

Chapter 01

Introduction to Financial Management

Test Bank - Static Key

1. Jenna has been promoted and is now in charge of all external financing. In other words, she is in charge of:

- A. capital structure management.
- B. asset allocation.
- C. risk management.
- D. capital budgeting.
- E. working capital management.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.
Section: 1.2 Business Finance and the Financial Manager
Topic: Financial management decisions

2. Uptown Markets is financed with 45 percent debt and 55 percent equity. This mixture of debt and equity is referred to as the firm's:

- A. capital structure.
- B. capital budget.
- C. asset allocation.
- D. working capital.
- E. risk structure.

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Blooms: Remember
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3. Theo's BBQ has \$48,000 in current assets and \$39,000 in current liabilities. Decisions related to these accounts are referred to as:

- A. capital structure decisions.
- B. capital budgeting decisions.
- C. working capital management.
- D. operating management.
- E. fixed account structure.

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4. Margie opened a used bookstore and is both the 100 percent owner and the store's manager. Which type of business entity does Margie own if she is personally liable for all the store's debts?

- A. Sole proprietorship
- B. Limited partnership
- C. Corporation
- D. Joint stock company
- E. General partnership

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Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.3 Forms of Business Organization
Topic: Forms of business organization

5. Will and Bill both enjoy sunshine, water, and surfboards. Thus, the two friends decided to create a business together renting surfboards, paddle boats, and inflatable devices in California. Will and Bill will equally share in the decision making and in the business profits or losses. Which type of business did they create if they both have full personal liability for the firm's debts?

- A. Sole proprietorship
- B. Limited partnership
- C. Corporation
- D. Joint stock company
- E. General partnership

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6. Matt and Alicia created a firm that is a separate legal entity and will share ownership of that firm on a 75/25 basis. Which type of entity did they create if they have no personal liability for the firm's debts?

- A. Limited partnership
- B. Corporation
- C. Sole proprietorship
- D. General partnership
- E. Public company

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7. The potential conflict of interest between a firm's owners and its managers is referred to as which type of conflict?

- A. Organizational
- B. Structural
- C. Formative
- D. Agency
- E. Territorial

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.
Section: 1.5 The Agency Problem and Control of the Corporation

8. An employee has a claim on the cash flows of Martin's Machines. This claim is defined as a claim by one of the firm's:

- A. residual owners.
- B. shareholders.
- C. financiers.
- D. provisional partners.
- E. stakeholders.**

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Topic: Introduction to corporate finance

9. The shareholders of Weil's Markets would benefit if the firm were to be acquired by Better Foods. However, Weil's board of directors rejects the acquisition offer. This is an example of:

- A. a corporate takeover.
- B. a capital structure issue.
- C. a working capital decision.
- D. an agency conflict.**
- E. a compensation issue.

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Blooms: Remember
Difficulty: 1 Easy

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Topic: Agency costs and problems

10. When conducting a financial analysis of a firm, financial analysts:

- A. cannot use accounting information as it is historical.
- B. rely solely on accounting information.
- C. frequently use accounting information.**
- D. ignore accounting information but do use marketing information.
- E. assume the future will be a repeat of the past as reflected in the firm's accounting reports.

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Section: 1.1 Finance: A Quick Look
Topic: Introduction to corporate finance

11. Jamie is employed as a currency trader in the Japanese yen market. Her job falls into which one of the following areas of finance?

- A. International finance**
- B. Financial institutions
- C. Corporate finance
- D. Capital management
- E. Personal finance

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12. If you accept a job as a domestic security analyst for a brokerage firm, you are most likely working in which one of the following financial areas?

- A. International finance
- B. Private placements
- C. Corporate finance
- D. Capital management
- E. Investments**

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Topic: Introduction to corporate finance

13. Which one of the following occupations best fits into the corporate area of finance?

- A. Mortgage broker
- B. Treasury bill analyst
- C. Chief financial officer**
- D. Insurance risk manager
- E. Local bank manager

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14. Which one of the following functions is generally a responsibility assigned to the corporate treasurer?

- A. Cost accounting
- B. Data processing
- C. Corporate taxes
- D. Financial accounting
- E. Capital expenditures**

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Topic: Management organization and roles

15. Which one of the following functions should be assigned to the corporate treasurer rather than to the controller?

- A. Data processing
- B. Cost accounting
- C. Tax management
- D. Cash management**

E. Financial accounting

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Topic: Management organization and roles

16. Which one of the following correctly defines a common chain of command within a corporation?

- A. The controller reports directly to the corporate treasurer.
- B. The treasurer reports directly to the board of directors.
- C. The chief financial officer reports directly to the board of directors.
- D. The credit manager reports directly to the controller.
- E. The controller reports directly to the chief financial officer.**

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17. Capital budgeting includes the evaluation of which of the following?

- A. Size of future cash flows only
- B. Size and timing of future cash flows only
- C. Timing and risk of future cash flows only
- D. Risk and size of future cash flows only
- E. Size, timing, and risk of future cash flows**

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18. Which one of the following is a working capital decision?

- A. How should the firm raise additional capital to fund its expansion?
- B. What debt-equity ratio is best suited to the firm?
- C. What is the cost of debt financing?
- D. Should the firm borrow money for five or for ten years?
- E. How much cash should the firm keep in reserve?**

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Difficulty: 2 Medium

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19. Which one of the following is a capital structure decision?

- A. Determining the optimal inventory level
- B. Establishing the preferred debt-equity level**
- C. Selecting new equipment to purchase

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- D. Setting the terms of sale for credit sales
- E. Determining when suppliers should be paid

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20. Working capital management includes which one of the following?

- A. Deciding which new projects to accept
- B. Deciding whether to purchase a new machine or fix a currently owned machine
- C. Determining which customers will be granted credit**
- D. Determining how many new shares of stock should be issued
- E. Establishing the target debt-equity ratio

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21. The daily financial operations of a firm are primarily controlled by managing the:

- A. total debt level.
- B. working capital.**
- C. capital structure.
- D. capital budget.
- E. long-term liabilities.

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22. A sole proprietorship:

- A. provides limited financial liability for its owner.
- B. involves significant legal costs during the formation process.
- C. has an unlimited life.
- D. has its profits taxed as personal income.**
- E. can generally raise significant capital from non-owner sources.

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23. Which one of the following forms of business organization offers liability protection to some of its owners but not to all of its owners?

- A. Sole proprietorship

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- B. General partnership
- C. Limited partnership**
- D. Limited liability company
- E. Corporation

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24. Maria is the sole proprietor of an antique store that is located in a rented warehouse. The store has an outstanding loan with the local bank but no other debt obligations. There are no specific assets pledged as security for the loan. Due to a sudden and unexpected downturn in the economy, the store is unable to generate sufficient funds to pay the loan payments due to the bank. Which of the following options does the bank have to collect the money it is owed?

- I. Sell the inventory and apply the proceeds to the debt
- II. Sell the lighting fixtures from the building and apply the proceeds to the debt
- III. Withdraw funds from Maria's personal account at the bank to pay the store's debt
- IV. Sell any assets Maria personally owns and apply the proceeds to the store's debt

- A. I only
- B. III only
- C. I and II only
- D. I, II, and III only
- E. I, III, and IV only**

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25. Which one of the following statements correctly applies to a sole proprietorship?

- A. The business entity has an unlimited life.
- B. The ownership can easily be transferred to another individual.
- C. The owner enjoys limited liability for the firm's debts.
- D. Debt financing is easy to arrange in the firm's name.
- E. Obtaining additional equity is dependent on the owner's personal finances.**

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26. Which one of the following applies to a general partnership?

- A. The firm's operations must be controlled by a single partner.
- B. Any one of the partners can be held solely liable for all of the partnership's debt.**
- C. The profits of the firm are taxed as a separate entity.
- D. Each partner's liability for the firm's debts is limited to each partner's investment in the firm.

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E. The profits of a general partnership are taxed the same as those of a corporation.

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27. In a general partnership, each partner is personally liable for:

- A. only the partnership debts that he or she personally created.
- B. his or her proportionate share of all partnership debts regardless of which partner incurred that debt.
- C.** the total debts of the partnership, even if he or she was unaware of those debts.
- D. the debts of the partnership up to the amount he or she invested in the firm.
- E. all personal and partnership debts incurred by any partner, even if he or she was unaware of those debts.

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28. Which one of the following is an advantage of being a limited partner?

- A. Nontaxable share of any profits
- B. Control over the daily operations of the firm
- C.** Losses limited to capital invested
- D. Unlimited profits without risk of incurring a loss
- E. Active market for ownership interest

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29. Which one of the following statements about a limited partnership is correct?

- A. All partners have their losses limited to their capital investment in the partnership.
- B. All partners are treated equally.
- C.** There must be at least one general partner.
- D. Equity financing is easy to obtain and unlimited.
- E. Any partner can transfer his or her ownership interest without ending the partnership.

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30. A corporation:

- A. is ultimately controlled by its board of directors.

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- B.** is a legal entity separate from its owners.
- C. is prohibited from entering into contractual agreements.
- D. has its identity defined by its bylaws.
- E. has its existence regulated by the rules set forth in its charter.

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31. Which one of the following is contained in the corporate bylaws?

- A.** Procedures for electing corporate directors
- B. State of incorporation
- C. Number of authorized shares
- D. Intended life of the corporation
- E. Business purpose of the corporation

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Difficulty: 1 Easy

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Section: 1.3 Forms of Business Organization
Topic: Forms of business organization

32. One advantage of the corporate form of organization is the:

- A. taxation of the corporate profits.
- B. unlimited liability for its shareholders.
- C. double taxation of profits.
- D.** ability to raise larger sums of equity capital than other organizational forms.
- E. ease of formation compared to other organizational forms.

AACSB: Analytical Thinking
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Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
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33. Corporate shareholders:

- A. are proportionately liable for the firm's debts.
- B. are protected from all financial losses.
- C.** have the ability to change the corporation's bylaws.
- D. receive tax-free distributions since all profits are taxed at the corporate level.
- E. have basically no control over the actual corporation.

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34. A limited liability company (LLC):

- A. is a hybrid between a sole proprietorship and a partnership.
- B.** prefers its profits be taxed as personal income to its owners.

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- C. that meets the IRS criteria to be an LLC will be taxed like a corporation.
- D. provides limited liability for some, but not all, of its owners.
- E. cannot be created for professional service firms, such as accountants and attorneys.

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35. Limited liability companies are primarily designed to:

- A. allow a portion of their owners to enjoy limited liability while granting the other portion of their owners control over the entity.
- B. provide the benefits of the corporate structure only to foreign-based entities.
- C. spin off a wholly owned subsidiary.
- D. allow companies to reorganize themselves through the bankruptcy process.
- E. provide limited liability while avoiding double taxation.

AACSB: Analytical Thinking
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 Difficulty: 1 Easy

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36. The primary goal of financial management is to maximize:

- A. current profits.
- B. market share.
- C. current dividends.
- D. the market value of existing stock.
- E. revenue growth.

AACSB: Analytical Thinking
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 Blooms: Remember
 Difficulty: 1 Easy

Learning Objective: 01-02 Identify the goal of financial management.
 Section: 1.4 The Goal of Financial Management
 Topic: Goal of financial management

37. The primary goal of financial management is most associated with increasing the:

- A. dollar amount of each sale.
- B. traffic flow within the firm's stores.
- C. the fixed costs while lowering the variable costs.
- D. firm's liquidity.
- E. market value of the firm.

AACSB: Analytical Thinking
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 Blooms: Understand
 Difficulty: 2 Medium

Learning Objective: 01-02 Identify the goal of financial management.
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38. The goal of financial management is to increase the:

- A. future value of the firm's total equity.
- B. book value of equity.

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- C. dividends paid per share.
- D.** current market value per share.
- E. number of shares outstanding.

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 Difficulty: 1 Easy
 Learning Objective: 01-02 Identify the goal of financial management.
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39. What is the primary goal of financial management for a sole proprietorship?

- A. Maximize net income given the current resources of the firm
- B. Decrease long-term debt to reduce the risk to the owner
- C. Minimize the tax impact on the proprietor
- D.** Maximize the market value of the equity
- E. Minimize the reliance on fixed costs

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40. The Sarbanes-Oxley Act in 2002 was primarily prompted by which one of the following from the 1990s?

- A. Increased stock market volatility
- B.** Corporate accounting and financial fraud
- C. Increased executive compensation
- D. Increased foreign investment in U.S. stock markets
- E. Increased use of tax loopholes

AACSB: Ethics
 Accessibility: Keyboard Navigation
 Blooms: Remember
 Difficulty: 1 Easy
 Learning Objective: 01-02 Identify the goal of financial management.
 Section: 1.4 The Goal of Financial Management
 Topic: Ethics, governance, and regulation

41. The Sarbanes-Oxley Act of 2002 has:

- A. reduced the annual compliance costs of all publicly traded firms in the U.S.
- B. decreased senior management's involvement in the corporate annual report.
- C. greatly increased the number of U.S. firms that are going public for the first time.
- D. decreased the number of U.S. firms going public on foreign exchanges.
- E.** essentially made officers of publicly traded firms personally responsible for the firm's financial statements.

AACSB: Ethics
 Accessibility: Keyboard Navigation
 Blooms: Understand
 Difficulty: 2 Medium
 Learning Objective: 01-02 Identify the goal of financial management.
 Section: 1.4 The Goal of Financial Management
 Topic: Ethics, governance, and regulation

42. Which one of the following best describes the primary intent of the Sarbanes-Oxley Act of 2002?

- A. Decrease the number of corporations that can be publicly traded
- B.** Increase the protections against corporate fraud
- C. Limit secondary issues of corporate securities
- D. Increase the dividends paid to shareholders

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E. Increase the number of firms that "go dark"

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Topic: Ethics, governance, and regulation

43. The Sarbanes-Oxley Act:

- A. require the corporate officers to personally attest that the financial statements are a fair representation of the company's financial results.
- B. requires all corporations to fully disclose its financial dealings to the general public.
- C. places the responsibility for a firm's financial statements solely on the chief financial officer.
- D. requires that the board of directors be solely responsible for the firm's financial dealings.
- E. places total responsibility for the financial statements of a firm on the auditor who certifies the statements.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
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Section: 1.4 The Goal of Financial Management
Topic: Ethics, governance, and regulation

44. Which one of the following situations is most apt to create an agency conflict?

- A. Compensating a manager based on his or her division's net income
- B. Giving all employees a bonus if a certain level of efficiency is maintained
- C. Hiring an independent consultant to study the operating efficiency of the firm
- D. Basing management bonuses on the length of employment
- E. Laying off employees during a slack period

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
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Section: 1.5 The Agency Problem and Control of the Corporation
Topic: Agency costs and problems

45. An agency issue is most apt to develop when:

- A. a firm encounters a period of stagnant growth.
- B. a firm downsizes.
- C. the control of a firm is separated from the firm's ownership.
- D. the firm's owner is also its key manager.
- E. a firm is structured as a general partnership.

AACSB: Ethics
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46. Which one of the following is most apt to align management's priorities with shareholders' interests?

- A. Holding corporate and shareholder meetings at high-end resort-type locations preferred by managers
- B. Compensating managers with shares of stock that must be held for a minimum of three years
- C. Paying a special management bonus on every fifth year of employment
- D. Increasing the number of paid holidays that long-term employees are entitled to receive
- E. Allowing employees to retire early with full retirement benefits

AACSB: Ethics
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Difficulty: 2 Medium
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47. Probably the least effective means of aligning management goals with shareholder interests is:

- A. the potential for a proxy fight by an unhappy segment of shareholders.
- B. basing all management bonuses on performance goals.
- C. holding management salaries steady while increasing stock option grants.
- D. the threat of a takeover of the firm.
- E. automatically increasing management salaries on an annual basis.**

AACSB: Ethics
Accessibility: Keyboard Navigation
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48. Levi had an unexpected surprise when he returned home this morning. He found that a chemical spill from a local manufacturer had spilled over onto his property. The potential claim that he has against this manufacturer is that of a(n):

- A. general creditor.
- B. debtholder.
- C. shareholder.
- D. stakeholder.**
- E. agent.

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49. One example of a primary market transaction would be the:

- A. sale of 100 shares of stock by Maria to her best friend.
- B. purchase by Theo of 5,000 shares of stock from his father.
- C. sale of 1,000 shares of newly issued stock by Alt Company to Miquel.**
- D. sale by Terry of 50,000 shares of stock to his brother.
- E. sale of 5,000 shares of stock owned by a corporate CEO to his son.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Primary and secondary markets

50. You contacted your stock broker this morning and placed an order to sell 300 shares of a stock that trades on the NYSE. This sale will occur in the:

- A. dealer market.
- B. over-the-counter market.
- C. secondary market.**
- D. primary market.
- E. tertiary market.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Primary and secondary markets

51. Which one of the following statements is correct?

- A. All secondary markets are dealer markets.
- B. All secondary markets are broker markets.
- C. All stock trades between existing shareholders are primary market transactions.
- D. All stock transactions are secondary market transactions.
- E. All over-the-counter sales occur in dealer markets.**

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Topic: Primary and secondary markets

52. The issuer of a security must be involved in all _____ transactions involving that security.

- A. exchange-listed
- B. secondary market
- C. over-the-counter
- D. dealer market
- E. primary market**

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53. Which one of the following parties can sell shares of ABC stock in the primary market?

- A. ABC company**
- B. Any corporation, other than the ABC Company
- C. Any institutional shareholder
- D. Any private individual shareholder
- E. Only officers and directors of ABC Company

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Section: 1.6 Financial Markets and the Corporation
Topic: Primary and secondary markets

54. Security dealers:

- A. match buyers with sellers.
- B. buy and sell from their own inventory.**
- C. operate on a physical trading floor.
- D. operate exclusively in auction markets.
- E. are limited to trading non-listed stocks.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Dealers and brokers

55. An auction market:

- A. is an electronic means of exchanging securities.
- B. has a physical trading floor.**
- C. handles primary market transactions exclusively.
- D. is also referred to as an OTC market.
- E. is dealer-based.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Financial market regulation

56. Which one of the following statements is correct?

- A. NASDAQ has more listed stocks than does the NYSE.**
- B. The NYSE is a dealer market.
- C. NASDAQ is an auction market.
- D. NASDAQ has the most stringent listing requirements of any U.S. exchange.
- E. The trading floor for NASDAQ is located in Chicago.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Financial market regulation

57. A private placement is most apt to involve:

- A. a large number of private investors.
- B. only foreign investors.
- C. a life-insurance company.**
- D. several private securities dealers.
- E. the U.S. Treasury department.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.
Section: 1.6 Financial Markets and the Corporation
Topic: Private placements and leveraged buyouts

58. Which one of the following statements is correct?

- A. All of the major stock exchanges are U.S. based.
- B. The NYSE was created by the National Association of Securities Dealers in the early 1930s.
- C. The Chicago Stock Exchange is a dealer market.
- D. OTC markets have a physical trading floor generally located in either New York City or Chicago.

E. The primary purpose of the NYSE is to match buyers with sellers.

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6 Financial Markets and the Corporation

Topic: Financial management decisions