

Corporate Finance, 12e (Ross)

Chapter 1 Introduction to Corporate Finance

1) 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.

Answer: E

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Management organization and roles

Bloom's: Remember

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2) Which one of the following statements correctly depicts the common chain of command in a corporation?

- A) The information systems manager reports to the treasurer.
- B) The credit manager reports to the treasurer.
- C) The controller reports to the chief executive officer.
- D) The tax manager reports to the treasurer.
- E) The capital expenditures manager reports to the controller.

Answer: B

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Management organization and roles

Bloom's: Remember

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- 3) 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 a new production facility should be built
 - C) Deciding when to repay a long-term debt
 - D) Determining how much inventory to keep on hand
 - E) Deciding how much credit to grant to a particular customer

Answer: B

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Capital budgeting

Bloom's: Understand

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- 4) Which one of these is a correct definition?
- A) Net working capital equals current assets plus current liabilities.
 - B) Current liabilities are debts that must be repaid in 18 months or less.
 - C) Current assets are assets with short lives, such as accounts receivable.
 - D) Long-term debt is defined as a residual claim on a firm's assets.
 - E) Tangible assets are fixed assets such as patents.

Answer: C

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Introduction to corporate finance

Bloom's: Remember

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- 5) The corporate controller is generally responsible for which one of these functions?
- A) Capital expenditures
 - B) Cash management
 - C) Tax reporting
 - D) Financial planning
 - E) Credit management

Answer: C

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Management organization and roles

Bloom's: Remember

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6) The corporate treasurer oversees which one of these areas?

- A) Financial planning
- B) Cost accounting
- C) Tax reporting
- D) Information systems
- E) Financial accounting

Answer: A

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Management organization and roles

Bloom's: Remember

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7) A firm's capital structure refers to the firm's:

- A) mixture of various types of production equipment.
- B) investment selections for its excess cash reserves.
- C) combination of cash and cash equivalents.
- D) combination of accounts appearing on the left side of its balance sheet.
- E) proportions of financing from current and long-term debt and equity.

Answer: E

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Capital structure

Bloom's: Remember

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8) Short-term finance deals with:

- A) the timing of cash flows.
- B) acquiring and selling fixed assets.
- C) financing long-term projects.
- D) capital budgeting.
- E) issuing additional shares of common stock.

Answer: A

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Cash management - general

Bloom's: Understand

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9) Which one of these accounts is included in net working capital?

- A) Copyright
- B) Manufacturing equipment
- C) Common stock
- D) Long-term debt
- E) Inventory

Answer: E

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Net working capital

Bloom's: Understand

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10) The process of planning and managing a firm's long-term assets is called:

- A) working capital management.
- B) cash management.
- C) cost accounting management.
- D) capital budgeting.
- E) capital structure management.

Answer: D

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Capital budgeting

Bloom's: Remember

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11) Any debt that must be repaid within the next year is recorded on the balance sheet as:

- A) a current liability.
- B) long-term debt.
- C) an intangible asset.
- D) accounts receivable.
- E) a current asset.

Answer: A

Difficulty: 1 Easy

Section: 1.1 What is Corporate Finance?

Topic: Balance sheet

Bloom's: Remember

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12) The cheapest business entity to form is typically the:

- A) limited liability company.
- B) joint stock company.
- C) general partnership.
- D) limited partnership.
- E) sole proprietorship.

Answer: E

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Remember

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13) 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.

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Remember

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14) Which one of the following statements concerning a sole proprietorship is correct?

- A) A sole proprietorship is difficult to form.
- B) The business profits are taxed twice at the federal level.
- C) The business profits are taxed separately from the personal income of the owner.
- D) The owner may be forced to sell his/her personal assets to pay company debts.
- E) A sole proprietorship has an unlimited life.

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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15) Which one of the following statements concerning a sole proprietorship is correct?

- A) The ability to raise capital is limited by the owner's personal wealth.

- B) The proprietorship pays taxes at the corporate tax rate.
- C) The ownership of the firm is easy to transfer to another individual.
- D) The company must pay income taxes separate from the taxes paid by the owner.
- E) The legal costs to form a sole proprietorship are quite substantial.

Answer: A

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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16) Which one of these characteristics 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) Day-to-day management control of the business
- C) Profits free of any income taxation
- D) Overall control of the partnership
- E) Personal financial liability limited to the capital invested

Answer: E

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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17) A general partner:

- A) has less legal liability than a limited partner.
- B) can end the partnership by withdrawing.
- C) faces double taxation of profits 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.

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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18) A partnership:

- A) is taxed the same as a corporation.
- B) terminates at the death of any limited partner.
- C) creates an unlimited liability for all general partners for the partnership's debts.
- D) has the same ability as a corporation to raise capital.
- E) allows for easy transfer of interest from one general partner to another.

Answer: C

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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19) One advantage of a partnership is the:

- A) personal liability for all of the firm's debts.
- B) limited life of the entity.
- C) limited liability protection for all of the partners.
- D) relatively low formation cost.
- E) ease of transferring full ownership.

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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20) One disadvantage of the corporate form of business ownership is the:

- A) limited liability protection provided for all owners.
- B) firm's ability to raise cash.
- C) unlimited life of the firm.
- D) difficulties encountered when changing ownership.
- E) double taxation of profits.

Answer: E

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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- 21) Which one of the following statements is correct?
- A) Both partnerships and corporations incur double taxation.
 - B) 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.

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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- 22) The articles of incorporation:
- A) can be used to remove the firm's management.
 - B) are amended annually by the firm's stockholders.
 - C) set forth the rights granted to shareholders.
 - 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.

Answer: C

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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- 23) Corporate bylaws:
- A) establish the name of the corporation.
 - B) establish the rights granted to its shareholders.
 - C) set forth the purpose of the firm.
 - D) establish the rules by which the corporation regulates its existence.
 - E) set forth the number of members of the initial board of directors.

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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24) Which statement concerning corporations is correct?

- A) There are time limits placed on the transfer of ownership.
- B) The ability to raise capital is limited to that of a general partnership.
- C) Primary shareholders have unlimited liability for corporate debts.
- D) The entity can outlive all of its initial owners.
- E) When the last original owner dies or withdraws, the entity is terminated.

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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25) Given the corporate form of business organization, ownership:

- A) must be granted with equal rights assigned to each and every shareholder.
- B) transfers are unlimited.
- C) can only be transferred with the approval of the board of directors.
- D) is controlled by the corporate officers.
- E) must be held by non-management owners.

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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26) The owners of a limited liability company generally 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.

Answer: C

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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27) In a general partnership, the general partners have _____ liability for the firm's debts and have _____ control over day-to-day operations.

- A) limited; no
- B) unlimited; total
- C) limited; total
- D) unlimited; no
- E) unlimited; limited

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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28) 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

Answer: C

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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29) Which type of business organization has the respective rights and privileges of a legal person?

- A) Sole proprietorship
- B) General partnership
- C) Limited partnership
- D) Corporation
- E) Limited liability company

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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30) A business formed by two or more individuals who each have unlimited personal liability for all of the firm's debts is called a:

- A) corporation.
- B) sole proprietorship.
- C) general partnership.
- D) limited partnership.
- E) limited liability company.

Answer: C

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

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31) The understanding of the work and cash to be contributed to a partnership by each member of that partnership is formalized in the:

- A) indemnity clause.
- B) indenture contract.
- C) statement of purpose.
- D) partnership agreement.
- E) group charter.

Answer: D

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Remember

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32) A business created as a distinct legal entity is called a:

- A) corporation.
- B) sole proprietorship.
- C) general partnership.
- D) limited partnership.
- E) unlimited liability company.

Answer: A

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Remember

AACSB: Reflective Thinking

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- 33) In a limited partnership, each limited partner's liability for the partnership's debts is:
- A) limited to his or her personal net worth.
 - B) limited to the amount he or she invested into the partnership.
 - C) limited to his or her total earnings received from the partnership.
 - D) unlimited.
 - E) limited to the total amount invested by all partners.

Answer: B

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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- 34) A business entity that provides each owner with limited liability while the firm is operated and taxed like a partnership is called a:
- A) limited liability company.
 - B) general partnership.
 - C) limited proprietorship.
 - D) limited partnership.
 - E) corporation.

Answer: A

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

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- 35) Partnership profits:
- A) are fully distributed as taxable income to the partners.
 - B) are distributed to general partners with interest paid to limited partners.
 - C) are distributed to the partners on an aftertax basis.
 - D) are generally reinvested in the firm rather than being distributed.
 - E) are generally held by the partnership and later distributed as dividend payments.

Answer: A

Difficulty: 1 Easy

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 36) Financial managers primarily create firm value by:
- A) maximizing current dividends.
 - B) investing in assets that generate cash in excess of their cost.
 - C) lowering the earnings per share.
 - D) increasing the firm's market share.
 - E) maximizing current sales.

Answer: B

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 37) Accounting profits and cash flows are generally:
- A) the same since they reflect current laws and accounting standards.
 - B) the same since accounting profits reflect the timing of cash flows.
 - C) different because of GAAP rules regarding the recognition of income.
 - D) different because cash inflows must occur before revenue recognition.
 - E) the same due to the requirements of GAAP.

Answer: C

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 38) Which one of these is a cash outflow from a corporation?
- A) Sale of an asset
 - B) Tax payment
 - C) Sale of common stock
 - D) Issuance of debt
 - E) Profit retained by the firm

Answer: B

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

39) A firm creates value by:

- A) having a greater cash inflow from its stockholders than its outflow to them.
- B) paying more cash to its creditors and stockholders than the amount it received from them.
- C) borrowing long-term debt.
- D) generating sales whether or not payment is received for all of those sales.
- E) purchasing assets that create cash inflows equal to the cost of those assets.

Answer: B

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

40) If a firm is currently profitable, then:

- A) its current cash inflows must exceed its current cash outflows.
- B) its reported sales exceed its costs.
- C) its cash flows are known with certainty.
- D) it will always have sufficient cash to pay its bills in a timely manner.
- E) the timing of the related cash flows is irrelevant.

Answer: B

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

41) Which one of these statements is correct?

- A) Individuals tend to prefer later cash flows over current cash flows.
- B) The value of an investment depends on the size, timing, and risk of the investment's cash flows.
- C) When selecting one of two projects, managers should select the project with the higher total expected cash flow.
- D) Most investors prefer greater risk over less risk.
- E) Accountants record sales and expenses after the related cash flows occur.

Answer: B

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

42) Closet Keeper is considering a new project. Which one of these estimated project values has the greatest level of certainty?

- A) The amount of the cash inflow in Year 3
- B) The timing of the last cash inflow from the project
- C) The initial project cost
- D) The risk of a pessimistic scenario occurring
- E) The amount of the cash inflow in Year 1

Answer: C

Difficulty: 1 Easy

Section: 1.3 The Importance of Cash Flows

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

43) Financial managers should primarily strive to:

- A) minimize costs while increasing current dividends.
- B) maximize the current profits of the firm.
- C) maximize the current value per share of existing stock.
- D) maximize current dividends even if doing so adds financial distress costs to the firm.
- E) maximize current market share in every market in which the firm participates.

Answer: C

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

44) 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) firm's current sales.

Answer: D

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

45) Which one of the following actions by a financial manager creates an agency problem?

- A) Borrowing money when doing so creates value for the firm
- B) Lowering selling prices that will result in increased firm value
- C) Agreeing to expand the company at the expense of stockholders' value
- D) Agreeing to pay management bonuses based on the market value of the firm's stock
- E) Refusing to spend current cash on an unprofitable project

Answer: C

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

46) 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.

Answer: B

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

47) Which one of these represents the best means of increasing current shareholder value?

- A) Maximizing the capital rate of the firm
- B) Increasing the current value of the overall firm
- C) Forsaking all new projects
- D) Minimizing the overall size of the firm
- E) Decreasing the number of employees

Answer: B

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 48) A financial manager should make decisions based on:
- A) the effects those decisions will have on current profits.
 - B) the best interests of the current employees.
 - C) the welfare of the current shareholders.
 - D) minimizing the firm's tax liability.
 - E) their personal goals and ambitions.

Answer: C

Difficulty: 1 Easy

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 49) A conflict of interest between the stockholders and managers of a firm is referred to as the:
- A) stockholders' liability.
 - B) corporate breakdown.
 - C) agency problem.
 - D) corporate activism.
 - E) legal liability.

Answer: C

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 50) Which one of these is most apt to be an agency problem?
- A) Increasing the dividend payments to shareholders
 - B) Paying off debt in a timely manner
 - C) Increasing the sales of a profitable division
 - D) Forsaking a profitable project because it involves some risk
 - E) Selling an unprofitable division of the firm

Answer: D

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

51) Which one of the following is *least* apt to help convince managers to work in the best interest of the stockholders?

- A) Threat of a takeover of the firm by unsatisfied stockholders
- B) Implementation of a stock option plan
- C) Salary raises based on length of service
- D) Management compensation tied to the market value of the firm's stock
- E) Threat of a proxy fight

Answer: C

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

52) Which form of business structure typically has the greatest potential for agency problems?

- A) Sole proprietorship
- B) General partnership
- C) Limited partnership
- D) Corporation
- E) Limited liability company

Answer: D

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

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53) A proxy fight occurs when:

- A) the board of directors disagree on the members of the management team.
- B) a group solicits voting rights to replace the board of directors.
- C) a competitor offers to sell their ownership interest in the firm.
- D) the firm files for bankruptcy.
- E) the firm is declared insolvent.

Answer: B

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

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- 54) The ultimate control of a corporation lies in the hands of the corporate:
- A) board of directors.
 - B) stockholders.
 - C) president.
 - D) chief executive officer.
 - E) chairman of the board.

Answer: B

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 55) Members of the board of directors are selected by:
- A) shareholder voting.
 - B) company management.
 - C) the firm's Chief Executive Officer.
 - D) the largest five shareholders.
 - E) the firm's managers and employees.

Answer: A

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Management organization and roles

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 56) Stock options granted to a corporation's managers are primarily designed to:
- A) reduce agency costs.
 - B) increase current profits.
 - C) replace salary increases.
 - D) reward long-term employment.
 - E) replace promotions.

Answer: A

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

57) Which one of these best fits the description of an agency cost?

- A) The costs of increasing the dividend payment per share
- B) The benefits received from reducing production costs per unit
- C) The payment of corporate income taxes
- D) The payment required for an outside audit of the firm
- E) The payment of interest on a firm's debts

Answer: D

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Agency costs and problems

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

58) Which one of the following parties is considered a stakeholder of a firm?

- A) Customer
- B) Short-term creditor
- C) Long-term creditor
- D) Preferred stockholder
- E) Common stockholder

Answer: A

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Introduction to corporate finance

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

59) A stakeholder is any person or entity:

- A) owning shares of stock of a corporation.
- B) owning bonds or other long-term debt issued by a corporation.
- C) that initially started a firm and currently has management control over that firm.
- D) to whom the firm currently owes money.
- E) other than a stockholder or creditor who potentially has a financial interest in a firm.

Answer: E

Difficulty: 1 Easy

Section: 1.5 The Agency Problem and Control of the Corporation

Topic: Introduction to corporate finance

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

60) One intent of the Sarbanes Oxley Act of 2002 is to:

- A) prevent minority investors from making demands on corporations.
- B) protect corporate directors from frivolous lawsuits.
- C) guarantee the repayment of all future personal loans to corporate officers and directors.
- D) protect investors from corporate abuses.
- E) require all public corporations to "go dark" within the next twenty years.

Answer: D

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

61) The Sarbanes-Oxley Act requires public corporations to:

- A) assess the company's internal control structure at least quarterly.
- B) distribute at least 90 percent of their profits in dividends on an annual basis.
- C) list any deficiencies in internal controls.
- D) file annual audit reports if the firm has "gone dark".
- E) disclose all personal loans to corporate officers or directors made after 2002.

Answer: C

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

62) Insider trading is:

- A) prohibited by the Securities Act of 1933.
- B) prohibited by the Securities Exchange Act of 1934.
- C) impossible in today's efficient markets.
- D) highly discouraged, but still legal.
- E) prohibited by the Sarbanes-Oxley Act of 2002.

Answer: B

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

63) The basic regulatory framework for the public trading of securities in the United States was provided by the:

- A) New York Stock Exchange when it was founded.
- B) Securities Exchange Act of 1934.
- C) Federal Reserve Bank.
- D) Securities Act of 1933 and the Securities Exchange Act of 1934.
- E) Sarbanes-Oxley Act in 2002.

Answer: D

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

64) The Securities Act of 1933 focuses on:

- A) all stock transactions.
- B) the sales of existing securities.
- C) the issuance of new securities.
- D) insider trading.
- E) Federal Deposit Insurance Corporation (FDIC) insurance.

Answer: C

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

65) The intent of the registration statement required for all new securities by the Securities Act of 1933 is to:

- A) provide a governmental evaluation of the risks associated with those new securities.
- B) set the price at which the securities will be offered.
- C) guarantee the profitability of the new securities.
- D) prevent any insider trading.
- E) provide all necessary information to allow a potential investor to make an informed decision.

Answer: E

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

66) Which of these have been cited as results from a corporation "going dark"?

- A) Increased market liquidity and lower costs
- B) Lower audit costs and lower interest rates on bank loans
- C) Increased access to capital and lower costs associated with that capital
- D) Increased audit costs and stock price increases
- E) Limited access to capital markets and stock price declines

Answer: E

Difficulty: 1 Easy

Section: 1.6 Regulation

Topic: Ethics, governance, and regulation

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

67) List and briefly describe the three basic areas addressed by a financial manager.

Answer: The three areas are:

- Capital budgeting: The identification and management of investment opportunities that are worth more to the firm than they cost to acquire.
- Capital structure: The determination of the optimal mixture of current and long-term debt and equity used to finance a firm's operations.
- Working capital management: The daily control over the firm's short-term assets and liabilities.

Difficulty: 2 Medium

Section: 1.1 What is Corporate Finance?

Topic: Financial management decisions

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

68) What advantages and disadvantages does the corporate form of organization have compared to sole proprietorships and general partnerships?

Answer: The advantages of the corporate form of organization over sole proprietorships and general 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 for the business. The key disadvantages are double taxation and higher formation costs.

Difficulty: 2 Medium

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

69) Why might a professional group select the LLC form of business over a general partnership or a corporate structure?

Answer: A limited liability company (LLC) limits the liability of each partner for the debts of the partnership to the amount that partner invested in the firm. Under a general partnership, each partner is fully liable for all of the partnership's debts. An LLC avoids the double taxation of profits since the profits are distributed to partners and taxed as personal income. Thus, an LLC is taxed like a partnership while offering the limited liability to owners like a corporation.

Difficulty: 2 Medium

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

70) Why might a highly successful sole proprietor change the structure of his/her firm to the corporate form of ownership if that change results in the sharing of profits with other investors?

Answer: A sole proprietorship has a limited life, limited access to additional capital, and unlimited liability for the owner. By switching to the corporate form, the sole proprietor can obtain additional capital while reducing his/her potential liability to the amount he/she invested in the firm. Also, the sole proprietor can sell a portion of the business enabling him/her to diversify their holdings while still maintaining majority control if desired. The primary downside of the change is the incurrence of double taxation.

Difficulty: 2 Medium

Section: 1.2 The Corporate Firm

Topic: Forms of business organization

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

71) What should be the primary goal of the financial manager of a corporation? Explain why this is appropriate.

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

Difficulty: 2 Medium

Section: 1.4 The Goal of Financial Management

Topic: Goal of financial management

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation