# Chapter 1

# Introduction to the Problem of Accounting Fraud

**SOLUTIONS**

**True/False Questions:**

1. False
2. False
3. False (The Sarbanes-Oxley Act was passed in 2002.)
4. True
5. False
6. False
7. True
8. False (The Dodd-Frank Act revised and increased the power of the SEC.)
9. False (They usually neither admit nor deny the findings.)
10. True

**Fill-in-the-Blank Questions:**

11. Section 404

12. audit

13. banking

14. damages

15. 2010

16. agents

17. lower (But not by much. Byrne, Lavelle, Byrnes, and Vickers, May 2002, reported that in 2001, “CEOs of large corporations made 411 times as much as the average factory worker.” The Institute for Policy Studies pointed out: “The pay gap between CEOs and average American workers has grown from 195-to-1 in 1993 to 354-to-1 in 2012.”)

18. Volcker

19. Adelphia

20. toxic or risky

**Multiple-Choice Questions:**

21. c

Explanation: The SEC is a government regulatory body and was not complicit in the fraud, nor was its role examined or faulted by the Bankruptcy Examiner.

* Answers a, b, and d are incorrect because Thornburgh found gatekeeping failures in WorldCom‘s internal audit structure and with its external auditors and its board of directors.

22. b

Explanation: In many cases, senior management compensation agreements included stock options that would provide significant additional remuneration if analysts’ earnings expectations were met.

* Answers a, c, and d are incorrect because they were not cited as common reasons to orchestrate frauds.

23. b

Explanation:

* Answers a, c, and d are true statements.

24. d

Explanation: Directors with no stake in the company, and who are not officers in the company, would be least likely to succumb to pressures.

* Answers a, b, and c are incorrect because Levitt believed that situations described in a, b, and c could undermine many directors’ abilities to act autonomously.

25. a

Explanation: The major objectives of Dodd-Frank are to “reshape the U.S. regulatory system in a number of areas including but not limited to consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency” (“The Laws” 2012).

* Answer a is correct because Dodd-Frank does not attempt to increase the number of audit firms.

26. d

Explanation: All of the changes mentioned, plus others, have resulted from Dodd-Frank.

1. a

Explanation: Through Dodd-Frank’s whistleblower program, whistleblowers are offered more protection than under Sarbanes-Oxley, and they can now receive monetary awards from the SEC which is pursuing whistleblower tips very seriously.

* Answers b, c, and d are incorrect because whistleblowers are taken seriously by the SEC and they can receive monetary awards.

28. a

Explanation: The director who works for a competing company, Raining Raisins, may have a conflict of interests.

* The employment status of the other directors would be unlikely to result in conflicts of interest.

29. d

Explanation: According to SOX, an audit partner cannot be the lead or reviewing auditor of the same company for more than five years.

* Answers a, b, and c would be unlikely to influence the ability of Ethical Auditors to carry out an impartial audit.

30. a

Explanation: Answers b and c were instituted by the SEC only after the Dodd Frank Act of

2010.