ch01

Student: ____

1. The person generally directly responsible for overseeing the tax management, cost accounting, financial accounting, and information system functions is the:
A. treasurer.
B. director.
C. controller.
D. chairman of the board.
E. chief executive officer.

2. The person generally directly responsible for overseeing the cash and credit functions, financial planning, and capital expenditures is the:
A. treasurer.
B. director.
C. controller.
D. chairman of the board.
E. chief operations officer.

3. The process of planning and managing a firm's long-term investments is called:
A. working capital management.
B. financial depreciation.
C. agency cost analysis.
D. capital budgeting.
E. capital structure.

4. The mixture of debt and equity used by a firm to finance its operations is called:
A. working capital management.
B. financial depreciation.
C. cost analysis.
D. capital budgeting.
E. capital structure.

5. The management of a firm's short-term assets and liabilities is called:
A. working capital management.
B. debt management.
C. equity management.
D. capital budgeting.
E. capital structure.

6. A business owned by a single individual is called a:
A. corporation.
B. sole proprietorship.
C. general partnership.
D. limited partnership.
E. limited liability company.

7. A business formed by two or more individuals who each have unlimited liability for business debts is called a:
A. corporation.
B. sole proprietorship.
C. general partnership.
D. limited partnership.
E. limited liability company.

8. The division of profits and losses among the members of a partnership is formalized in the:
A. indemnity clause.
B. indenture contract.
C. statement of purpose.
D. partnership agreement.
E. group charter.

9. A business created as a distinct legal entity composed of one or more individuals or entities is called a:
A. corporation.
B. sole proprietorship.
C. general partnership.
D. limited partnership.
E. unlimited liability company.

10. The corporate document that sets forth the business purpose of a firm is the:
A. indenture contract.
B. state tax agreement.
C. corporate bylaws.
D. debt charter.
E. articles of incorporation.

11. The rules by which corporations govern themselves are called:
A. indenture provisions.
B. indemnity provisions.
C. charter agreements.
D. bylaws.
E. articles of incorporation.

12. A business entity operated and taxed like a partnership, but with limited liability for the owners, is called a:
A. limited liability company.
B. general partnership.
C. limited proprietorship.
D. sole proprietorship.
E. corporation.

13. The primary goal of financial management is to:
A. maximize current dividends per share of the existing stock.
B. maximize the current value per share of the existing stock.
C. avoid financial distress.
D. minimize operational costs and maximize firm efficiency.
E. maintain steady growth in both sales and net earnings.

14. A conflict of interest between the stockholders and management of a firm is called:
A. stockholders' liability.
B. corporate breakdown.
C. the agency problem.
D. corporate activism.
E. legal liability.

15. Agency costs refer to:
A. the total dividends paid to stockholders over the lifetime of a firm.
B. the costs that result from default and bankruptcy of a firm.
C. corporate income subject to double taxation.
D. the costs of any conflicts of interest between stockholders and management.
E. the total interest paid to creditors over the lifetime of the firm.

16. A stakeholder is:
    A. any person or entity that owns shares of stock of a corporation.
    B. any person or entity that has voting rights based on stock ownership of a corporation.
    C. a person who initially started a firm and currently has management control over the cash flows of the firm due to his/her current ownership of company stock.
    D. a creditor to whom the firm currently owes money and who consequently has a claim on the cash flows of the firm.
    E. any person or entity other than a stockholder or creditor who potentially has a claim on the cash flows of the firm.

17. The Sarbanes Oxley Act of 2002 is intended to:
    A. protect financial managers from investors.
    B. not have any effect on foreign companies.
    C. reduce corporate revenues.
    D. protect investors from corporate abuses.
    E. decrease audit costs for U.S. firms.

18. The treasurer and the controller of a corporation generally report to the:
    A. board of directors.
    B. chairman of the board.
    C. chief executive officer.
    D. president.
    E. chief financial officer.

19. Which one of the following statements is correct concerning the organizational structure of a corporation?

    A. The vice president of finance reports to the chairman of the board.
    B. The chief executive officer reports to the board of directors.
    C. The controller reports to the president.
    D. The treasurer reports to the chief executive officer.
    E. The chief operations officer reports to the vice president of production.

20. Which one of the following is a capital budgeting decision?
    A. Determining how much debt should be borrowed from a particular lender
    B. Deciding whether or not to open a new store
    C. Deciding when to repay a long-term debt
    D. Determining how much inventory to keep on hand
    E. Determining how much money should be kept in the checking account

21. The Sarbanes Oxley Act was enacted in:
    A. 1952.
    B. 1967.
    C. 1998.
    D. 2002.
    E. 2006.

22. Since the implementation of Sarbanes-Oxley, the cost of going public in the United States has:
    A. increased.
    B. decreased.
    C. remained about the same.
    D. been erratic, but over time has decreased.
    E. It is impossible to tell since Sarbanes-Oxley compliance does not involve direct cost to the firm.

23. Working capital management includes decisions concerning which of the following?

I. accounts payable
II. long-term debt
III. accounts receivable
IV. inventory
A. I and II only
B. I and III only
C. II and IV only
D. I, II, and III only
E. I, III, and IV only

24. Working capital management:
A. ensures that sufficient equipment is available to produce the amount of product desired on a daily basis.
B. ensures that long-term debt is acquired at the lowest possible cost.
C. ensures that dividends are paid to all stockholders on an annual basis.
D. balances the amount of company debt to the amount of available equity.
E. is concerned with the upper portion of the balance sheet.

25. Which one of the following statements concerning a sole proprietorship is correct?
A. A sole proprietorship is the least common form of business ownership.
B. The profits of a sole proprietorship are taxed twice.
C. The owners of a sole proprietorship share profits as established by the partnership agreement.
D. The owner of a sole proprietorship may be forced to sell his/her personal assets to pay company debts.
E. A sole proprietorship is often structured as a limited liability company.

26. Which one of the following statements concerning a sole proprietorship is correct?
A. The life of the firm is limited to the life span of the owner.
B. The owner can generally raise large sums of capital quite easily.
C. The ownership of the firm is easy to transfer to another individual.
D. The company must pay separate taxes from those paid by the owner.
E. The legal costs to form a sole proprietorship are quite substantial.

27. Which one of the following best describes the primary advantage of being a limited partner rather than a general partner?
A. Entitlement to a larger portion of the partnership's income
B. Ability to manage the day-to-day affairs of the business
C. No potential financial loss
D. Greater management responsibility
E. Liability for firm debts limited to the capital invested

28. A general partner:
A. has less legal liability than a limited partner.
B. has more management responsibility than a limited partner.
C. faces double taxation whereas a limited partner does not.
D. cannot lose more than the amount of his/her equity investment.
E. is the term applied only to corporations which invest in partnerships.

29. A partnership:
A. is taxed the same as a corporation.
B. agreement defines whether the business income will be taxed like a partnership or a corporation.
C. terminates at the death of any general partner.
D. has less of an ability to raise capital than a proprietorship.
E. allows for easy transfer of interest from one general partner to another.

30. Which of the following are disadvantages of a partnership?

    I. Limited life of the firm
    II. Personal liability for firm debt
    III. Greater ability to raise capital than a sole proprietorship
    IV. Lack of ability to transfer partnership interest
    A. I and II only
    B. III and IV only
    C. II and III only
    D. I, II, and IV only
    E. I, III, and IV only

31. Which of the following are advantages of the corporate form of business ownership?

    I. limited liability for firm debt
    II. double taxation
    III. ability to raise capital
    IV. unlimited firm life
    A. I and II only
    B. III and IV only
    C. I, II, and III only
    D. II, III, and IV only
    E. I, III, and IV only

32. Which one of the following statements is correct concerning corporations?
    A. The largest firms are usually corporations.
    B. The majority of firms are corporations.
    C. The stockholders are usually the managers of a corporation.
    D. The ability of a corporation to raise capital is quite limited.
    E. The income of a corporation is taxed as personal income of the stockholders.

33. Which one of the following statements is correct?
    A. Both partnerships and corporations incur double taxation.
    B. Both sole proprietorships and partnerships are taxed in a similar fashion.
    C. Partnerships are the most complicated type of business to form.
    D. Both partnerships and corporations have limited liability for general partners and shareholders.
    E. All types of business formations have limited lives.

34. The articles of incorporation:
    A. can be used to remove company management.
    B. are amended annually by the company stockholders.
    C. set forth the number of shares of stock that can be issued.
    D. set forth the rules by which the corporation regulates its existence.
    E. can set forth the conditions under which the firm can avoid double taxation.

35. The bylaws:
    A. establish the name of the corporation.
    B. are rules which apply only to limited liability companies.
    C. set forth the purpose of the firm.
    D. mandate the procedure for electing corporate directors.
    E. set forth the procedure by which the stockholders elect the senior managers of the firm.

36. The owners of a limited liability company prefer:
    A. being taxed like a corporation.
    B. having liability exposure similar to that of a sole proprietor.
    C. being taxed personally on all business income.
    D. having liability exposure similar to that of a general partner.
    E. being taxed like a corporation with liability like a partnership.

37. Which one of the following business types is best suited to raising large amounts of capital?
    A. sole proprietorship
    B. limited liability company
    C. corporation
    D. general partnership
    E. limited partnership

38. Which type of business organization has all the respective rights and privileges of a legal person?
    A. sole proprietorship
    B. general partnership
    C. limited partnership
    D. corporation
    E. limited liability company

39. Financial managers should strive to maximize the current value per share of the existing stock because:
    A. doing so guarantees the company will grow in size at the maximum possible rate.
    B. doing so increases the salaries of all the employees.
    C. the current stockholders are the owners of the corporation.
    D. doing so means the firm is growing in size faster than its competitors.
    E. the managers often receive shares of stock as part of their compensation.

40. The decisions made by financial managers should all be ones which increase the:
    A. size of the firm.
    B. growth rate of the firm.
    C. marketability of the managers.
    D. market value of the existing owners' equity.
    E. financial distress of the firm.

41. Which one of the following actions by a financial manager creates an agency problem?
    A. Refusing to borrow money when doing so will create losses for the firm
    B. Refusing to lower selling prices if doing so will reduce the net profits
    C. Agreeing to expand the company at the expense of stockholders' value
    D. Agreeing to pay bonuses based on the book value of the company stock
    E. Increasing current costs in order to increase the market value of the stockholders' equity

42. Which of the following help convince managers to work in the best interest of the stockholders?

    I. compensation based on the value of the stock
    II. stock option plans
    III. threat of a proxy fight
    IV. threat of conversion to a partnership
    A. I and II only
    B. II and III only
    C. I, II and III only
    D. I and III only
    E. I, II, III, and IV

43. Which form of business structure faces the greatest agency problems?
    A. sole proprietorship
    B. general partnership
    C. limited partnership
    D. corporation
    E. limited liability company

44. A proxy fight occurs when:
A. the board solicits renewal of current members.
B. a group solicits proxies to replace the board of directors.
C. a competitor offers to sell their ownership in the firm.
D. the firm files for bankruptcy.
E. the firm is declared insolvent.

45. Which one of the following parties is considered a stakeholder of a firm?
A. employee
B. short-term creditor
C. long-term creditor
D. preferred stockholder
E. common stockholder

46. Which of the following are key requirements of the Sarbanes-Oxley Act?

I. Officers of the corporation must review and sign annual reports.
II. Officers of the corporation must now own more than 5% of the firm's stock.
III. Annual reports must list deficiencies in internal controls.
IV. Annual reports must be filed with the SEC within 30 days of year end.
A. I only.
B. II only.
C. I and III only.
D. II and III only.
E. II and IV only.

47. Insider trading is:
A. legal.
B. illegal.
C. impossible to have in our efficient market.
D. discouraged, but legal.
E. list only the securities of the largest firms.

48. Sole proprietorships are predominantly started because:
A. they are easily and cheaply setup.
B. the proprietorship life is limited to the business owner's life.
C. all business taxes are paid as individual tax.
D. All of these.
E. None of these.

49. Managers are encouraged to act in shareholders' interests by:
A. shareholder election of a board of directors who select management.
B. the threat of a takeover by another firm.
C. compensation contracts that tie compensation to corporate success.
D. Both shareholder election of a board of directors who select management; and the threat of a takeover by another firm.
E. All of these.

50. The Securities Exchange Act of 1934 focuses on:
A. all stock transactions.
B. sales of existing securities.
C. issuance of new securities.
D. insider trading.
E. Federal Deposit Insurance Corporation (FDIC) insurance.

51. The basic regulatory framework in the United States was provided by:
    A. the Securities Act of 1933.
    B. the Securities Exchange Act of 1934.
    C. the monetary system.
    D. the Securities Act of 1933 and the Securities Exchange Act of 1934.
    E. All of these.

52. The Securities Act of 1933 focuses on:
    A. all stock transactions.
    B. sales of existing securities.
    C. issuance of new securities.
    D. insider trading.
    E. Federal Deposit Insurance Corporation (FDIC) insurance.

53. In a limited partnership:
    A. each limited partner's liability is limited to his net worth.
    B. each limited partner's liability is limited to the amount he put into the partnership.
    C. each limited partner's liability is limited to his annual salary.
    D. there is no limitation on liability; only a limitation on what the partner can earn.
    E. None of these.

54. Accounting profits and cash flows are:
    A. generally the same since they reflect current laws and accounting standards.
    B. generally the same since accounting profits reflect when the cash flows are received.
    C. generally not the same since GAAP allows for revenue recognition separate from the receipt of cash flows.
    D. generally not the same because cash inflows occur before revenue recognition.
    E. Both generally not the same since GAAP allows for revenue recognition separate from the receipt of cash flows; and generally not the same because cash inflows occur before revenue recognition.

55. The Chief Executive Officer typically reports to the
    A. Board of Director's
    B. Granting authority
    C. President
    D. CFO
    E. None of these

56. The cheapest business to form is typically the
    A. General corporation
    B. Sub-chapter S Corporation
    C. General Partnership
    D. Limited Partnership
    E. Sole proprietorship

57. In a general partnership, the general partners have
    A. Limited liability
    B. Unlimited liability
    C. No liability
    D. Minimal liability
    E. It depends on the partners' decision

58. Managers that are successful in pursuing stockholder goals can
    A. See very little reward
    B. See no financial gain through raises and bonuses
    C. Never become stockholders
    D. Reap enormous rewards
    E. Start a proxy fight with stockholders

59. List and briefly describe the three basic questions addressed by a financial manager.

60. What advantages does the corporate form of organization have over sole proprietorships or partnerships?

61. If the corporate form of business organization has so many advantages over the sole proprietorship, why is it so common for small businesses to initially be formed as sole proprietorships?

62. What should be the goal of the financial manager of a corporation? Why?

63. Do you think agency problems arise in sole proprietorships and/or partnerships?

64. Assume for a moment that the stockholders in a corporation have unlimited liability for corporate debts. If so, what impact would this have on the functioning of primary and secondary markets for common stock?

65. Suppose you own 100 shares of IBM stock which you intend to sell today. Since you will sell it in the secondary market, IBM will receive no direct cash flows as a consequence of your sale. Why, then, should IBM's management care about the price you get for your shares?

66. One thing lenders sometimes require when loaning money to a small corporation is an assignment of the common stock as collateral on the loan. Then, if the business fails to repay its loan, the ownership of the stock certificates can be transferred directly to the lender. Why might a lender want such an assignment? What advantage of the corporate form of organization comes into play here?

67. Why might a corporation wish to list its shares on a national exchange such as the NYSE as opposed to a regional exchange or NASDAQ?

ch01 Key

1. C
2. A
3. D
4. E
5. A
6. B
7. C
8. D
9. A
10. E
11. D
12. A
13. B
14. C
15. D
16. E
17. D
18. E
19. B
20. B
21. D
22. A
23. E
24. E
25. D
26. A
27. E
28. B
29. C
30. D
31. E
32. A
33. B
34. C
35. D
36. C

37. C

38. D

39. C

40. D

41. C

42. C

43. D

44. B

45. A

46. C

47. B

48. D

49. E

50. D

51. D

52. C

53. B

54. C

55. A

56. E

57. B

58. D

3. Working capital management: This refers to a firm's short-term assets and short-term liabilities. Managing the firm's working capital is a day-to-day activity that ensures the firm has sufficient resources to continue its operations and avoid costly interruptions.
2. Capital structure: This refers to the specific mixture of long-term debt and equity a firm uses to finance its operations.
1. Capital budgeting: The financial manager tries to identify investment opportunities that are worth more to the firm than they cost to acquire.
59. The three areas are:

60. The advantages of the corporate form of organization over sole proprietorships and partnerships are the ease of transferring ownership, the owners' limited liability for business debts, the ability to raise more capital, and the opportunity of an unlimited life of the business.

61. A significant advantage of the sole proprietorship is that it is cheap and easy to form. If the sole proprietor has limited capital to start with, it may not be desirable to spend part of that capital forming a corporation. Also, limited liability for business debts may not be a significant advantage if the proprietor has limited capital, most of which is tied up in the business anyway. Finally, for a typical small business, the heart and soul of the business is the person who founded it, so the life of the business may effectively be limited to the life of the founder during its early years.

62. The correct goal is to maximize the current value of the outstanding stock. This goal focuses on enhancing the returns to stockholders who are the owners of the firm. Other goals, such as maximizing earnings, focus too narrowly on accounting income and ignore the importance of market values in managerial finance.

63. Agency conflicts typically arise when there is a separation of ownership and management of a business. In a sole proprietorship and a small partnership, such separation is not likely to exist to the degree it does in a corporation. However, there is still potential for agency conflicts. For example, as employees are hired to represent the firm, there is once again a separation of ownership and management.

64. With unlimited liability, you would be very careful which stocks you invest in. In particular, you would not invest in companies you expected to be unable to satisfy their financial obligations. Both the primary and secondary markets for common stock would be severely hampered if this rule existed. It would be very difficult for a young, untested business to acquire enough capital to grow.

65. The current market price of IBM stock reflects, among other things, market opinion about the quality of firm management. If the shareholder's sale price is low, this indirectly reflects on the reputation of the managers, as well as potentially impacting their standing in the employment market. Alternatively, if the sale price is high, this indicates that the market believes current management is increasing firm value and therefore doing a good job.

66. In the event of a loan default, a lender may wish to liquidate the business. Often it is time consuming and difficult to take title of all of the business assets individually. By taking control of the stock, the lender is able to sell the business simply by reselling the stock in the business. This illustrates once again the ease of transfer of ownership of a corporation.

67. Being listed on a regional exchange effectively limits the capital access for the business. Plus, there is a prestige factor in being listed on one of the national exchanges. There is still a perceived prestige factor in moving from NASDAQ to the NYSE since the NYSE has more restrictive membership requirements. However, the lure of greater prestige certainly hasn't prompted some major corporations, such as Microsoft, to move to the NYSE.

ch01 Summary

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