

Name: _____ Date: _____

1. The financial manager is responsible for making decisions that are in the best interest of the firm's owners.
A) True
B) False
2. The demand for a potential business product, as well as the identification of what product or services is to be produced, are both contained in a business plan.
A) True
B) False
3. The local Republican Party is a stakeholder in a local firm that makes no political donations to either party.
A) True
B) False
4. A patent is a productive asset for a technology-based firm.
A) True
B) False
5. Intangible assets generate most of a firm's cash flows.
A) True
B) False
6. The most fundamental way that a business can grow in size is from the reinvestment of cash flows or earnings.
A) True
B) False
7. When bankruptcy occurs, the firm will always be liquidated.
A) True
B) False
8. Capital assets are generally short term in nature.
A) True
B) False

9. A good capital budgeting decision is one in which the benefits are worth more to the firm than the cost of the asset.
A) True
B) False
10. The financing decision determines how firms raise cash to pay for their investments.
A) True
B) False
11. The dollar difference between current assets and liabilities is called working capital.
A) True
B) False
12. A sole proprietorship is an owner's only business.
A) True
B) False
13. The greatest number of businesses in the United States are corporations.
A) True
B) False
14. Unlimited liability means that the owner of a firm is responsible for paying all the firm's bills.
A) True
B) False
15. The process of transferring ownership of a sole proprietorship is relatively easy.
A) True
B) False
16. General partners in a business have limited liability with regard to their firm's obligations.
A) True
B) False

17. Most large corporations are incorporated in New York because of its favorable tax treatment of corporate income and its statutes protecting the rights of its owners.
A) True
B) False
18. Corporations do not have their income subject to double taxation.
A) True
B) False
19. Privately held corporations are allowed to have shareholders.
A) True
B) False
20. The treasurer of a corporation usually reports to the CFO of the firm.
A) True
B) False
21. The external auditors of the firm report their findings directly to the CFO of the firm.
A) True
B) False
22. Maximizing revenue should be the goal of the firm.
A) True
B) False
23. An agency problem can arise when the agent of the firm is the sole owner of the firm.
A) True
B) False
24. The owners of a firm are unaffected by agency costs.
A) True
B) False
25. Corruption in business does not affect the functioning of the financial markets.
A) True
B) False

26. To start a business, the owners need
- A) a market where there is demand for their product.
 - B) a clear vision of what products or services they want to produce.
 - C) the know-how to successfully market their product.
 - D) all of the above.
27. A stakeholder is
- A) anyone geographically close to the firm's headquarters.
 - B) anyone with a claim on the cash flows of the firm.
 - C) any governmental agency.
 - D) all of the above.
28. If you have loaned capital to a firm, then you could be
- A) a shareholder.
 - B) a stakeholder.
 - C) a partner.
 - D) all of the above.
29. Which of the following are stakeholders?
- A) a shareholder
 - B) a lender
 - C) the IRS
 - D) all of the above
30. A trademark is an example of
- A) a productive asset.
 - B) an intangible asset.
 - C) a nebulous asset.
 - D) none of the above.
31. Which of the following asset purchase decisions are the most important to the firm?
- A) an intangible asset
 - B) a tangible asset
 - C) a financing decision
 - D) all of the above

32. Which of the following is a basic source of funds for the firm?
- A) debt
 - B) equity
 - C) asset liquidations
 - D) a and b above
33. The cash remaining after the firm has met its operating expenses, payments to creditors, and taxes is called
- A) earnings per share.
 - B) capital contributed in excess of par.
 - C) residual cash.
 - D) assets.
34. Cash dividends are paid out of
- A) residual cash.
 - B) liquidated assets.
 - C) long-term debt.
 - D) all of the above.
35. Current liabilities are liabilities that
- A) will be converted to cash within a year.
 - B) must be paid within a year.
 - C) will be converted to equity within a year.
 - D) none of the above
36. Capital budgeting involves
- A) how a firm's day-to-day financial matters should be managed.
 - B) how the firm should finance its assets.
 - C) which productive assets the firm should employ.
 - D) all of the above.
37. Working capital management decisions involve
- A) how a firm's day-to-day financial matters should be managed.
 - B) how the firm should finance its assets.
 - C) which productive assets the firm should employ.
 - D) all of the above.

38. Capital budgeting decisions generally involve
- A) the fixed asset portion of the balance sheet.
 - B) the short-term portion of the balance sheet.
 - C) the current liability portion of the balance sheet.
 - D) all of the above.
39. A good capital budgeting decision is
- A) one in which the benefits of the project are equal to the cost of the asset.
 - B) one in which the benefits of the project are less than the cost of the asset.
 - C) one in which the benefits of the project are more than the cost of the asset.
 - D) all of the above.
40. Financial markets in which equity and debt instruments with maturities greater than one year are traded are called
- A) money markets.
 - B) capital markets.
 - C) stock markets.
 - D) none of the above.
41. Profitability of a firm can be negatively affected by
- A) too much inventory.
 - B) too little inventory.
 - C) either a or b.
 - D) neither a nor b.
42. About 75 percent of all businesses in the United States are
- A) sole proprietorships.
 - B) partnerships.
 - C) corporations.
 - D) limited liability partnerships.
43. Which of the following business organizational forms subjects the owner(s) to unlimited liability?
- A) sole proprietorship
 - B) partnership
 - C) corporation
 - D) a and b

44. Which of the following business organizational forms creates a tax liability on income at the personal income tax rate?
- A) sole proprietorship
 - B) partnership
 - C) corporation
 - D) a and b
45. Which of the following business organizational forms is easiest to raise capital?
- A) sole proprietorship
 - B) partnership
 - C) corporation
 - D) a and b
46. Which of the following owners is protected by limited liability?
- A) a sole proprietor
 - B) a general partner
 - C) a limited partner
 - D) none of the above
47. Which of the following cannot be engaged in managing the business?
- A) a sole proprietor
 - B) a general partner
 - C) a limited partner
 - D) none of the above
48. Most large corporations are incorporated in what state?
- A) California
 - B) Delaware
 - C) Massachusetts
 - D) New York
49. Which organizational form accounts for 90 percent of the revenues of all firms in the United States?
- A) sole proprietorship
 - B) partnership
 - C) corporation
 - D) a and b

50. Which organizational form best enables a firm to sell its securities to the market?
- A) sole proprietorship
 - B) partnership
 - C) private corporation
 - D) public corporation
51. Which of the following organizational forms is subject to the most SEC regulations?
- A) sole proprietorship
 - B) partnership
 - C) private corporation
 - D) public corporation
52. Which organizational form best enables the owners of the firm to monitor the actions of other owners of the same firm?
- A) sole proprietorship
 - B) partnership
 - C) private corporation
 - D) public corporation
53. Which of the following is considered a hybrid organizational form?
- A) sole proprietorship
 - B) partnership
 - C) corporation
 - D) limited liability partnership
54. Which of the following reports directly to the owners of the firm (assume the firm is a public corporation)?
- A) CFO
 - B) CEO
 - C) board of directors
 - D) audit committee
55. Which of the following is responsible for seeing that the best possible financial analysis is presented?
- A) CFO
 - B) CEO
 - C) board of directors
 - D) audit committee

56. Which of the following is responsible for performing an independent audit of the firm's financial statements?
- A) CFO
 - B) CEO
 - C) CPA firm
 - D) audit committee
57. How is the CPA firm insulated from being pressured by management?
- A) The audit committee approves the external auditor's fees as well as the engagement letter.
 - B) The chairman of the board approves the external auditor's fees as well as the engagement letter.
 - C) The IRS approves the external auditor's fees as well as the engagement letter.
 - D) The CPA firm is not insulated from management.
58. Which of the following is an appropriate goal for the firm?
- A) profit maximization
 - B) revenue maximization
 - C) shareholder wealth maximization
 - D) tax minimization
59. When analysts and investors determine the value of a firm's stock, they should consider
- A) the size of the expected cash flows associated with owning the stock.
 - B) the timing of the cash flows.
 - C) the riskiness of the cash flows.
 - D) all of the above.
60. One reason for the existence of agency problems between managers and share holders is that
- A) there is a separation of ownership and control of the firm.
 - B) managers know how to manage the firm better than shareholders.
 - C) shareholders have unreasonable expectations about managerial performance.
 - D) none of the above
61. Which of the following is a principal within the agency relationship?
- A) a company engineer
 - B) the CEO of the firm
 - C) a shareholder
 - D) the board of directors

62. Shareholders elect _____ to represent their interest in the firm.
- A) a chairman
 - B) CEO
 - C) a board of directors
 - D) all of the above
63. An example of a direct agency cost is
- A) a manager turning down a value-contributing project because of its risks.
 - B) a manager expensing a large dinner on the company expense report.
 - C) a manager using too little debt within the firm's capital structure because of the additional risk associated with debt.
 - D) all of the above
64. Which of the following can help align the behavior of managers with the goals of shareholders?
- A) management compensation
 - B) managerial labor markets
 - C) an independent board of directors
 - D) all of the above
65. The point in time when ownership of a compensation-related option or share of stock passes to the manager refers to
- A) the agency date.
 - B) the compensation payment date.
 - C) granting.
 - D) vesting.
66. If a firm has had an agency problem that is reflected in a poor performing stock for a long period of time, then the firm may become a target of _____.
- A) an SEC investigation.
 - B) a corporate raider.
 - C) an IRS investigation.
 - D) a bankruptcy lawyer.
67. Executives that repeatedly put their own interests before that of the firm may find that they have difficulty finding another job after their current one. This is an example of
- A) the managerial labor market disciplining managers.
 - B) the market for corporate control.
 - C) the board of directors affecting the prospects of a manager.
 - D) none of the above.

68. Who or what is responsible for setting the agenda at meetings of the board of directors?
- A) chairman of the board of directors
 - B) president
 - C) nominating committee
 - D) audit committee
69. A director who is not an employee of the firm is called
- A) an executive director.
 - B) an inside director.
 - C) an independent director.
 - D) an official director.
70. Which of the following is **NOT** one of the strategies incorporated in the Sarbanes-Oxley Act of 2002?
- A) attain greater board independence
 - B) establish compliance programs
 - C) establish ethics programs
 - D) dictate maximum compensation levels
71. Which of the following powers does the audit committee have the authority to do?
- A) audit the personal bank account of the CEO
 - B) question any person employed by the firm
 - C) audit the compensation files of firms in the same industry
 - D) none of the above
72. What is the major complaint concerning the Sarbanes-Oxley Act of 2002 by firms?
- A) the legislative maximum allowable compensation for a CEO
 - B) the legal requirement to disclose project information
 - C) the cost of compliance
 - D) the cost of maintaining an SEC-employed officer at the firm's premises
73. A society's ideas about what actions are right and wrong are
- A) morals.
 - B) ethics.
 - C) laws.
 - D) unwritten laws.

74. The golden rule is an example of
- A) a current law.
 - B) an historical law.
 - C) an unworkable rule in financial markets.
 - D) an ethical norm.
75. An example of an economy that had trouble establishing a stock market and attracting foreign investment is
- A) Russia.
 - B) China.
 - C) the Czech Republic.
 - D) Japan.
76. Corruption in business
- A) creates inefficiencies in an economy.
 - B) inhibits growth in an economy.
 - C) slows the rate of economic growth in a country.
 - D) all of the above
77. Which corporate officer, when he or she is guilty of serious misconduct, can subject the firm to the most serious losses in financial wealth?
- A) CEO
 - B) CFO
 - C) Chief Technology Officer
 - D) Chief Risk Officer
78. An officer of a firm that is a majority owner in a competing firm will probably be subject to
- A) an IRS audit.
 - B) a conflict of interest with his share holders.
 - C) arbitrage profit returns to the SEC.
 - D) an FBI investigation.
79. _____ occur(s) when one party in a business transaction has information that is unavailable to the other parties in the transaction.
- A) Profits
 - B) Information asymmetry
 - C) Information efficiency
 - D) None of the above

80. With regard to information, a central idea of fairness suggests that
- A) decisions should be made on an even playing field.
 - B) insiders should be able to trade whenever they want.
 - C) insiders should never be able to trade.
 - D) outsiders should not be allowed to trade since, by definition, they are at a disadvantage.
81. Explain what should be the goal of the firm.
82. Explain how agency costs might be found within a firm whose CEO owns no shares in the firm and whose compensation package is unaffected by the profits (cash or accounting profits) of the firm.
83. You have a friend who tells you that ethics are completely unimportant in business since a number of laws have been set up for us to know the rules of the game.

Answer Key

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

- 45. C
- 46. C
- 47. C
- 48. B
- 49. C
- 50. D
- 51. D
- 52. B
- 53. D
- 54. C
- 55. A
- 56. C
- 57. A
- 58. C
- 59. D
- 60. A
- 61. C
- 62. C
- 63. B
- 64. D
- 65. D
- 66. B
- 67. B
- 68. A
- 69. C
- 70. D
- 71. B
- 72. C
- 73. B
- 74. D
- 75. A
- 76. D
- 77. B
- 78. B
- 79. B
- 80. A
- 81. The goal of the firm should be to maximize shareholder wealth, which in most cases is equivalent to maximizing the price of the shares of the firm. Note that this is not the same as maximizing profits since maximizing profits can occur while taking on too much risk (which can lower the value of the shareholders investment). Maximizing profits also does not take the timing of the profits into account. Profits, moreover, should not be confused with cash. Maximizing shareholder wealth is also not the same as minimizing risk, which can occur without taking any risks.
- 82. Since the manager has no ownership interest in the firm, she has no incentive to make the cash profits of the firm as high as possible. In fact, she has a personal incentive to have the firm pay for as many personal luxuries as possible since her compensation

package will be completely unaffected by her decision to purchase the luxuries. In a firm like the above, we might expect the firm to expend a material amount of resources on items that the manager should probably pay for herself.

83. Despite heavy regulation, the financial sector has a long and rich history of financial scandals. While a good many of the scandals are due to laws that have been disregarded, many of the scandals began as ethical lapses. This suggests that laws are not enough to preclude behavior that is detrimental to the well-functioning of the markets.