Chapter 01

Introduction to Corporate Finance

Multiple Choice Questions

1. Short-term finance:

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 managing net working capital.

2. Which one of the following is a capital budgeting decision?

A. Deciding whether or not to open a new store
B. Determining how much inventory to keep on hand
C. Determining how much debt should be borrowed from a particular lender
D. Deciding if stock shares should be repurchased
E. Determining how much cash to keep on hand

3. The process of planning and managing a firm's long-term investments is referred to as:

A. capital budgeting.
B. agency cost analysis.
C. financial depreciation.
D. working capital management.
E. capital structure.

4. Capital structure refers to:

A. the determination of the ideal mix of current versus long-term assets.
B. the methods by which fixed assets are used to produce a tangible product.
C. the mix of current assets and current liabilities.
D. the acquisition or disposition of a building or other long-term asset.
E. decisions related to long-term debt and equity financing.

5. Net working capital is best defined as:

A. excess cash on hand.
B. a firm's current assets.
C. current assets minus current liabilities.
D. total assets minus total liabilities.
E. cash and near-cash assets.

6. The treasurer and the controller of a corporation generally report to the:

A. president.
B. board of directors.
C. chief executive officer.
D. chief financial officer.
E. chairman of the board.

7. 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.

8. Which one of these best describes the key difference between the duties of the controller and those of the treasurer?

A. Separation of duties related to assets versus those related to debt and equity
B. Separation of authority over tax records versus accounting records
C. Separation of internal versus external responsibilities
D. Separation of duties related to production versus marketing
E. Separation of cash control from accounting records

9. Which position is generally directly responsible for financial planning and capital expenditures?

A. Controller
B. Treasurer
C. Director
D. Chairman of the board
E. Chief operations officer

10. Which type of business is the easiest to form?

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

11. A business entity 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.

12. The division of profits and losses among the members of a partnership is formalized in the:

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

13. Which form(s) of business is a treated as a distinct legal entity separate from its owners?

A. Limited partnership
B. Sole proprietorship
C. General partnership
D. Corporation
E. Both a limited partnership and a corporation

14. Which one of these is a corporate document that sets forth the intended life of the firm?

A. Federal charter
B. Articles of incorporation
C. Corporate bylaws
D. Indenture contract
E. State charter

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

A. A sole proprietorship is often structured as a limited liability company.
B. The owner of a sole proprietorship may be forced to sell his/her personal assets to pay company debts.
C. The owners of a sole proprietorship share profits as established by the partnership agreement.
D. The profits of a sole proprietorship are taxed twice.
E. A sole proprietorship is difficult to create.

16. Sole proprietorships:

A. are expensive to setup.
B. are limited to the business owner's life.
C. are faced with double taxation of profits.
D. can have multiple owners.
E. provide limited liability to owners.

17. 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. A formal charter is required to form a new proprietorship.
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.

18. Which one of the following best describes the primary advantage of being a limited partner rather than a general partner?

A. No potential financial loss
B. Entitlement to a larger portion of the partnership's income
C. Liability for firm debts limited to the capital invested
D. Greater management responsibility
E. Ability to manage the day-to-day affairs of the business

19. A general partner:

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

20. A limited partnership generally:

A. has less of an ability to raise capital than a proprietorship.
B. has ten or more limited partners and no general partners.
C. permits limited partners to sell their ownership interest without the partnership terminating.
D. is taxed the same as a corporation.
E. provides for the transfer of a general partner's ownership interest to any outside party.

21. Which of the following are disadvantages of a general 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

22. 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 his annual salary.
C. each limited partner's liability is limited to the amount he/she invested.
D. there is no limitation on liability; only a limitation on what the partner can earn.
E. limitations are placed on both the salary and personal liability of each limited partner.

23. Art purchased 2,500 shares of Delta stock. His purchase represents ten percent ownership in the firm. His shares have increased in value from the $12 a share he originally paid to today's market value of $23 share. Assume Delta goes bankrupt and owes $450,000 more in debts than the firm can pay after liquidating all of its assets. What is the maximum loss per share Art will incur on this investment?

A. $0 a share
B. $12 a share
C. $17.50 a share, computed as ($12 + 23)/2
D. $23 a share
E. $18 share, computed as (10% × $450,000)/2,500 shares

24. Which one of the following statements is correct concerning corporations?

A. The shareholders of a corporation select the top managers of that corporation.
B. A corporation is a distinct legal entity.
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.

25. Which one of the following statements is correct?

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

26. 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.

27. The articles of incorporation:

A. establish the rights of the shareholders.
B. are rules which apply only to limited liability companies.
C. address only those issues related to a corporation's managers and directors.
D. establish the compensation to be granted to senior managers.
E. include only the name, purpose, and intended life of the corporation.

28. 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.

29. Which one of the following business types is best suited to raising large amounts of capital?

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

30. Which type of business organization has all the respective rights and privileges of a legal person?

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

31. The rules by which corporations govern themselves are called:

A. indenture provisions.
B. indemnity provisions.
C. bylaws.
D. charter agreements.
E. articles of incorporation.

32. 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.

33. The primary goal of financial management is to:

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

34. The issuance of new equity shares is a cash flow from:

A. long-term creditors to a firm.
B. a firm to its shareholders.
C. a firm's suppliers to the firm.
D. the financial markets to a firm.
E. any one of a firm's stakeholders to the firm.

35. Which one of these terms refers to a conflict of interest between the stockholders and managers of a corporation?

A. Stakeholder claim
B. Corporate activism
C. Legal liability
D. Breach of indemnity
E. Agency problem

36. Agency costs refer to:

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

37. A stakeholder is best described as:

A. any person or entity owning shares of corporate stock.
B. any person or entity having voting rights based on stock ownership.
C. a person who founded a firm and currently controls that firm based on 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 a firm.

38. The primary purpose of the Sarbanes Oxley Act of 2002 was to:

A. protect investors from corporate abuses.
B. apply restrictions on foreign firms operating in the U.S.
C. protect financial managers from investors.
D. decrease audit costs for U.S. firms.
E. reduce corporate revenues.

39. Since the implementation of Sarbanes-Oxley, the cost of corporate audits in the United States:

A. has steadily increased.
B. has steadily decreased.
C. has remained about the same.
D. increased substantially, but over time has been decreasing.
E. decreased substantially, but over time has been increasing.

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

I. Officers of the corporation must now own more than 5 percent of the firm's stock.
II. Officers of the corporation must review and sign annual reports.
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

41. 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.

42. 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. market value of the existing owners' equity.
D. marketability of the managers.
E. financial distress of the firm.

43. Which one of the following actions by a financial manager *least* meets the goal of financial management?

A. Increasing current costs in order to increase the market value of the stockholders' equity
B. Agreeing to expand the company at the expense of stockholders' value
C. Refusing to lower selling prices if doing so will reduce the net profits
D. Agreeing to pay bonuses based on the market value of the company stock
E. Refusing to borrow money when doing so will create losses for the firm

44. 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

45. Which form of business structure faces the greatest agency problems?

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

46. A proxy fight occurs when:

A. the board of directors solicits renewal of current members.
B. a firm files for bankruptcy.
C. a shareholder sells shares in the open market.
D. a group solicits votes to replace the board of directors.
E. a firm is declared insolvent.

47. Which one of the following parties is considered a stakeholder of a firm?

A. Long-term creditor
B. Short-term creditor
C. Employee
D. Preferred stockholder
E. Common stockholder

48. Insider trading is:

A. illegal.
B. impossible to have in our efficient market.
C. legal.
D. discouraged, but legal.
E. defined as the trading of stock by a corporate director based on publicly-available information.

49. Which one of the following is *least* apt to encourage managers to act in the best interest of shareholders?

A. Shareholder election of the board of directors, who in turn select managers
B. Threat of a takeover by another firm
C. Linking manager compensation to share value
D. Compensating managers with fixed salaries
E. Granting stock options to key managers

50. The Securities Act of 1933 focuses on:

A. all new and outstanding stock transactions.
B. the issuance of new securities.
C. the redemption of outstanding debt.
D. insider trading.
E. Federal Deposit Insurance Corporation (FDIC) insurance.

51. The basic regulatory framework for public trading of securities within the United States is provided by:

A. the Securities Act of 1933 and the Securities Exchange Act of 1934.
B. state governments.
C. the Federal Reserve Bank.
D. the Sarbanes Oxley Act of 2002.
E. NASDAQ.

Essay Questions

52. Explain why financial managers are more concerned with cash flows than with accounting profits.

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

54. What are some of the similarities between a general partnership and a sole proprietorship?

55. 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?

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

Chapter 01 Introduction to Corporate Finance Answer Key

Multiple Choice Questions

1. Short-term finance:

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 managing net working capital.

Difficulty Level: 1 Easy
Topic: Short-term finance

2. Which one of the following is a capital budgeting decision?

A. Deciding whether or not to open a new store
B. Determining how much inventory to keep on hand
C. Determining how much debt should be borrowed from a particular lender
D. Deciding if stock shares should be repurchased
E. Determining how much cash to keep on hand

Difficulty Level: 1 Easy
Topic: Capital Budgeting

3. The process of planning and managing a firm's long-term investments is referred to as:

A. capital budgeting.
B. agency cost analysis.
C. financial depreciation.
D. working capital management.
E. capital structure.

Difficulty Level: 1 Easy
Topic: Capital Budgeting

4. Capital structure refers to:

A. the determination of the ideal mix of current versus long-term assets.
B. the methods by which fixed assets are used to produce a tangible product.
C. the mix of current assets and current liabilities.
D. the acquisition or disposition of a building or other long-term asset.
E. decisions related to long-term debt and equity financing.

Difficulty Level: 1 Easy
Topic: Capital Structure

5. Net working capital is best defined as:

A. excess cash on hand.
B. a firm's current assets.
C. current assets minus current liabilities.
D. total assets minus total liabilities.
E. cash and near-cash assets.

Difficulty Level: 1 Easy
Topic: Net working capital

6. The treasurer and the controller of a corporation generally report to the:

A. president.
B. board of directors.
C. chief executive officer.
D. chief financial officer.
E. chairman of the board.

Difficulty Level: 1 Easy
Topic: Organizational Structure

7. 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.
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Difficulty Level: 1 Easy
Topic: Organizational Structure

8. Which one of these best describes the key difference between the duties of the controller and those of the treasurer?

A. Separation of duties related to assets versus those related to debt and equity
B. Separation of authority over tax records versus accounting records
C. Separation of internal versus external responsibilities
D. Separation of duties related to production versus marketing
E. Separation of cash control from accounting records

Difficulty Level: 2 Medium
Topic: Organizational Structure

9. Which position is generally directly responsible for financial planning and capital expenditures?

A. Controller
B. Treasurer
C. Director
D. Chairman of the board
E. Chief operations officer

Difficulty Level: 1 Easy
Topic: Treasurer

10. Which type of business is the easiest to form?

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

Difficulty Level: 1 Easy
Topic: Sole Proprietorship

11. A business entity 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.

Difficulty Level: 1 Easy
Topic: General Partnership

12. The division of profits and losses among the members of a partnership is formalized in the:

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

Difficulty Level: 1 Easy
Topic: Partnership Agreement

13. Which form(s) of business is a treated as a distinct legal entity separate from its owners?

A. Limited partnership
B. Sole proprietorship
C. General partnership
D. Corporation
E. Both a limited partnership and a corporation

Difficulty Level: 1 Easy
Topic: Corporation

14. Which one of these is a corporate document that sets forth the intended life of the firm?

A. Federal charter
B. Articles of incorporation
C. Corporate bylaws
D. Indenture contract
E. State charter

Difficulty Level: 1 Easy
Topic: Articles of Incorporation

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

A. A sole proprietorship is often structured as a limited liability company.
B. The owner of a sole proprietorship may be forced to sell his/her personal assets to pay company debts.
C. The owners of a sole proprietorship share profits as established by the partnership agreement.
D. The profits of a sole proprietorship are taxed twice.
E. A sole proprietorship is difficult to create.

Difficulty Level: 1 Easy
Topic: Sole Proprietorship

16. Sole proprietorships:

A. are expensive to setup.
B. are limited to the business owner's life.
C. are faced with double taxation of profits.
D. can have multiple owners.
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Difficulty Level: 1 Easy
Topic: Sole Proprietorship

18. Which one of the following best describes the primary advantage of being a limited partner rather than a general partner?

A. No potential financial loss
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C. Liability for firm debts limited to the capital invested
D. Greater management responsibility
E. Ability to manage the day-to-day affairs of the business

Difficulty Level: 1 Easy
Topic: Partnership

19. A general partner:

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

Difficulty Level: 1 Easy
Topic: Partnership

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B. has ten or more limited partners and no general partners.
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D. is taxed the same as a corporation.
E. provides for the transfer of a general partner's ownership interest to any outside party.

Difficulty Level: 1 Easy
Topic: Limited Partnership

21. Which of the following are disadvantages of a general 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

Difficulty Level: 2 Medium
Topic: Partnership

22. 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 his annual salary.
C. each limited partner's liability is limited to the amount he/she invested.
D. there is no limitation on liability; only a limitation on what the partner can earn.
E. limitations are placed on both the salary and personal liability of each limited partner.

Difficulty Level: 1 Easy
Topic: Limited Partnership

23. Art purchased 2,500 shares of Delta stock. His purchase represents ten percent ownership in the firm. His shares have increased in value from the $12 a share he originally paid to today's market value of $23 share. Assume Delta goes bankrupt and owes $450,000 more in debts than the firm can pay after liquidating all of its assets. What is the maximum loss per share Art will incur on this investment?

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C. $17.50 a share, computed as ($12 + 23)/2
D. $23 a share
E. $18 share, computed as (10% × $450,000)/2,500 shares

Difficulty Level: 2 Medium
Topic: Corporation

24. Which one of the following statements is correct concerning corporations?

A. The shareholders of a corporation select the top managers of that corporation.
B. A corporation is a distinct legal entity.
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.

Difficulty Level: 1 Easy
Topic: Corporation

25. Which one of the following statements is correct?

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

Difficulty Level: 2 Medium
Topic: Business Types

26. 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.

Difficulty Level: 2 Medium
Topic: Articles of Incorporation

27. The articles of incorporation:

A. establish the rights of the shareholders.
B. are rules which apply only to limited liability companies.
C. address only those issues related to a corporation's managers and directors.
D. establish the compensation to be granted to senior managers.
E. include only the name, purpose, and intended life of the corporation.

Difficulty Level: 2 Medium
Topic: Articles of Incorporation

28. 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.

Difficulty Level: 2 Medium
Topic: Limited Liability Company

29. Which one of the following business types is best suited to raising large amounts of capital?

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

Difficulty Level: 1 Easy
Topic: Corporation

30. Which type of business organization has all the respective rights and privileges of a legal person?

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

Difficulty Level: 1 Easy
Topic: Corporation

31. The rules by which corporations govern themselves are called:

A. indenture provisions.
B. indemnity provisions.
C. bylaws.
D. charter agreements.
E. articles of incorporation.

Difficulty Level: 1 Easy
Topic: Bylaws

32. 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.

Difficulty Level: 1 Easy
Topic: Limited Liability Company

33. The primary goal of financial management is to:

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

Difficulty Level: 1 Easy
Topic: Financial Management Goal

34. The issuance of new equity shares is a cash flow from:

A. long-term creditors to a firm.
B. a firm to its shareholders.
C. a firm's suppliers to the firm.
D. the financial markets to a firm.
E. any one of a firm's stakeholders to the firm.

Difficulty Level: 1 Easy
Topic: Cash Flows

35. Which one of these terms refers to a conflict of interest between the stockholders and managers of a corporation?

A. Stakeholder claim
B. Corporate activism
C. Legal liability
D. Breach of indemnity
<u>E.</u> Agency problem

Difficulty Level: 1 Easy
Topic: Agency Problem

36. Agency costs refer to:

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

Difficulty Level: 1 Easy
Topic: Agency Costs

37. A stakeholder is best described as:

A. any person or entity owning shares of corporate stock.
B. any person or entity having voting rights based on stock ownership.
C. a person who founded a firm and currently controls that firm based on 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.
<u>E.</u> any person or entity other than a stockholder or creditor who potentially has a claim on the cash flows of a firm.

Difficulty Level: 1 Easy
Topic: Stakeholders

38. The primary purpose of the Sarbanes Oxley Act of 2002 was to:

<u>A.</u> protect investors from corporate abuses.
B. apply restrictions on foreign firms operating in the U.S.
C. protect financial managers from investors.
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Topic: Sarbanes Oxley

39. Since the implementation of Sarbanes-Oxley, the cost of corporate audits in the United States:

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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.

Difficulty Level: 1 Easy
Topic: Goal of Financial Management

42. 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. market value of the existing owners' equity.
D. marketability of the managers.
E. financial distress of the firm.

Difficulty Level: 1 Easy
Topic: Goal of Financial Management

43. Which one of the following actions by a financial manager *least* meets the goal of financial management?

A. Increasing current costs in order to increase the market value of the stockholders' equity
B. Agreeing to expand the company at the expense of stockholders' value
C. Refusing to lower selling prices if doing so will reduce the net profits
D. Agreeing to pay bonuses based on the market value of the company stock
E. Refusing to borrow money when doing so will create losses for the firm

Difficulty Level: 2 Medium
Topic: Agency Problem

44. 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

Difficulty Level: 2 Medium
Topic: Agency Problem

45. Which form of business structure faces the greatest agency problems?

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

Difficulty Level: 2 Medium
Topic: Agency Problem

46. A proxy fight occurs when:

A. the board of directors solicits renewal of current members.
B. a firm files for bankruptcy.
C. a shareholder sells shares in the open market.
D. a group solicits votes to replace the board of directors.
E. a firm is declared insolvent.

Difficulty Level: 1 Easy
Topic: Proxy Fight

47. Which one of the following parties is considered a stakeholder of a firm?

A. Long-term creditor
B. Short-term creditor
C. Employee
D. Preferred stockholder
E. Common stockholder

Difficulty Level: 1 Easy
Topic: Stakeholders

48. Insider trading is:

A. illegal.
B. impossible to have in our efficient market.
C. legal.
D. discouraged, but legal.
E. defined as the trading of stock by a corporate director based on publicly-available information.

Difficulty Level: 2 Medium
Topic: Regulation

49. Which one of the following is *least* apt to encourage managers to act in the best interest of shareholders?

A. Shareholder election of the board of directors, who in turn select managers
B. Threat of a takeover by another firm
C. Linking manager compensation to share value
D. Compensating managers with fixed salaries
E. Granting stock options to key managers

Difficulty Level: 2 Medium
Topic: Governance

50. The Securities Act of 1933 focuses on:

A. all new and outstanding stock transactions.
B. the issuance of new securities.
C. the redemption of outstanding debt.
D. insider trading.
E. Federal Deposit Insurance Corporation (FDIC) insurance.

Difficulty Level: 2 Medium
Topic: Regulation

51. The basic regulatory framework for public trading of securities within the United States is provided by:

A. the Securities Act of 1933 and the Securities Exchange Act of 1934.
B. state governments.
C. the Federal Reserve Bank.
D. the Sarbanes Oxley Act of 2002.
E. NASDAQ.

Difficulty Level: 2 Medium
Topic: Regulation

Essay Questions

52. Explain why financial managers are more concerned with cash flows than with accounting profits.

To create value, firms need to create more cash inflows than cash outflows. The excess cash flows can be used to grow the firm, or return funds to bondholders and stockholders. To avoid financial distress, or the inability to pay debts in a timely manner, firms also need cash. Accounting profits are affected by GAAP. Sales and related costs are recorded when sales are realized, not when cash is affected. Thus, a firm with profits may not have sufficient cash to meet its needs.

Difficulty Level: 3 Hard
Topic: Cash Flows

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

The three areas are:

1. Capital budgeting: Acquiring the types and proportions of long-term assets that will produce greater cash inflows than the assets cost.
2. Capital structure: Acquiring funds through the issuance of long-term debt and equity securities.
3. Short-term finance: Managing the firm's daily working capital to ensure the firm has sufficient resources to continue its operations and avoid costly interruptions.

Difficulty Level: 3 Hard
Topic: Financial Management

54. What are some of the similarities between a general partnership and a sole proprietorship?

Similarities:

1. Each general partner or sole proprietor is personally responsible for 100 percent of the debts of the business.
2. Both types of firms have business lives that are dependent upon the owner's life and also the owner's willingness to be involved in the business.
3. Both types of firms are easy to form.
4. Both types of firms are limited in their ability to raise large amounts of external funding.
5. Both types of firms have their profits taxed as personal income.

Difficulty Level: 3 Hard
Topic: Business Organizations

55. 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?

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.

Difficulty Level: 3 Hard
Topic: Business Organizations

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

The primary goal of financial management is to maximize the current market value of the outstanding stock. This goal focuses on enhancing the returns to current stockholders who are the owners of the firm.

Difficulty Level: 2 Medium
Topic: Financial Management Goal