   a) The transaction affects overall shareholder interests
   b) General shareholders assembly have the final authority to approve
   c) Directors have the duty to shareholders to scrutinize every aspect of the transaction, including price, and terms of the acquisition
   d) All of the above

3. **Mergers can be of several types, including:**
   a) Horizontal and congeneric
   b) Horizontal and vertical
   c) Horizontal, vertical, conglomerate and congeneric
   d) Horizontal, vertical and conglomerate

4. **The motives for a merger could be:**
   a) Disciplinary only
   b) Both Synergistic and disciplinary
   c) Synergistic only
   d) Both Disciplinary and horizontal

5. **In a merger, synergy effect is said to exist when**
   a) The sum of the two firms is very large
   b) The target firm's value is greater than the acquirer firm
   c) Shareholder value is created through the combination of the two firms as a whole.
   d) The acquirer gains more diversification in its markets.

6. **Why is there usually an increase in the value of the target firm in a merger?**
   a) Shareholders of the targeted firm increase their share prices
   b) It is in the nature of all hostile takeover bids.
   c) Because the acquirer firm usually pays a premium for the target firm, to convince its shareholders to sell their shares.
   d) None of the above.

7. **In a merger, the goals of the acquiring firm is:**
   a) To takeover the targeted firm to create synergies
   b) To takeover the target firm and improve its operating efficiency and increase its profits and dividends to add more shareholder value to the combined firm
   c) To discipline bad management at an unsuccessful firm
   d) All of the above.

8. **Due diligence is:**
   a) A diligent action by the directors of a firm targeted for acquisition
   b) A process whereby the potential acquirer of a firm makes a through assessment of the targeted firm to determine the costs and benefits of acquiring it, and to seek potential intrinsic value drivers
   c) In a hostile acquisition, this is the market intelligence gathering process necessary to build an information base for the acquirer to use in the bidding process.
   d) B and c

9. **There are a number of firm level pre-emptive takeover defenses, such as:**
   a) Poison pills which makes the shares of the targeted firm unattractive to a potential acquirer
   b) Golden parachutes, which provide the management of target firms certain large benefits to make the target un attractive
   c) Staggered boards, which require that board members are elected each year to multiple terms so the acquirer can not fire the board altogether.
   d) All of the above.

10. **Are takeover defenses useful for the governance system?**
    a) Yes, always, because take over defenses make it difficult to acquire a firm.
    b) No. Because many firms with takeover defenses eventually agree to be acquired.
    c) Takeover defenses are good for the governance system as it protects management.
    d) Shareholders would not want to give up their shares when there is a takeover defense mechanism in place.

Module 8 Exercises and Test

Module 8: Exercises

Risk Management

Review Questions:

1- Discuss the definition of risk. How does it relate to corporate governance?
2- What is Enterprise Risk Management? Why is it necessary?
3- Discuss ERM framework
4- What is internal control mechanism essential for the firm? What is the role of Audit in ERM?
5- Discuss the connection between risk, finance and corporate governance.
6- Why should the firms manage risk?
7- Discuss the evolution of risk management. How many types of risk does a firm face in its operations, and why is it necessary to have a risk management strategy?
8- What does ERM entail?
9- Discuss the challenges at the firm level for or against ERM.
10- What is “risk maturity of a corporation” concept all about?

Exercises:

1- Do some research to determine the corporate capital structures of top 20 ASE listed and traded Jordanian companies. Classify them by industry sectors if you can. What is the average capital structure like in the leading private sector companies in Jordan? Discuss how this capital structure trend might pose risks to these companies. Given what you find, do you think ERM would be useful for all of them, some or none?

2- Why is a business’ capital structure (i.e. debt to equity relationship) so important to its success? Why is financing decision a major determinant in the cost of capital for a firm? How does it affect value creation? Discuss intuitively.

3- Discuss the underlying principles of COSO ERM framework. What are some of the crucial steps that ought to be followed? Why?

4- List the risks a firm faces during its life. Discuss in what ways you would try to protect your company from the possible effects of each risk. What types of risk would be relatively most prevalent in Jordan as compared to others? Referring to the ERM Framework discussed, try to rationalize this question.

5- Do some research. Find out about the “Value at Risk” concept. How does that relate to the subjects we have discussed? What are the ways in which mathematical modeling might help calculate the risks that a firm faces? Could ERM simply be applied non-qualitatively? How does one quantify “risk”? What is the best measure of risk for a Jordanian firm?

6- How would Sarbanes-Oxley affect Enterprise risk management? In what way has that piece of legislation affected Jordanian corporate governance environment with especially relative to the risk management concept. Are there any legal and regulatory frameworks in Jordan that requires a rational risk management process in Jordanian corporations.

7- Find out about the major challenges to the effective implementation of ERM at Jordanian top 20 listed companies. Explain some of the underlying reasons why there is or there is no ERM application in Jordan. What might be the reason and what ought to be done to remedy this situation?

Module 8: Self- Test

Risk Management

1- Risk management:

a. Is a company wide phenomenon faced at all levels and business units of the firm
b. Is not just a corporate function
c. Requires that the boards have a structured understanding of key risks and approaches to manage them.
d. All of the above

2- Firms should manage risk, because:

e. It affects a business at all levels, and it is an ongoing process.
f. The board must champion risk management and determine rules of conduct.
g. It is a smart thing to do
h. A and b.

3- Firms need to deal with risk in order to:

i. Lower the expected tax payments
j. Align the interests of management with those of the shareholders
k. Discourage other firms to attempt to takeover the firm
l. A and b

4- Failure to develop effective risk management strategies may result in:

m. Losing the public image of the firm
n. Saving money from operations
o. An adverse effect on firm's credit rating
p. A and c

5- Total firm risk may be a combination of:

q. Operating, input, and physical risks
r. Operating, input, tax, legal and regulatory, financial and product market risks
s. Corporate governance and management risks
t. None of the above.

6- International and domestic codes of CG, including the Jordanian Code of Corporate Governance, suggest that:

u. The board is generally responsible for the oversight of corporation's risk management
v. The CEO is the executive responsible for managing risk and delegates the management of it to the Chief Risk Officer.
w. The board should approve the overall business strategy of the company, including the overall risk policy.
x. All of the above.

7- In the context of ERM, the board needs to constantly ask the question of whether the firm:

y. Is taking the right kind of risks; in the right amount and is managing it adequately
z. Is mitigating its risks adequately
aa. Has a well balanced total risk profile
bb. Has a relevant strategy.

8- Having a well defined "risk appetite" means:

a. Business is all about taking risks
b. The firm has determined a targeted level of return consistent with its capacity to take on its overall risk level.
c. Risk management process is cost effective.
d. Taking on risky activities must create value

9- Risk and reward scenarios are developed so that

e. The firm's board and management have a clear idea of its risk appetite
f. Returns from various business units are plotted to help the board decide the right amount and kind of risk to be taken on a timely basis given the current realities.
g. Building a risk management competence results in generating superior returns to shareholders
h. All of the above

10- ERM framework, developed by COSO:

i. Consists of eight interrelated components and objectives in four categories.
j. The objectives are strategic, operational, reporting and compliance based
k. The components include the internal environment, the objective setting, risk assessment and risk response.
l. All of the above.

11- The concept of "Risk maturity of a corporation" refers to:

m. The degree of executive support for ERM based approach in the firm.
n. How the ERM process is weaved through the business
o. The firm with a well defined risk appetite management system that shows the degree of risk-reward tradeoff the firm is facing in its business.
p. All of the above.

12- The role of Audit in ERM:

q. Is about monitoring but not having the primary responsibility in the ERM
r. Is to assist management and the board in monitoring the ERM process
s. Is to be on the lookout for more risky projects
t. A and b.

Module 9 Exercises and Test

Module 9: Exercises

Role of Financial Institutions Analysts, Creditors and Credit Rating Agencies

Role of Financial Institutions and Securities Analysts on CG

Section A: Investment Banking and Securities Analysts

Review Questions

1. Compare and contrast “universal banking” practices in Germany with the “unitary banking” practice in the US. How might each affect their client firms to implement good corporate governance practices?
2. What is the role of investment banking in corporate governance?
3. What are the main ways an investment bank offers a security for sale?
4. Discuss why and how investment banks can be considered potentially effective monitors of corporations.
5. Why does it seem like IPOs are underpriced in the offering?
6. Describe how investment banks contributed to the investor confidence crisis in the early 2000s.
7. What is the financial analyst's function? How might analysts be important participants in the monitoring of the firm?
8. Are analysts good at evaluating firms? Elaborate.
9. Name and describe the conflicts of interest analysts face.

Discussion Questions

1. Provide some ideas on how investment banks can be made more conservative with regard to taking firms public.
2. When investment banks take firms public, they have in effect two clients: the going-public firm and the investors who buy the new shares.
3. Which client do you think the bank is mostly concerned with? Why might they be equally concerned with both?
4. How would you standardize analysts' recommendations?

5. Some people think that fewer recommendations, such as simply recommending buy, hold, or sell, is the best system. What do think is the rationale behind this view? Do you agree?

6. What is your overall view of the sell side analysts profession? Given that the accuracy of their recommendations does not directly lead profits for the analysts firm, how do you think sell-side analysts should be compensated?

Exercises

1. Find a firm that recently conducted an IPO in Jordan or elsewhere. What are the details of the offering? Which investment bank(s) underwrote the offering? How successful was the offering from the perspectives of the firm, the banks, and investors? Do you think the firm was ready to conduct an IPO? Explain.
2. Find an Jordanian firm that is scheduled to conduct an IPO in the near future. What types of information are provided to the interested investor? Describe how the information is useful in making a buy versus no-buy decision.
3. Provide a status report on the current state of investment banking. Are they underwriting fewer IPOs and other financial deals? If so, then are they in danger of getting into financial trouble?
4. Go to the AIMR web site (www.aimr.org). Identify and describe the ideas that AIMR proposes to improve investor confidence in analyst recommendations. Evaluate the potential of these ideas for resolving the problems.
5. Describe the actions of investment banking institutions that has led many to criticize analysts.
6. Pick a company and report its analysts' recommendations for trading and their predictions of future earning. Pick another company in the same industry and do the same. Does one company have a wider dispersion of analysts' recommendations and predictions? Why do you think this is?
7. Describe the investment banking business in Jordan. Do you think they do a good job of bringing only good firms public? Explain your opinion.
8. Describe the nature of analysts in Jordan. Are securities analysts important in your country? How are they compensated?
9. To what extent are the problems outlined in this module pertinent to Jordan? Explain.

Section B: Creditors and Credit Ratings

Review Questions

1. Describe how debt, in and of itself, might keep management in check?
2. Describe the efficacy of financial institutions to be corporate monitors.
3. How are credit rating agencies important for firms, investors, and investment banks?
4. Why is the distinction between investment grade and non-investment grade ratings so important?
5. The SEC awards the "Nationally Recognized Statistical Rating Organization" (NRSRO) designation. What criteria do they use to give the designation? Find out what kind of policies are followed by Jordan Securities Commission.
6. How did the rating agencies fail Enron bondholders and creditors?
7. Name and describe the conflicts of interest that credit agencies face.

Discussion Questions

1. Debt financing has a tax-advantage that equity financing does not have. Given this fact, do you think large firms have enough debt in Jordan or elsewhere? In your opinion, which kinds of firms might be able to handle more debt?
2. If you were the CEO of a small high-tech firm and you wanted to borrow money for your firm, would you borrow from an institution such as a bank or would you issue bonds? Why? What if you were the CEO of General Electric? How would you advise the CEO in this case, if you were a member of the board the same company monitoring this situation?
3. In the U.S. it is difficult for a bank to be a lender and a stockholder for legal reasons (refer to the Glass-Steagall Act). What do you think are the cost and benefits of preventing bank lenders from being stockholders? How do these issues compare in Jordan? It seems like the universal banking system of Germany may be influential on the industry but after maturing, does the universal banking system work as efficiently as the capital markets?
4. What are the role of banks and capital markets towards improved credit rating information (disclosure and transparency rules).

5. There are only five US Government (Nationally Recognized Statistical Rating Organization" (NRSRO) designated rating firms which has so far set the tone of credit rating in the US as well as in the world. What might be done to increase the number of rating firms?

Exercises

1. Find two Jordanian firms from the same industry, but with different debt ratios. Try to work out why the two firms have different debt ratios. Try to find another pair of firms that have different debt ratios, but for a reason other than the ones that you cited for the first pair.
2. Try to identify a firm that has more bank debt than public debt and vice versa. Try to work out why each firm prefers its debt type.
3. Obtain the ratings from at least two credit rating firms for one company. Compare the ratings.
4. Obtain the credit ratings for a firm over the past five years. How and why has the rating changed?
5. What is the primary source of financing for firms in Jordan? Do you think this is best for the future financial development of Jordan? Explain.
6. Do you think banks have too much or too little power in Jordan's corporate landscape? Explain.
7. Compared to the firms in the U.S., do the firms in Jordan have more or less debt in their capital structure? Why do you suppose this is? Do you think this is good or bad for your Jordanian firms?
8. Are there credit rating agencies in Jordan? If so, describe the system and compare them to the international credit rating agency system.

Module 10 Exercises and Test

Module 10 Self Test

Corporate Social Responsibility

1. **Corporate social responsibility (CSR) is an increasingly important part of the business environment defined as:**
    a) The responsiveness of business entities to stakeholders' legal, ethical, social and environmental expectations.
    b) A relationship between a business and the society.
    c) The relationship between companies and civil society organizations as a paternalistic philanthropy.
    d) Private sector business entities acting on behalf of the government doing good to benefit the public.

2. **Public attitudes have shifted and new values have evolved for private companies, and CSR:**
    a) Has generally been a pragmatic response to consumer and civil society and environmental pressures.
    b) Is not a replacement for the rightful role of governments to set regulatory frameworks for the benefit of the society.
    c) Debate on how it can most effectively be applied by companies either voluntarily or through regulatory pressures to improve social and environmental performance is misplaced.
    d) All of the above.

3. **The stakeholder view of the firm as compared to the shareholder view of corporate governance has been advanced because**:
    a) A company must maintain simultaneous relationships with several groups that affect or are affected by its decisions.
    b) While shareholders and the board are the core group of investors that the management must be accountable and responsible to, companies have varying responsibilities to each of their stakeholders.
    c) Even though some relationships may be more valuable or important to the firm than others (i.e. employees, creditors, and suppliers), no one group ought to be able to dominate the others.
    d) All of the above.

4. **Stakeholders view of the firm basically:**
    a) Disregards the maximization of shareholder wealth concept but rather focuses on optimization of the sustainable economic wealth of all stakeholders.
    b) Cares about maximization of wealth of shareholders but requires the firm to do more for the society
    c) Seeks to advance good relationships with the public at large by a firm.
    d) Requires that the firm take care of its environment on behalf of the shareholders

5. **The impact of CSR on corporate performance results are difficult to measure, however some strategic performance measurement approaches have been developed such as:**
    a) The Balanced Score Card, which measures internal processes, customers, employee learning, and financial perspectives to accomplish the mission of a firm.
    b) The Triple Bottom Line approach which measures stakeholder welfare gains from CSR actions through a combination of financial environmental and social outcomes.
    c) Application of these approaches require full involvement of every member of the business organization, and thus each method could provide a holistic, accountable and responsible performance outcome.
    d) All of the above.

6. **Aligning managerial incentives with multiple stakeholder groups to do good and measuring overall corporate performance can become a very difficult process. In this regard:**
    a) Every business firm must be socially responsible, and what is good for the company ought to be good for the society.
    b) Corporate governance and CSR are not really related
    c) There is still no consensus on how to measure and report on changes in stakeholder welfare as a result of CSR actions, even though some measures have been developed.
    d) Focusing on the profits ought to be adequate.

7. **What is the Corporate Citizenship Pyramid" developed by the World Economic Forum?**

   a) It is a framework that shows the parameters of how businesses could be more responsible in the future.

   b) It is a framework that has good corporate governance at its core, and seeks to identify how CSR actions will contribute to the people dimension through improvements in products and services; the environment dimension through improvements in global and local environmental quality; and, the contribution to economic development through enterprise development.

   c) It is a framework that seeks to provide a rationale for the various understandings of corporate social responsibility concept and its relationship to corporate governance.

   d) Only b and c.

8. **The World Economic Forum framework for corporate citizenship emphasizes**:

   a) Charitable leadership and philanthropy.

   b) Leadership, meaning of citizenship to the firm, action and transparency.

   c) Management action and profit making.

   d) Transparency and maximization of shareholder wealth.

9. **CSR has different historical and social roots in the different regions of the world and therefore it is viewed with different cultural perspectives:**

   a) In the US, CSR has been derived from the conflict between shareholder focused managers, and social activists and many US business groups have begun to embrace the CSR ideas.

   b) In the UK corporate citizenship is viewed more positively than in the US.

   c) In UK the directors are required to include the interests of employees in decision making.

   d) All of the above

10. There are many criticisms leveled against the CSR, and some of the important ones include the following:

a) It is difficult to assess and evaluate the stakeholder view, because it is not a well-defined theory as the shareholder focused, principal-agent theory.

b) Economic progress does not only come from profit related activities.

c) Management has to focus on activities that will maximize shareholder wealth, and so getting themselves in stakeholder engagement would be counterproductive to achieve the overall goal of the firm.

d) A and c

Module 10 Exercises

Corporate Social Responsibility

Review Questions

1. Name and describe as many stakeholders of the corporation as you can.
2. Describe the differences between agency theory and stakeholder theory.
3. Name and describe the four levels of corporate social responsibility.
4. What are the criticisms of a profit maximization focus?
5. What are the criticisms of the stakeholder view of the firm?

Discussion Questions

1. Do you think corporations should have a responsibility to society in general? Explain.
2. Lets say companies should be good citizens. How can this be measured? How can it be enforced?
3. How should we solve a stakeholder crisis? Who should be the monitors? What regulations can be imposed?

Exercises

1. Report on the latest developments of CSR as described by The Conference Board (www.conference-board.org).
2. Go to www.wakeupwalmart.com. Describe the current stakeholder problems with Wal-Mart. Also go to www.walmart.com and determine what Wal-Mart is doing to engage the stakeholders.
3. How might corporations engage environmental activists in a productive and legal way?
4. Investigate and report on the standards of corporate social responsibility issued by the Social Venture Network (www.svn.org).
5. Does Jordan subscribe to an agency (Shareholder) view or the stakeholder view of the firm? Explain.
6. In what ways are firms in Jordan viewed differently from U.S. firms? Are they seen as contributors to the national economy? Are corporate executives looked upon as greedy or as important social leaders?
7. What is your overall opinion of the role of Jordanian firms in the country? Is it good for the long run? What criteria (profits, environment, etc.) should be applied?

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