

Chapter 1

The Role and Environment of Managerial Finance

Learning Goal 1 Define finance, its major areas and opportunities, and the legal forms of business organization.

- 1.1.1) A financial analyst is responsible for maintaining and controlling the firm's daily cash balances. Frequently manages the firm's short-term investments and coordinates short-term borrowing and banking relationships.

Answer: FALSE

Topic: Career Opportunities

- 1.1.2) Finance is concerned with the process institutions, markets, and instruments involved in the transfer of money among and between individuals, businesses and government.

Answer: TRUE

Topic: Finance Defined

- 1.1.3) Financial services are concerned with the duties of the financial manager.

Answer: FALSE

Topic: Role of Financial Manager

- 1.1.4) Financial managers actively manage the financial affairs of many types of business—financial and non-financial, private and public, for-profit and not-for-profit.

Answer: TRUE

Topic: Role of Financial Manager

- 1.1.5) In partnerships, owners have unlimited liability and may have to cover debts of other less financially sound partners.

Answer: TRUE

Topic: Legal Form of Organization

- 1.1.6) In partnerships, a partner can readily transfer his/her wealth to other partners.

Answer: FALSE

Topic: Legal Form of Organization

- 1.1.7) The board of directors is responsible for managing day-to-day operations and carrying out the policies established by the chief executive officer.

Answer: FALSE

Topic: Corporate Governance

- 1.1.8) The sole proprietor has unlimited liability; his or her total investment in the business, but not his or her personal assets, can be taken to satisfy creditors.

Answer: FALSE

Topic: Legal Form of Organization

- 1.1.9) In limited partnerships, only one partner may assume limited liability. All other partners have to have unlimited liability.

Answer: FALSE

Topic: Legal Form of Organization

- 1.1.10) The president or chief executive officer is elected by the firm's stockholders and has ultimate authority to guide corporate affairs and make general policy.

Answer: FALSE

Topic: *Corporate Governance*

- 1.1.11) In limited partnerships, all partners' liabilities are limited to their investment in the partnership.

Answer: FALSE

Topic: *Legal Form of Organization*

- 1.1.12) In limited liability partnerships, the liability protection does not protect partners from their own individual acts of malpractice.

Answer: TRUE

Topic: *Legal Form of Organization*

- 1.1.13) The capital expenditures analyst/manager is responsible for the evaluation and recommendation of proposed asset investments and may be involved in the financial aspects of implementation of approved investments.

Answer: TRUE

Topic: *Managerial Finance Functions*

- 1.1.14) The financial analyst administers the firm's credit policy by analyzing or managing the evaluation of credit applications, extending credit, and monitoring and collecting accounts receivable.

Answer: FALSE

Topic: *Managerial Finance Functions*

- 1.1.15) In large companies, the project finance manager is responsible for coordinating the assets and liabilities of the employees' pension fund.

Answer: FALSE

Topic: *Managerial Finance Functions*

- 1.1.16) In S corporations, stockholders receive all of the organizational benefits of a corporation and the tax advantages of a partnership, but lose certain tax advantages related to pension plans that are available to traditional corporations.

Answer: TRUE

Topic: *Legal Form of Organization*

- 1.1.17) Unlike an S corporation, the limited liability corporation (LLC) can own more than 80 percent of another corporation, and corporations, partnerships, or non-U.S. residents can own limited liability corporation shares.

Answer: TRUE

Topic: *Legal Form of Organization*

- 1.1.18) In limited liability partnership, all partners have limited liability with regard to the business—they are not personally liable for other partners' malpractice—and the limited liability partnership is taxed as partnership.

Answer: TRUE

Topic: *Legal Form of Organization*

1.1.19) The part of finance concerned with design and delivery of advice and financial products to individuals, business, and government is called

- A) Managerial Finance.
- B) Financial Manager.
- C) Financial Services.
- D) none of the above.

Answer: C

Topic: Managerial Finance Functions

1.1.20) Managerial finance

- A) involves tasks such as budgeting, financial forecasting, cash management, and funds procurement.
- B) involves the design and delivery of advice and financial products.
- C) recognizes funds on an accrual basis.
- D) devotes the majority of its attention to the collection and presentation of financial data.

Answer: A

Topic: Managerial Finance Functions

1.1.21) Finance can be defined as

- A) the system of debits and credits.
- B) the science of the production, distribution, and consumption of wealth.
- C) the art and science of managing money.
- D) the art of merchandising products and services.

Answer: C

Topic: Finance Defined

1.1.22) Financial service

- A) is concerned with the duties of the financial manager.
- B) involves the design and delivery of advice and financial products.
- C) provides guidelines for the efficient operation of the business.
- D) handles accounting activities related to data processing.

Answer: B

Topic: Career Opportunities

1.1.23) Career opportunities in financial services include all of the following EXCEPT

- A) investments.
- B) real estate and insurance.
- C) capital expenditures management.
- D) personal financial planning.

Answer: C

Topic: Career Opportunities

1.1.24) Which of the following is a career opportunity in managerial finance?

- A) Investment.
- B) Real Estate and Insurance.
- C) Capital expenditures Management.
- D) Personal Financial Planning.

Answer: C

Topic: Career Opportunities

1.1.25) Which of the following legal forms of organization is most expensive to organize?

- A) Sole proprietorships.
- B) Partnerships.
- C) Corporations.
- D) Limited partnership.

Answer: C

Topic: Legal Form of Organization

1.1.26) Which of the following legal forms of organization's income is NOT taxed under individual income tax rate?

- A) Sole proprietorships.
- B) Partnerships.
- C) Limited partnership.
- D) Corporation.

Answer: D

Topic: Legal Form of Organization

1.1.27) Under which of the following legal forms of organization, is ownership readily transferable?

- A) Sole proprietorships.
- B) Partnerships.
- C) Limited partnership.
- D) Corporation.

Answer: D

Topic: Legal Form of Organization

1.1.28) The true owner(s) of the corporation is (are) the _____.

- A) board of directors
- B) chief executive officer
- C) stockholders
- D) creditors

Answer: C

Topic: Corporate Governance

1.1.29) The _____ has/have the ultimate responsibility in guiding corporate affairs and carrying out policies.

- A) board of directors
- B) chief executive officer
- C) stockholders
- D) creditors

Answer: A

Topic: Corporate Governance

1.1.30) The responsibility for managing day-to-day operations and carrying out corporate policies belongs to the _____.

- A) board of directors
- B) chief executive officer
- C) stockholders
- D) creditors

Answer: B

Topic: Corporate Governance

- 1.1.31) In a corporation, the members of the board of directors are elected by the
- A) chief executive officer.
 - B) creditors.
 - C) stockholders.
 - D) employees.

Answer: C

Topic: Corporate Governance

- 1.1.32) _____ is concerned with the duties of the financial manager in the business firm.
- A) Financial Services
 - B) Financial Manager
 - C) Managerial Finance
 - D) None of the above

Answer: C

Topic: Role of Financial Manager

- 1.1.33) About 75 percent of all business firms are
- A) sole proprietorships.
 - B) partnerships.
 - C) corporations.
 - D) S-corporations.

Answer: A

Topic: Legal Form of Organization

- 1.1.34) A major weakness of a partnership is
- A) limited liability.
 - B) difficulty liquidating or transferring ownership.
 - C) access to capital markets.
 - D) low organizational costs.

Answer: B

Topic: Legal Form of Organization

- 1.1.35) All of the following are key strengths of a corporation EXCEPT
- A) access to capital markets.
 - B) limited liability.
 - C) low organization costs.
 - D) readily transferable ownership.

Answer: C

Topic: Legal Form of Organization

- 1.1.36) Which of the following legal forms of organization is characterized by limited liability?
- A) Sole proprietorship.
 - B) Partnership.
 - C) Corporation.
 - D) Professional partnership.

Answer: C

Topic: Legal Form of Organization

- 1.1.37) The dominant form of organization with respect to receipts and net profits is the
- A) sole proprietorship.
 - B) partnership.
 - C) corporation.
 - D) S-corporation.

Answer: C

Topic: Legal Form of Organization

- 1.1.38) A "legal entity" which can sue and be sued, make and be party to contracts, and acquire property in its own name is
- A) a sole proprietorship.
 - B) a partnership.
 - C) a corporation.
 - D) a professional partnership.

Answer: C

Topic: Legal Form of Organization

- 1.1.39) The _____ is responsible for evaluating and recommending proposed asset investments.
- A) Financial Analyst
 - B) Credit Analyst
 - C) Pension Fund Manager
 - D) Capital Expenditures Analyst

Answer: D

Topic: Managerial Finance Functions

- 1.1.40) In a(n) _____, owners have limited liability with regard to the business. They are not personally liable for the malpractice of other owners.
- A) limited partnership
 - B) S-corporation
 - C) partnership
 - D) limited liability partnership

Answer: D

Topic: Legal Form of Organization

Learning Goal 2 Describe the managerial finance function and its relationship to economics and accounting.

- 1.2.1) Marginal analysis states that financial decisions should be made and actions taken only when added benefits exceeds added costs.

Answer: TRUE

Topic: Fundamental Concepts

- 1.2.2) The corporate controller typically handles the accounting activities, such as tax management, data processing, and cost and financial accounting.

Answer: TRUE

Topic: Managerial Finance Functions

- 1.2.3) The financial manager places primary emphasis on cash flows, the inflow and outflow of cash.

Answer: TRUE

Topic: Fundamental Concepts

1.2.4) Managerial finance is concerned with design and delivery of advice and financial products to individuals, business, and government.

Answer: FALSE

Topic: Managerial Finance Functions

1.2.5) The corporate treasurer typically handles the both cost accounting and financial accounting.

Answer: FALSE

Topic: Managerial Finance Functions

1.2.6) The accrual method recognizes revenue at the point of sale and recognizes expenses when incurred.

Answer: TRUE

Topic: Accounting Concepts

1.2.7) The accountant evaluates financial statements, develops additional data, and makes decisions based on his or her assessment of the associated returns and risks.

Answer: FALSE

Topic: Accounting Concepts

1.2.8) The corporate treasurer is the officer responsible for the firm's accounting activities, such as corporate accounting, tax management, financial accounting, and cost accounting.

Answer: FALSE

Topic: Managerial Finance Functions

1.2.9) The corporate controller is the officer responsible for the firm's financial activities such as financial planning and fund raising, making capital expenditure decisions, and managing cash, credit, the pension fund, and foreign exchange.

Answer: FALSE

Topic: Managerial Finance Functions

1.2.10) High cash flow is generally associated with a higher share price whereas higher risk tends to result in a lower share price.

Answer: TRUE

Topic: Fundamental Concepts

1.2.11) The corporate treasurer's focus tends to be more external, while the controller's focus is more internal.

Answer: TRUE

Topic: Managerial Finance Functions

1.2.12) The financial manager prepares financial statements that recognize revenue at the point of sale and expenses when incurred.

Answer: FALSE

Topic: Role of Financial Manager

1.2.13) Using certain standardized and generally accepted principles, the accountant prepares financial statements that recognize revenue at the point of sale and expenses when incurred.

Answer: TRUE

Topic: Accounting Concepts

- 1.2.14) The financial manager must look beyond financial statements to obtain insight into developing or existing problems since the accrual accounting data do not fully describe the circumstances of a firm.

Answer: TRUE

Topic: *Role of Financial Manager*

- 1.2.15) Managerial finance

- A) involves tasks such as budgeting, financial forecasting, cash management, and funds procurement.
- B) involves the design and delivery of advice and financial products.
- C) recognizes funds on an accrual basis.
- D) devotes the majority of its attention to the collection and presentation of financial data.

Answer: A

Topic: *Managerial Finance Functions*

- 1.2.16) The treasurer is commonly responsible for

- A) taxes.
- B) data processing.
- C) making capital expenditures.
- D) cost accounting.

Answer: C

Topic: *Managerial Finance Functions*

- 1.2.17) The controller is commonly responsible for

- A) managing cash.
- B) financial accounting.
- C) managing credit activities.
- D) financial planning.

Answer: B

Topic: *Managerial Finance Functions*

- 1.2.18) The accountant's primary function is

- A) evaluating the financial statements.
- B) making decisions based on financial data.
- C) the collection and presentation of financial data.
- D) planning cash flows.

Answer: C

Topic: *Accounting Concepts*

- 1.2.19) The accountant recognizes revenues and expenses on

- A) a cash basis.
- B) a revenue basis.
- C) an accrual basis.
- D) an expense basis.

Answer: C

Topic: *Accounting Concepts*

- 1.2.20) The financial manager recognizes revenues and expenses utilizing
- A) the accrual method.
 - B) the actual inflows and outflows of cash.
 - C) the standardized, generally accepted, accounting principles.
 - D) the revenue method.

Answer: B

Topic: Role of Financial Manager

- 1.2.21) The financial manager is interested in the cash inflows and outflows of the firm, rather than the accounting data, in order to ensure
- A) profitability.
 - B) the ability to pay dividends.
 - C) the ability to acquire new assets.
 - D) solvency.

Answer: D

Topic: Role of Financial Manager

- 1.2.22) The accountant may be responsible for any of the following EXCEPT
- A) processing purchase orders and invoices.
 - B) ensuring accounts payable are paid on time.
 - C) preparing the monthly income statement.
 - D) analyzing the mix of current to fixed assets.

Answer: D

Topic: Accounting Concepts

- 1.2.23) Economic theories that the financial manager must be able to utilize for efficient business operations, include
- A) supply-and-demand analysis.
 - B) marginal analysis.
 - C) profit-maximizing strategies.
 - D) price theory.
 - E) all of the above.

Answer: E

Topic: Fundamental Concepts

- 1.2.24) The primary economic principle used in managerial finance is
- A) supply and demand.
 - B) the liquidity trap.
 - C) the crowding out effect.
 - D) marginal analysis.

Answer: D

Topic: Fundamental Concepts

1.2.25) Johnson, Inc. has just ended the calendar year making a sale in the amount of \$10,000 of merchandise purchased during the year at a total cost of \$7,000. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow from this sale for the year are

- A) \$3,000 and \$10,000, respectively.
- B) \$3,000 and -\$7,000, respectively.
- C) \$7,000 and -\$3,000, respectively.
- D) \$3,000 and \$7,000, respectively.

Answer: B

Topic: *Fundamental Concepts*

1.2.26) A firm has just ended its calendar year making a sale in the amount of \$150,000 of merchandise purchased during the year at a total cost of \$112,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow from this sale for the year are

- A) \$0 and \$150,000, respectively.
- B) \$37,500 and -\$150,000, respectively.
- C) \$37,500 and -\$112,500, respectively.
- D) \$150,000 and \$112,500, respectively.

Answer: C

Topic: *Fundamental Concepts*

1.2.27) The primary emphasis of the financial manager is the use of

- A) accrued earnings.
- B) cash flow.
- C) organization charts.
- D) profit incentives.

Answer: B

Topic: *Role of Financial Manager*

1.2.28) By concentrating on cash flows within the firm the financial manager should be able to

- A) prepare tax returns.
- B) speak authoritatively to stockholders.
- C) avoid insolvency.
- D) control expenses.

Answer: C

Topic: *Role of Financial Manager*

1.2.29) The officer responsible for the firm's financial activities such as financial planning and fund raising, making capital expenditure decisions, and managing cash, credit, the pension fund, and foreign exchange is

- A) treasurer.
- B) controller.
- C) foreign exchange manager.
- D) none of the above.

Answer: A

Topic: *Managerial Finance Functions*

- 1.2.30) Marginal analysis states that financial decisions should be made and actions taken only when
- A) demand equals supply.
 - B) benefits equal costs.
 - C) added benefits exceed added costs.
 - D) added benefits are greater than zero.

Answer: C

Topic: Fundamental Concepts

- 1.2.31) The officer responsible for the firm's accounting activities, such as corporate accounting, tax management, financial accounting, and cost accounting is the
- A) treasurer.
 - B) controller.
 - C) foreign exchange manager.
 - D) none of the above.

Answer: B

Topic: Managerial Finance Functions

- 1.2.32) A firm has just ended its calendar year making a sale in the amount of \$200,000 of merchandise purchased during the year at a total cost of \$150,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The possible problem this firm may face is
- A) low profitability.
 - B) lack of cash flow.
 - C) inability to receive credit.
 - D) high leverage.

Answer: B

Topic: Fundamental Concepts

Learning Goal 3 Identify the primary activities of the financial manager.

- 1.3.1) When considering each financial decision alternative or possible action in terms of its impact on the share price of the firm's stock, financial managers should accept only those actions that are expected to increase the firm's profitability.

Answer: FALSE

Topic: Goal of the Firm

- 1.3.2) Financial analysis and planning is concerned with analyzing the mix of assets and liabilities.

Answer: FALSE

Topic: Managerial Finance Functions

- 1.3.3) Financing decisions deal with the left-hand side of the firm's balance sheet and involve the most appropriate mix of current and fixed assets.

Answer: FALSE

Topic: Managerial Finance Functions

- 1.3.4) The key role of the financial manager is
- A) decision making.
 - B) the presentation of financial statements.
 - C) the preparation of data for future evaluation.
 - D) the collection of financial data.

Answer: A

Topic: Role of Financial Manager

- 1.3.5) The key activities of the financial manager include all of the following EXCEPT
- A) making financing decisions.
 - B) financial analysis and planning.
 - C) managing financial accounting.
 - D) making investment decisions.

Answer: C

Topic: Role of Financial Manager

- 1.3.6) Included in the primary activities of the financial manager are
- A) financial analysis and planning.
 - B) making investment decisions.
 - C) making financing decisions.
 - D) analyzing and planning cash flows.
 - E) all of the above.

Answer: E

Topic: Role of Financial Manager

- 1.3.7) The financial manager may be responsible for any of the following EXCEPT
- A) monitoring of quarterly tax payments.
 - B) analyzing budget and performance reports.
 - C) determining whether to accept or reject a capital asset acquisition.
 - D) analyzing the effects of more debt on the firm's capital structure.

Answer: A

Topic: Role of Financial Manager

- 1.3.8) Making investment decisions includes all of the following EXCEPT
- A) inventory.
 - B) fixed assets.
 - C) accounts receivable.
 - D) notes payable.

Answer: D

Topic: Managerial Finance Functions

- 1.3.9) Making financing decisions includes all of the following EXCEPT
- A) determining the appropriate mix of short-term and long-term financing.
 - B) deciding which individual short-term sources are best at a given point in time.
 - C) analyzing quarterly budget and performance reports.
 - D) deciding which individual long-term sources are best at a given point in time.

Answer: C

Topic: Managerial Finance Functions

1.3.10) Managing the firm's assets includes all of the following EXCEPT

- A) inventory.
- B) fixed assets.
- C) accounts receivable.
- D) notes payable.

Answer: D

Topic: Managerial Finance Functions

1.3.11) Managing the firm's liabilities includes all of the following EXCEPT

- A) accruals.
- B) notes payable.
- C) cash.
- D) accounts payable.

Answer: C

Topic: Managerial Finance Functions

1.3.12) The financial manager may be responsible for any of the following EXCEPT

- A) keeping track of quarterly tax payments.
- B) analyzing quarterly budget and performance reports.
- C) determining whether to accept or reject a capital asset acquisition.
- D) analyzing the effects of more debt on the firm's capital structure.

Answer: A

Topic: Role of Financial Manager

1.3.13) Financial analysis and planning involve all of the following EXCEPT

- A) transforming data into a form that can be used to monitor the firm's financial position.
- B) evaluating the need for increased or reduced productive capacity.
- C) controlling the data processing activities.
- D) determining the additional financing needs.

Answer: C

Topic: Managerial Finance Functions

1.3.14) The financial manager's investment decisions determine

- A) both the mix and the type of assets found on the firm's balance sheet.
- B) both the mix and the type of liabilities found on the firm's balance sheet.
- C) both the mix and the type of assets and liabilities found on the firm's balance sheet.
- D) both the mix and the type of short-term and long-term financing.

Answer: A

Topic: Managerial Finance Functions

1.3.15) In planning and managing the requirements of the firm, the financial manager is concerned with

- A) the mix and type of assets, but not the type of financing utilized.
- B) the type of financing utilized, but not the mix and type of assets.
- C) the acquisition of fixed assets, allowing someone else to plan the level of current assets required.
- D) the mix and type of assets, the type of financing utilized, and analysis in order to monitor the financial condition.

Answer: D

Topic: Managerial Finance Functions

1.3.16) The financial manager's financing decisions determine

- A) both the mix and the type of assets found on the firm's balance sheet.
- B) the most appropriate mix of short-term and long-term financing.
- C) both the mix and the type of assets and liabilities found on the firm's balance sheet.
- D) the proportion of the firm's earnings to be paid as dividend.

Answer: B

Topic: *Managerial Finance Functions*

Learning Goal 4 Explain the goal of the firm, corporate governance, the role of ethics, and the agency issue.

1.4.1) The goal of ethics is to motivate business and market participants to adhere to both the letter and the spirit of laws and regulations in all aspects of business and professional practice.

Answer: TRUE

Topic: *The Role of Ethics*

1.4.2) To achieve the goal of profit maximization for each alternative being considered, the financial manager would select the one that is expected to result in the highest monetary return.

Answer: TRUE

Topic: *Fundamental Concepts*

1.4.3) Dividend payments change directly with changes in earnings per share.

Answer: FALSE

Topic: *Fundamental Concepts*

1.4.4) The wealth of corporate owners is measured by the share price of the stock.

Answer: TRUE

Topic: *Goal of the Firm*

1.4.5) Risk and the magnitude and timing of cash flows are the key determinants of share price, which represents the wealth of the owners in the firm.

Answer: TRUE

Topic: *Fundamental Concepts*

1.4.6) A high earnings per share (EPS) does not necessarily translate into a high stock price.

Answer: TRUE

Topic: *Fundamental Concepts*

1.4.7) The profit maximization goal ignores the timing of returns, does not directly consider cash flows, and ignores risk.

Answer: TRUE

Topic: *Goal of the Firm*

1.4.8) When considering each financial decision alternative or possible action in terms of its impact on the share price of the firm's stock, financial managers should accept only those actions that are expected to maximize shareholder value.

Answer: TRUE

Topic: *Goal of the Firm*

1.4.9) An increase in firm risk tends to result in a higher share price since the stockholder must be compensated for the greater risk.

Answer: FALSE

Topic: *Goal of the Firm*

1.4.10) Stockholders expect to earn higher rates of return on investments of lower risk and lower rates of return on investments of higher risk.

Answer: FALSE

Topic: *Goal of the Firm*

1.4.11) The likelihood that managers may place personal goals ahead of corporate goals is called the agency problem.

Answer: TRUE

Topic: *Agency Issue*

1.4.12) Agents of corporate owners are themselves owners of the firm and have been elected by all the corporate owners to represent them in decision-making and management of the firm.

Answer: FALSE

Topic: *Agency Issue*

1.4.13) The agency problem occurs when the firm selects an ineffective marketing advertising and PR firm to represent them.

Answer: FALSE

Topic: *Agency Issue*

1.4.14) Market forces and incurring agency costs such as bonding and insurance help to prevent or minimize agency problems.

Answer: TRUE

Topic: *Financial Institutions*

1.4.15) The major purpose of the Sarbanes-Oxley Act of 2002 was to place caps on the compensation that could be paid to corporate executives.

Answer: FALSE

Topic: *Corporate Governance*

1.4.16) Institutional investors are professional investors who work on behalf of the federal government to ensure fairness in the financial markets.

Answer: FALSE

Topic: *Corporate Governance*

1.4.17) Recent studies on executive compensation have failed to find a strong relationship between CEO compensation and share price.

Answer: TRUE

Topic: *Agency Issue*

1.4.18) The primary goal of the financial manager is

- A) minimizing risk.
- B) maximizing profit.
- C) maximizing wealth.
- D) minimizing return.

Answer: C

Topic: Goal of the Firm

1.4.19) Corporate owner's receive realizable return through

- A) earnings per share and cash dividends.
- B) increase in share price and cash dividends.
- C) increase in share price and earnings per share.
- D) profit and earnings per share.

Answer: B

Topic: Goal of the Firm

1.4.20) The wealth of the owners of a corporation is represented by

- A) profits.
- B) earnings per share.
- C) share value.
- D) cash flow.

Answer: C

Topic: Goal of the Firm

1.4.21) Wealth maximization as the goal of the firm implies enhancing the wealth of

- A) the Board of Directors.
- B) the firm's employees.
- C) the federal government.
- D) the firm's stockholders.

Answer: D

Topic: Goal of the Firm

1.4.22) If a company's managers are NOT owners of the company, then they are

- A) dealers.
- B) agents.
- C) outsiders.
- D) brokers.

Answer: B

Topic: Agency Issue

1.4.23) The conflict between the goals of a firm's owners and the goals of its non-owner managers is

- A) the agency problem.
- B) incompatibility.
- C) serious only when profits decline.
- D) of little importance in most large U.S. firms.

Answer: A

Topic: Agency Issue

1.4.24) The agency problem may result from a manager's concerns about any of the following EXCEPT

- A) job security.
- B) personal wealth.
- C) corporate goals.
- D) company-provided perquisites.

Answer: C

Topic: Agency Issue

1.4.25) Agency costs include all of the following EXCEPT

- A) bonding and structuring expenses.
- B) cost of goods sold.
- C) monitoring expenditures.
- D) opportunity costs.

Answer: B

Topic: Agency Issue

1.4.26) Agency costs include all of the following EXCEPT

- A) management reports to stockholders.
- B) performance incentives paid to managers.
- C) the cost of monitoring management behavior.
- D) purchasing insurance against management misconduct.

Answer: A

Topic: Agency Issue

1.4.27) One way often used to insure that management decisions are in the best interest of the stockholders is to

- A) threaten to fire managers who are seen as not performing adequately.
- B) remove management's perquisites.
- C) tie management compensation to the performance of the company's common stock price.
- D) tie management compensation to the level of earnings per share.

Answer: C

Topic: Agency Issue

1.4.28) The amount earned during the accounting period on each outstanding share of common stock is called

- A) common stock dividend.
- B) earnings per share.
- C) net profits after taxes.
- D) net income.

Answer: B

Topic: Accounting Concepts

1.4.29) The goal of profit maximization would result in priority for

- A) cash flows available to stockholders.
- B) risk of the investment.
- C) earnings per share.
- D) timing of the returns.

Answer: C

Topic: Goal of the Firm

- 1.4.30) Profit maximization as a goal is not ideal because it does NOT directly consider
- A) risk and cash flow.
 - B) cash flow and stock price.
 - C) risk and EPS.
 - D) EPS and stock price.

Answer: A

Topic: Agency Issue

- 1.4.31) Profit maximization as the goal of the firm is NOT ideal because
- A) profits are only accounting measures.
 - B) cash flows are more representative of financial strength.
 - C) profit maximization does not consider risk.
 - D) profits today are less desirable than profits earned in future years.

Answer: C

Topic: Agency Issue

- 1.4.32) Profit maximization fails because it ignores all EXCEPT
- A) the timing of returns.
 - B) earnings per share.
 - C) cash flows available to stockholders.
 - D) risk.

Answer: B

Topic: Goal of the Firm

- 1.4.33) The key variables in the owner wealth maximization process are
- A) earnings per share and risk.
 - B) cash flows and risk.
 - C) earnings per share and share price.
 - D) profits and risk.

Answer: B

Topic: Goal of the Firm

- 1.4.34) Cash flow and risk are the key determinants in share price. Increased cash flow results in _____, other things remaining the same.
- A) a lower share price
 - B) a higher share price
 - C) an unchanged share price
 - D) an undetermined share price

Answer: B

Topic: Goal of the Firm

- 1.4.35) Cash flow and risk are the key determinants in share price. Increased risk, other things remaining the same, results in
- A) a lower share price.
 - B) a higher share price.
 - C) an unchanged share price.
 - D) an undetermined share price.

Answer: A

Topic: Goal of the Firm

- 1.4.36) Financial managers evaluating decision alternatives or potential actions must consider
- A) only risk.
 - B) only return.
 - C) both risk and return.
 - D) risk, return, and the impact on share price.

Answer: D

Topic: Goal of the Firm

- 1.4.37) An ethics program is expected to have a _____ impact on the firm's share price.
- A) positive
 - B) negative
 - C) no impact
 - D) undetermined

Answer: A

Topic: Role of Ethics

- 1.4.38) Higher cash flow and greater risk
- A) have no effect on share price.
 - B) have an inverse effect on share price.
 - C) adversely affect share price.
 - D) have the same effect on share price.

Answer: B

Topic: Goal of the Firm

- 1.4.39) As the risk of a stock investment increases, investors'
- A) return will increase.
 - B) return will decrease.
 - C) required rate of return will decrease.
 - D) required rate of return will increase.

Answer: D

Topic: Goal of the Firm

- 1.4.40) A more recent issue that is causing major problems in the business community is
- A) the privatization of ownership.
 - B) short-term versus long-term financial goals of management.
 - C) ethical problems.
 - D) environmental concerns.

Answer: C

Topic: Role of Ethics

- 1.4.41) All of the following are measures that can be used as a guide for establishing a corporate ethics policy, EXCEPT
- A) an effective internal control system.
 - B) an effective internal audit system.
 - C) making reference checks before hiring new employees.
 - D) making sure violations are penalized, while at the same time not subjecting the employee to publicity.

Answer: D

Topic: Role of Ethics

- 1.4.42) Corporate ethics policies typically apply to _____ in dealing with _____.
 A) employee actions; customers and creditors
 B) employee actions; customers, vendors, and regulators
 C) management actions; all corporate constituents
 D) employee actions; all corporate constituents

Answer: D

Topic: Role of Ethics

- 1.4.43) A financial manager must choose between four alternative Assets: 1, 2, 3, and 4. Each asset costs \$35,000 and is expected to provide earnings over a three-year period as described below.

Asset	Year 1	Year 2	Year 3
1	\$21,000	\$15,000	\$6,000
2	9,000	15,000	21,000
3	3,000	20,000	19,000
4	6,000	12,000	12,000

Based on the profit maximization goal, the financial manager would choose

- A) Asset 1.
 B) Asset 2.
 C) Asset 3.
 D) Asset 4.

Answer: B

Topic: Goal of the Firm

- 1.4.44) A financial manager must choose between three alternative investments. Each asset is expected to provide earnings over a three-year period as described below. Based on the wealth maximization goal, the financial manager would

Year	Asset 1	Asset 2	Asset 3
1	\$21,000	\$ 9,000	\$15,000
2	15,000	15,000	15,000
3	<u>9,000</u>	<u>21,000</u>	<u>15,000</u>
	\$45,000	\$45,000	\$45,000

- A) choose Asset 1.
 B) choose Asset 2.
 C) choose Asset 3.
 D) be indifferent between Asset 1 and Asset 2.

Answer: A

Topic: Goal of the Firm

- 1.4.45) A recent ethics survey indicated the opinion that maintaining high ethical standards
 A) weakened a firm's competitive position, particularly in foreign markets.
 B) had no effect on a firm's competitive position.
 C) strengthened a firm's competitive position.
 D) was difficult to enforce.

Answer: C

Topic: Role of Ethics

- 1.4.46) The implementation of a pro-active ethics program is expected to result in
- A) a positive corporate image and increased respect, but is not expected to affect cash flows.
 - B) an increased share price resulting from a decrease in risk, but is not expected to affect cash flows.
 - C) a positive corporate image and increased respect, but is not expected to affect share price.
 - D) a positive corporate image and increased respect, a reduction in risk, and enhanced cash flow resulting in an increase in share price.

Answer: D

Topic: *Role of Ethics*

- 1.4.47) Among solutions to the agency problem in publicly-held corporations are all of the following EXCEPT
- A) stock options.
 - B) performance shares.
 - C) cash bonuses tied to goal achievement.
 - D) bonuses based on short-term results.

Answer: D

Topic: *Agency Issue*

- 1.4.48) Emerging trends resulting from the agency problem are all of the following EXCEPT
- A) large private corporations.
 - B) restructuring through leveraged buyouts.
 - C) management by active investors.
 - D) prohibiting managers from maintaining an ownership interest.

Answer: D

Topic: *Agency Issue*

- 1.4.49) The board of directors is typically responsible for
- A) developing strategic goals and plans.
 - B) hiring and firing.
 - C) both A and B.
 - D) neither A nor B.

Answer: C

Topic: *Corporate Governance*

- 1.4.50) The Sarbanes-Oxley Act of 2002 was passed in response to
- A) insider trading activities.
 - B) false disclosures in financial reporting.
 - C) the decline in technology stocks.
 - D) all of the above.

Answer: B

Topic: *Corporate Governance*

- 1.4.51) The Sarbanes–Oxley Act of 2002 did all of the following EXCEPT
- A) tighten audit regulations and controls.
 - B) toughen penalties against overcompensated executives.
 - C) toughen penalties against executives who commit corporate fraud.
 - D) All of the above are true.

Answer: B

Topic: Corporate Governance

Learning Goal 5 Understand financial institutions and markets, and the role they play in managerial finance.

- 1.5.1) Primary and secondary markets are markets for short–term and long–term securities, respectively.

Answer: FALSE

Topic: Financial Markets

- 1.5.2) Financial markets are intermediaries that channel the savings of individuals, businesses and government into loans or investments.

Answer: FALSE

Topic: Financial Markets

- 1.5.3) Money markets involve the trading of securities with maturities of one year or less while capital market involve the buying and selling of securities with maturities of more than one year.

Answer: TRUE

Topic: Financial Markets

- 1.5.4) A financial institution is an intermediary that channels the savings of individuals, businesses, and governments into loans or investments.

Answer: TRUE

Topic: Financial Institutions

- 1.5.5) A public offering is the sale of a new security issue—typically debt or preferred stock—directly to an investor or group of investors.

Answer: FALSE

Topic: Financial Markets

- 1.5.6) Eurocurrency deposits arise when a corporation or individual makes a deposit in a bank in a currency other than the local currency of the country where the bank is located.

Answer: TRUE

Topic: Financial Institutions

- 1.5.7) A primary market is a financial market in which pre–owned securities are traded.

Answer: FALSE

Topic: Financial Markets

- 1.5.8) Loan transactions between commercial banks in which the federal government becomes involved are referred to as federal funds.

Answer: FALSE

Topic: Financial Institutions

1.5.9) The eurocurrency market is a market for short-term bank deposits denominated in U.S. dollars or other easily convertible currencies.

Answer: TRUE

Topic: Financial Markets

1.5.10) The Over-the-Counter (OTC) exchange is not an organization but an intangible market for trading securities which are not listed by the organized exchanges.

Answer: TRUE

Topic: Financial Markets

1.5.11) The money market is a financial relationship created by a number of institutions and arrangements that allows suppliers and demanders of long-term funds to make transactions.

Answer: FALSE

Topic: Financial Markets

1.5.12) Unlike the organized exchanges, the OTC makes a market in both outstanding securities and new public issues, making it both a secondary and a primary market.

Answer: TRUE

Topic: Financial Markets

1.5.13) In the OTC market, the ask price is the highest price offered by a dealer to purchase a given security.

Answer: FALSE

Topic: Financial Markets

1.5.14) In the OTC market, the prices at which securities are traded result from both competitive bids and negotiation.

Answer: TRUE

Topic: Financial Markets

1.5.15) The price-to-earnings (PE) ratio measures the amount common stock investors are willing to pay for each dollar of the firm's earnings.

Answer: TRUE

Topic: Fundamental Concepts

1.5.16) An efficient market is a market that allocates funds to their most productive use as a result of competition among wealth-maximizing investors.

Answer: TRUE

Topic: Financial Markets

1.5.17) Which of the following is NOT a financial institution?

- A) A commercial bank.
- B) An insurance company.
- C) A pension fund.
- D) A newspaper publisher.

Answer: D

Topic: Financial Institutions

1.5.18) The key participants in financial transactions are individuals, businesses, and governments. Individuals are net _____ of funds, and businesses are net _____ of funds.

- A) demanders; suppliers
- B) users; providers
- C) suppliers; demanders
- D) purchasers; sellers

Answer: C

Topic: Financial Markets

1.5.19) Most businesses raise money by selling their securities in a

- A) public offering.
- B) private placement.
- C) direct placement.
- D) stock exchange.

Answer: A

Topic: Financial Markets

1.5.20) The _____ is created by a financial relationship between suppliers and demanders of short-term funds.

- A) stock market
- B) capital market
- C) financial market
- D) money market

Answer: D

Topic: Financial Markets

1.5.21) Government usually

- A) is a net supplier of funds.
- B) is a net demander of funds.
- C) borrows funds directly from financial institutions.
- D) maintains permanent deposits with financial institutions.

Answer: B

Topic: Financial Markets

1.5.22) By definition, the money market involves the buying and selling of

- A) stocks and bonds.
- B) short-term funds.
- C) funds that mature in more than one year.
- D) flows of funds.

Answer: B

Topic: Financial Markets

1.5.23) A competitive market that allocates funds to their most productive use is called a(n)

- A) liquid market.
- B) middleman's market.
- C) efficient market.
- D) investor's market.

Answer: C

Topic: Financial Markets

- 1.5.24) The over-the-counter (OTC) market is
- A) the New York Stock Exchange.
 - B) an organized stock exchange.
 - C) a place where securities are bought and sold.
 - D) an intangible market for unlisted securities.

Answer: D

Topic: Financial Markets

- 1.5.25) Most money market transactions are made in
- A) common stock.
 - B) marketable securities.
 - C) stocks and bonds.
 - D) preferred stock.

Answer: B

Topic: Financial Markets

- 1.5.26) Firms that require funds from external sources can obtain them in one of the following ways EXCEPT
- A) financial institution.
 - B) financial markets.
 - C) government.
 - D) private placement.

Answer: C

Topic: Financial Institutions and Markets

- 1.5.27) The _____ is created by a number of institutions and arrangements that allow the suppliers and demanders of long-term funds to make transactions.
- A) financial market
 - B) capital market
 - C) money market
 - D) credit market

Answer: B

Topic: Financial Markets

- 1.5.28) Firms that require funds from external sources can obtain them from
- A) private placement.
 - B) financial institutions.
 - C) financial markets.
 - D) all of the above.

Answer: D

Topic: Financial Institutions and Markets

- 1.5.29) The nonexclusive sale of either bonds or stocks to the general public is called
- A) private placement.
 - B) public offering.
 - C) organized selling.
 - D) none of the above.

Answer: B

Topic: Financial Markets

- 1.5.30) Trading is carried out on the floor of the New York Stock Exchange by
- A) the negotiation process.
 - B) the auction process.
 - C) a telecommunications network.
 - D) investment bankers.

Answer: B

Topic: Financial Markets

- 1.5.31) All of the following are functions of security exchanges EXCEPT
- A) allocating scarce capital.
 - B) aiding in new financing.
 - C) creating continuous markets.
 - D) holding demand deposits.

Answer: D

Topic: Financial Markets

- 1.5.32) All of the following are examples of organized stock exchanges EXCEPT
- A) the New York Stock Exchange.
 - B) the American Stock Exchange.
 - C) the Pacific Stock Exchange.
 - D) the over-the-counter exchange.

Answer: D

Topic: Financial Markets

- 1.5.33) The major securities traded in the capital markets are
- A) commercial paper and Treasury bills.
 - B) Treasury bills and certificates of deposit.
 - C) stocks and bonds.
 - D) bonds and commercial paper.

Answer: C

Topic: Financial Markets

- 1.5.34) Long-term debt instruments used by both government and business are known as
- A) stocks.
 - B) bills.
 - C) bonds.
 - D) equities.

Answer: C

Topic: Financial Markets

- 1.5.35) The two key financial markets are
- A) primary market and secondary market.
 - B) primary market and money market.
 - C) money market and capital market.
 - D) capital market and secondary market.

Answer: C

Topic: Financial Markets

1.5.36) The _____ stock exchange is a primary market where new public issues are sold.

- A) regional
- B) American
- C) New York
- D) over-the-counter

Answer: D

Topic: Financial Markets

1.5.37) Trading is carried out in the Over-the-Counter (OTC) Exchange by

- A) the competitive bid process.
- B) the competitive bid process and the negotiation process.
- C) the auction process.
- D) an investment banker.

Answer: B

Topic: Financial Markets

1.5.38) Securities exchanges create efficient markets that do all of the following EXCEPT

- A) ensure a market in which the price reflects the true value of the security.
- B) allocate funds to the most productive uses.
- C) control the supply and demand for securities through price.
- D) allow the price to be determined by supply and demand of securities.

Answer: C

Topic: Financial Markets

Learning Goal 6 Discuss business taxes and their importance in financial decisions.

1.6.1) The ordinary income of a corporation is income earned through the sale of a firm's goods and services and is currently taxed subject to the individual income tax rates.

Answer: FALSE

Topic: Business Taxes

1.6.2) The marginal tax rate represents the rate at which additional income is taxed.

Answer: TRUE

Topic: Business Taxes

1.6.3) All dividend income received by one corporation from an investment in the common and preferred stock of another corporation is excluded from taxation.

Answer: FALSE

Topic: Business Taxes

1.6.4) Because of the dividend exclusion only 70 percent of intercorporate dividend dividend income is included as ordinary income.

Answer: FALSE

Topic: Business Taxes

1.6.5) Tax laws often are used to accomplish economic goals such as providing incentives for corporate investment in certain types of assets.

Answer: TRUE

Topic: Business Taxes

1.6.6) With progressive tax rates, the average tax rate is always less than or equal to the marginal tax rate.

Answer: TRUE

Topic: Business Taxes

1.6.7) Dividends received by a corporation on an investment in the common and preferred stock of another corporation (where ownership in the dividend paying corporation is less than 20%) is subject to 70 percent exclusion for tax purposes.

Answer: TRUE

Topic: Business Taxes

1.6.8) The tax deductibility of various expenses such as general and administrative expenses _____ their after-tax cost.

- A) increases
- B) reduces
- C) has no effect on
- D) has an undetermined effect on

Answer: B

Topic: Business Taxes

1.6.9) The tax liability of a corporation with ordinary income of \$105,000 is _____.

- A) \$42,000
- B) \$35,700
- C) \$23,950
- D) \$24,200

Answer: D

Topic: Business Taxes

1.6.10) The tax liability of a corporation with ordinary income of \$1,500,000 is _____.

- A) \$498,250
- B) \$510,000
- C) \$585,000
- D) \$690,000

Answer: B

Topic: Business Taxes

1.6.11) The tax liability of a corporation with ordinary income of \$1,100,000 is _____.

- A) \$362,250
- B) \$340,000
- C) \$374,000
- D) \$390,000

Answer: C

Topic: Business Taxes

1.6.12) Jennings, Inc. has a tax liability of \$170,000 on pretax income of \$500,000. What is the average tax rate for Jennings, Inc.?

- A) 34 percent
- B) 46 percent
- C) 25 percent
- D) 40 percent

Answer: A

Topic: Business Taxes

1.6.13) The average tax rate of a corporation with ordinary income of \$105,000 and a tax liability of \$24,200 is

- A) 46 percent.
- B) 23 percent.
- C) 34 percent.
- D) 15 percent.

Answer: B

Topic: Business Taxes

1.6.14) If a corporation sells certain capital equipment for more than their initial purchase price, the difference between the sale price and the purchase price is called a(n)

- A) ordinary gain.
- B) capital loss.
- C) capital gain.
- D) ordinary loss.

Answer: C

Topic: Business Taxes

1.6.15) In general, most corporate capital gains are taxed at _____ tax rate.

- A) a 46 percent
- B) the ordinary
- C) a 28 percent
- D) a 30 percent

Answer: B

Topic: Business Taxes

1.6.16) Congress allows corporations to exclude from taxes 70 to 100 percent of dividends received from other corporations. Congress did this to

- A) encourage corporations to invest in each other.
- B) avoid double taxation on dividends.
- C) avoid triple taxation on dividends.
- D) lower the cost of equity financing for corporations.

Answer: C

Topic: Business Taxes

1.6.17) Corporation X needs \$1,000,000 and can raise this through debt at an annual rate of 10 percent, or preferred stock at an annual cost of 7 percent. If the corporation has a 40 percent tax rate, the after-tax cost of each is

- A) debt: \$100,000; preferred stock: \$70,000.
- B) debt: \$60,000; preferred stock: \$42,000.
- C) debt: \$60,000; preferred stock: \$70,000.
- D) debt: \$100,000; preferred stock: \$42,000.

Answer: C

Topic: Business Taxes

1.6.18) Corporation A owns 15 percent of the stock of corporation B. Corporation B pays corporation A \$100,000 in dividends in 2002. Corporation A must pay tax on

- A) \$100,000 of ordinary income.
- B) \$ 30,000 of ordinary income.
- C) \$ 70,000 of ordinary income.
- D) \$ 70,000 of capital gain.

Answer: B

Topic: Business Taxes

1.6.19) The dividend exclusion for corporations receiving dividends from another corporation has resulted in

- A) a lower cost of equity for the corporation paying the dividend.
- B) a higher relative cost of bond-financing for the corporation paying the dividend.
- C) stock investments being relatively less attractive, relative to bond investments made by one corporation in another corporation.
- D) stock investments being relatively more attractive relative to bond investments made by one corporation in another corporation.

Answer: D

Topic: Business Taxes

1.6.20) All of the following are true EXCEPT

- A) Interest income received by a corporation is taxed as ordinary income.
- B) Corporations pay taxes on all dividends received from other corporations, no matter their share of ownership.
- C) Corporations may pay taxes on only 30 percent of the dividends received from other corporations, depending on their percentage of ownership.
- D) Capital gains is taxed as ordinary income.

Answer: B

Topic: Business Taxes

- 1.6.21) Meese Paper Distributors, Inc. has before-tax earnings of \$1,900,000. Calculate the amount of the total tax liability.

Answer:

Meese Paper Distributors		
		Tax Liability
$0.15 \times \$50,000$	=	\$ 7,500
$0.25 \times \$25,000$	=	6,250
$0.34 \times \$25,000$	=	8,500
$0.39 \times (\$335,000 - \$100,000)$	=	91,650
$0.34 \times (\$1,900,000 - \$335,000)$	=	\$532,100
Total tax liability	=	\$646,000

Topic: Business Taxes

- 1.6.22) During 2002, a firm has sold 5 assets described below. Calculate the tax liability on the assets. The firm pays a 40 percent tax rate on ordinary income.

Asset	Purchase Price	Sale Price
1	\$10,000	\$12,000
2	\$50,000	\$40,000
3	\$37,500	\$50,000
4	\$ 3,000	\$ 3,500
5	\$15,000	\$12,000

Answer:

Asset	Tax Liability		
1	\$ 2,000(0.40)	=	\$ 800
2	—		
3	\$12,500(0.40)	=	\$5,000
4	\$ 500(0.40)	=	\$ 200
5	—		

Topic: Business Taxes

- 1.6.23) Consider two firms, Go Debt corporation and No Debt corporation. Both firms are expected to have earnings before interest and taxes of \$100,000 during the coming year. In addition, Go Debt is expected to incur \$40,000 in interest expenses as a result of its borrowings whereas No Debt will incur no interest expense because it does not use debt financing. However, No Debt will have to pay stockholders \$40,000 in dividend income. Both firms are in the 40 percent tax bracket. Calculate the Earnings after tax for both firms. Which firm has the higher after-tax earnings? Which firm appears to have the higher cash flow? How do you account for the difference?

Answer:

	Go Debt	No Debt
Earnings before interest and taxes	\$100,000	\$100,000
Less: Interest expense	<u>40,000</u>	<u>0</u>
Earnings before taxes	\$ 60,000	\$100,000
Less: Taxes (40%)	<u>24,000</u>	<u>40,000</u>
Earnings after taxes	\$ 36,000	\$ 60,000
Less: Dividends paid	<u>0</u>	<u>40,000</u>

Go Debt has lower earnings after taxes compared to No Debt. However, from a cash outflow perspective, Go Debt paid out a total of only \$64,000 (\$40,000 in interest expenses plus \$24,000 in taxes) while No debt paid out a total of \$80,000 (\$40,000 in taxes and \$40,000 in dividends). The difference between the two is \$16,000 which is exactly the difference in taxes paid between the two firms (\$24,000 compared to \$40,000). This difference results from the fact that interest expense is a tax deductible expense.

Topic: Business Taxes