

Chapter 1

The Role and Environment of Managerial Finance

■ Learning Goals

1. Define finance, its major areas and opportunities available in this field, and the legal forms of business organization.
2. Describe the managerial finance function and its relationship to economics and accounting.
3. Identify the primary activities of the financial manager.
4. Explain the goal of the firm, corporate governance, the role of ethics, and the agency issue.
5. Understand financial institutions and markets, and the role they play in managerial finance.
6. Discuss business taxes and their importance in financial decisions.

■ True/False

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
Level of Difficulty: 1
Learning Goal: 1
Topic: Career Opportunities
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
Level of Difficulty: 1
Learning Goal: 1
Topic: Finance Defined
3. Financial services are concerned with the duties of the financial manager.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 1
Topic: Role of Financial Manager

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
Level of Difficulty: 1
Learning Goal: 1
Topic: Role of Financial Manager
5. In partnerships, owners have unlimited liability and may have to cover debts of other less financially sound partners.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 1
Topic: Legal Form of Organization
6. In partnerships, a partner can readily transfer his/her wealth to other partners.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 1
Topic: Legal Form of Organization
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
Level of Difficulty: 1
Learning Goal: 1
Topic: Corporate Governance
8. The sole proprietor has unlimited liability; his or her total investment in the business can be taken to satisfy creditors.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 1
Topic: Legal Form of Organization
9. In limited partnerships, only one partner may assume limited liability. All other partners have to have unlimited liability.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 1
Topic: Legal Form of Organization
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
Level of Difficulty: 2
Learning Goal: 1
Topic: Corporate Governance

11. In limited partnerships, partners' liabilities are limited to their investment in the partnership.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 1
Topic: Legal Form of Organization
12. In limited liability partnerships, the liability protection does not protect partners from their individual acts of malpractice.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 1
Topic: Legal Form of Organization
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
Level of Difficulty: 3
Learning Goal: 1
Topic: Managerial Finance Functions
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
Level of Difficulty: 3
Learning Goal: 1
Topic: Managerial Finance Functions
15. In large companies, the project finance manager is responsible for coordinating the assets and liabilities of the employees' pension fund.
Answer: FALSE
Level of Difficulty: 4
Learning Goal: 1
Topic: Managerial Finance Functions
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
Level of Difficulty: 4
Learning Goal: 1
Topic: Legal Form of Organization
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
Level of Difficulty: 4
Learning Goal: 1
Topic: Legal Form of Organization

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
Level of Difficulty: 4
Learning Goal: 1
Topic: Legal Form of Organization
19. Marginal analysis states that financial decisions should be made and actions taken only when added benefits exceeds added costs.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 2
Topic: Fundamental Concepts
20. The corporate controller typically handles the accounting activities, such as tax management, data processing, and cost and financial accounting.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 2
Topic: Managerial Finance Functions
21. The financial manager places primary emphasis on cash flows, the inflow and outflow of cash.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 2
Topic: Fundamental Concepts
22. Managerial finance is concerned with design and delivery of advice and financial products to individuals, business, and government.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 2
Topic: Managerial Finance Functions
23. The corporate treasurer typically handles the both cost accounting and financial accounting.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 2
Topic: Managerial Finance Functions
24. The accrual method recognizes revenue at the point of sale and recognizes expenses when incurred.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 2
Topic: Accounting Concepts

25. 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
Level of Difficulty: 1
Learning Goal: 2
Topic: Accounting Concepts
26. 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
Level of Difficulty: 2
Learning Goal: 2
Topic: Managerial Finance Functions
27. 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
Level of Difficulty: 2
Learning Goal: 2
Topic: Managerial Finance Functions
28. High cash flow is generally associated with a higher share price whereas higher risk tends to result in a lower share price.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 2
Topic: Fundamental Concepts
29. The corporate treasurer's focus tends to be more external, while the controller's focus is more internal.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 2
Topic: Managerial Finance Functions
30. The financial manager prepares financial statements that recognize revenue at the point of sale and expenses when incurred.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 2
Topic: Role of Financial Manager
31. 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
Level of Difficulty: 2
Learning Goal: 2
Topic: Accounting Concepts

32. 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
Level of Difficulty: 3
Learning Goal: 2
Topic: Role of Financial Manager
33. 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
Level of Difficulty: 2
Learning Goal: 3
Topic: Goal of the Firm
34. Financial analysis and planning is concerned with analyzing the mix of assets and liabilities.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 3
Topic: Managerial Finance Functions
35. 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
Level of Difficulty: 2
Learning Goal: 3
Topic: Managerial Finance Functions
36. 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
Level of Difficulty: 1
Learning Goal: 4
Topic: The Role of Ethics
37. 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
Level of Difficulty: 2
Learning Goal: 4
Topic: Fundamental Concepts
38. Dividend payments change directly with changes in earnings per share.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 4
Topic: Fundamental Concepts

39. The wealth of corporate owners is measured by the share price of the stock.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Goal of the Firm
40. Economic value added (EVA) is the difference between the cost of funds used to finance an investment and its after-tax operating profits.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Fundamental Concepts
41. Economic value added (EVA) is calculated by subtracting the cost of funds used to finance an investment from its after-tax operating profits.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Fundamental Concepts
42. Return and risk are the key determinants of share price, which represents the wealth of the owners in the firm.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Fundamental Concepts
43. A high earnings per share (EPS) does not necessarily translate into a high stock price.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 4
Topic: Fundamental Concepts
44. The profit maximization goal ignores the timing of returns, does not directly consider cash flows, and ignores risk.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 4
Topic: Goal of the Firm
45. 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 share price.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 4
Topic: Goal of the Firm

46. Higher risk tends to result in a higher share price since the stockholder must be compensated for the greater risk.
Answer: FALSE
Level of Difficulty: 3
Learning Goal: 4
Topic: Goal of the Firm
47. Where risk is involved, stockholders expect to earn higher rates of return on investments of lower risk and vice versa.
Answer: FALSE
Level of Difficulty: 3
Learning Goal: 4
Topic: Goal of the Firm
48. The likelihood that managers may place personal goals ahead of corporate goals is called the agency problem.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Agency Issue
49. 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
Level of Difficulty: 2
Learning Goal: 4
Topic: Agency Issue
50. The agency problem is the acquisition of a firm by another firm that is not supported by management.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 4
Topic: Agency Issue
51. Market forces and agency costs help to prevent or minimize agency problems.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 4
Topic: Financial Institutions
52. Credit unions are the largest type of financial intermediary that handle individual savings.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Institutions

53. A mutual fund is a type of financial intermediary that obtains funds through the sale of shares and uses the proceeds to acquire bonds and stocks issued by various business and governmental units.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Institutions
54. Primary and secondary markets are markets for short-term and long-term securities, respectively.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Markets
55. Financial markets are intermediaries that channel the savings of individuals, businesses and government into loans or investments.
Answer: FALSE
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Markets
56. 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
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Markets
57. A financial institution is an intermediary that channels the savings of individuals, businesses, and governments into loans or investments.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 5
Topic: Financial Institutions
58. 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
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Markets
59. 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
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Institutions

60. The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) instituted interest-rate ceilings on all accounts a financial institution offers.

Answer: FALSE

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions

61. A financial supermarket is an institution at which a customer can obtain a full array of financial services, such as checking, savings, brokerage, insurance, retirement and estate planning.

Answer: TRUE

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions

62. A primary market is a financial market in which pre-owned securities are traded.

Answer: FALSE

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

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

Answer: FALSE

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions

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

Answer: TRUE

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

65. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

66. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

67. 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
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Markets
68. In the OTC market, the ask price is the highest price offered by a dealer to purchase a given security.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Markets
69. In the OTC market, the prices at which securities are traded result from both competitive bids and negotiation.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Markets
70. 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
Level of Difficulty: 2
Learning Goal: 5
Topic: Fundamental Concepts
71. 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
Level of Difficulty: 2
Learning Goal: 5
Topic: Financial Markets
72. Investors find Eurobonds attractive because they provide currency diversification and because they provide anonymity to the investor wishing to avoid payment of taxes.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 5
Topic: Financial Markets
73. 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
Level of Difficulty: 1
Learning Goal: 6
Topic: Business Taxes

74. The marginal tax rate represents the rate at which additional income is taxed.
Answer: TRUE
Level of Difficulty: 1
Learning Goal: 6
Topic: Business Taxes
75. Dividends received on common and preferred stocks held in other corporations are all subject to exclusion for tax purposes in order to avoid triple taxation.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 6
Topic: Business Taxes
76. Because of the dividend exclusion only 70 percent of the intercorporate dividends are included as ordinary income.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 6
Topic: Business Taxes
77. Tax laws are used to accomplish economic goals such as providing incentives for corporate investment in certain types of assets.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 6
Topic: Business Taxes
78. With progressive tax rates, the average tax rate is always less than or equal to the marginal tax rate.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 6
Topic: Business Taxes
79. Dividends received by corporations on common and preferred stock held in other corporations and representing less than 20 percent ownership in them is subject to 70 percent exclusion for tax purposes.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 6
Topic: Business Taxes
80. The board of directors of most large corporations today include both inside directors and outside directors.
Answer: TRUE
Level of Difficulty: 2
Learning Goal: 4
Topic: Corporate Governance

81. 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
Level of Difficulty: 3
Learning Goal: 4
Topic: Corporate Governance
82. Institutional investors are professional investors who work on behalf of the federal government to ensure fairness in the financial markets.
Answer: FALSE
Level of Difficulty: 2
Learning Goal: 4
Topic: Corporate Governance
83. Recent studies on executive compensation have failed to find a strong relationship between CEO compensation and share price.
Answer: TRUE
Level of Difficulty: 3
Learning Goal: 4
Topic: Agency Issue

■ Multiple Choice Questions

1. 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
Level of Difficulty: 1
Learning Goal: 1
Topic: Managerial Finance Functions
2. 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
Level of Difficulty: 1
Learning Goal: 1
Topic: Managerial Finance Functions

3. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Finance Defined

4. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Career Opportunities

5. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Career Opportunities

6. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Career Opportunities

7. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Legal Form of Organization

8. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Legal Form of Organization

9. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Legal Form of Organization

10. The true owner(s) of the corporation is (are) the _____.
- (a) board of directors
 - (b) chief executive officer
 - (c) stockholders
 - (d) creditors

Answer: C

Level of Difficulty: 1

Learning Goal: 1

Topic: Corporate Governance

11. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Corporate Governance

12. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Corporate Governance

13. 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

Level of Difficulty: 1

Learning Goal: 1

Topic: Corporate Governance

14. _____ 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Role of the Financial Manager

15. About 75 percent of all business firms are

- (a) sole proprietorships.
- (b) partnerships.
- (c) corporations.
- (d) S-corporations.

Answer: A

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

16. 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

17. 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

18. 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

19. 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

20. 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

Level of Difficulty: 2

Learning Goal: 1

Topic: Legal Form of Organization

21. 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

Level of Difficulty: 3

Learning Goal: 1

Topic: Managerial Finance Functions

22. 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

Level of Difficulty: 3

Learning Goal: 1

Topic: Legal Form of Organization

23. 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

Level of Difficulty: 1

Learning Goal: 2

Topic: Managerial Finance Functions

24. The treasurer is commonly responsible for
- (a) taxes.
 - (b) data processing.
 - (c) making capital expenditures.
 - (d) cost accounting.
- Answer: C
Level of Difficulty: 1
Learning Goal: 2
Topic: Managerial Finance Functions
25. The controller is commonly responsible for
- (a) managing cash.
 - (b) financial accounting.
 - (c) managing credit activities.
 - (d) financial planning.
- Answer: B
Level of Difficulty: 1
Learning Goal: 2
Topic: Managerial Finance Functions
26. 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
Level of Difficulty: 1
Learning Goal: 2
Topic: Accounting Concepts
27. 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
Level of Difficulty: 1
Learning Goal: 2
Topic: Accounting Concepts
28. 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
Level of Difficulty: 1
Learning Goal: 2
Topic: Role of Financial Manager

29. 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

Level of Difficulty: 1

Learning Goal: 2

Topic: Role of Financial Manager

30. 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

Level of Difficulty: 1

Learning Goal: 2

Topic: Accounting Concepts

31. 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

Level of Difficulty: 1

Learning Goal: 2

Topic: Fundamental Concepts

32. 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

Level of Difficulty: 2

Learning Goal: 2

Topic: Fundamental Concepts

33. 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

Level of Difficulty: 2

Learning Goal: 2

Topic: Fundamental Concepts

34. 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

Level of Difficulty: 2

Learning Goal: 2

Topic: Fundamental Concepts

35. 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

Level of Difficulty: 2

Learning Goal: 2

Topic: Role of the Financial Manager

36. 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

Level of Difficulty: 2

Learning Goal: 2

Topic: Role of the Financial Manager

37. 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

Level of Difficulty: 3

Learning Goal: 2

Topic: Managerial Finance Functions

38. 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

Level of Difficulty: 3

Learning Goal: 2

Topic: Fundamental Concepts

39. 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

Level of Difficulty: 3

Learning Goal: 2

Topic: Managerial Finance Functions

40. 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

Level of Difficulty: 3

Learning Goal: 2

Topic: Fundamental Concepts

41. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Role of the Financial Manager

42. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Role of the Financial Manager

43. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Role of the Financial Manager

44. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Role of the Financial Manager

45. Making investment decisions includes all of the following EXCEPT

- (a) inventory.
- (b) fixed assets.
- (c) accounts receivable.
- (d) notes payable.

Answer: D

Level of Difficulty: 1

Learning Goal: 3

Topic: Managerial Finance Functions

46. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Managerial Finance Functions

47. Managing the firm's assets includes all of the following EXCEPT

- (a) inventory.
- (b) fixed assets.
- (c) accounts receivable.
- (d) notes payable.

Answer: D

Level of Difficulty: 1

Learning Goal: 3

Topic: Managerial Finance Functions

48. Managing the firm's liabilities includes all of the following EXCEPT

- (a) accruals.
- (b) notes payable.
- (c) cash.
- (d) accounts payable.

Answer: C

Level of Difficulty: 1

Learning Goal: 3

Topic: Managerial Finance Functions

49. 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

Level of Difficulty: 1

Learning Goal: 3

Topic: Role of the Financial Manager

50. 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

Level of Difficulty: 2

Learning Goal: 3

Topic: Managerial Finance Functions

51. 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

Level of Difficulty: 2

Learning Goal: 3

Topic: Managerial Finance Functions

52. 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

Level of Difficulty: 2

Learning Goal: 3

Topic: Managerial Finance Functions

53. 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

Level of Difficulty: 3

Learning Goal: 3

Topic: Managerial Finance Functions

54. The primary goal of the financial manager is
- (a) minimizing risk.
 - (b) maximizing profit.
 - (c) maximizing wealth.
 - (d) minimizing return.

Answer: C

Level of Difficulty: 1

Learning Goal: 4

Topic: Goal of the Firm

55. 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

Level of Difficulty: 1

Learning Goal: 4

Topic: Goal of the Firm

56. The wealth of the owners of a corporation is represented by
- (a) profits.
 - (b) earnings per share.
 - (c) share price.
 - (d) cash flow.

Answer: C

Level of Difficulty: 1

Learning Goal: 4

Topic: Goal of the Firm

57. 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

Level of Difficulty: 1

Learning Goal: 4

Topic: Goal of the Firm

58. If a company's managers are NOT owners of the company, they are
- (a) dealers.
 - (b) agents.
 - (c) outsiders.
 - (d) brokers.

Answer: B

Level of Difficulty: 1

Learning Goal: 4

Topic: Agency Issue

59. 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

Level of Difficulty: 1

Learning Goal: 4

Topic: Agency Issue

60. 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

Level of Difficulty: 1

Learning Goal: 4

Topic: Agency Issue

61. 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

Level of Difficulty: 1

Learning Goal: 4

Topic: Agency Issue

62. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Agency Issue

63. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Agency Issue

64. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Accounting Concepts

65. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

66. Profit maximization does NOT take into consideration
- (a) risk and cash flow.
 - (b) cash flow and stock price.
 - (c) risk and EPS.
 - (d) EPS and stock price.

Answer: A

Level of Difficulty: 2

Learning Goal: 4

Topic: Agency Issue

67. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Agency Issue

68. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

69. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

70. Return and risk are the key determinants in share price. Increased return 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

71. Return 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

72. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Goal of the Firm

73. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Role of Ethics

74. The difference between the cost of funds used to finance an investment and its after-tax operating profits is called
- (a) earnings per share.
 - (b) dividend.
 - (c) economic value added.
 - (d) retained earnings.

Answer: C

Level of Difficulty: 3

Learning Goal: 4

Topic: Fundamental Concepts

75. Return and 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

Level of Difficulty: 3

Learning Goal: 4

Topic: Goal of the Firm

76. As the risk of a stock investment increases

- (a) return will increase.
- (b) return will decrease.
- (c) required rate of return will decrease.
- (d) required rate of return will increase.

Answer: D

Level of Difficulty: 3

Learning Goal: 4

Topic: Goal of the Firm

77. 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

Level of Difficulty: 3

Learning Goal: 4

Topic: Role of Ethics

78. 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

Level of Difficulty: 3

Learning Goal: 4

Topic: Role of Ethics

79. 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

Level of Difficulty: 3

Learning Goal: 4

Topic: Role of Ethics

80. A financial manager must choose between four alternative investments, 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Goal of the Firm

81. A financial manager must choose between four alternative investments, 1, 2, 3, and 4. Each asset 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	\$ 9,000
2	9,000	15,000	21,000
3	3,000	18,000	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: A

Level of Difficulty: 4

Learning Goal: 4

Topic: Goal of the Firm

82. 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	\$ 8,000
2	15,000	15,000	21,000
3	9,000	18,000	19,000
	\$46,000	\$41,000	\$48,000

- (a) choose Asset 1.
- (b) choose Asset 2.
- (c) choose Asset 3.
- (d) be indifferent between Asset 1 and Asset 2.

Answer: A

Level of Difficulty: 4

Learning Goal: 4

Topic: Goal of the Firm

83. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Role of Ethics

84. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Role of Ethics

85. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Agency Issue

86. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Agency Issue

87. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

88. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

89. A _____ is similar to a commercial bank except that it may not hold demand deposits.
- (a) savings bank
 - (b) credit union
 - (c) mutual fund
 - (d) insurance company

Answer: A

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

90. A _____ is a financial intermediary that deals primarily in the transfer of funds between consumers. Membership is generally based on some common bond.
- (a) savings bank
 - (b) credit union
 - (c) life insurance company
 - (d) commercial bank

Answer: B

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

91. A _____ is the largest financial intermediary handling individual savings. It receives premium payments that are placed in loans or investments to accumulate funds to cover future benefits.
- (a) savings bank
 - (b) credit union
 - (c) life insurance company
 - (d) commercial bank

Answer: C

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

92. A _____ is set up so that employees of corporations or governments can receive income after retirement.
- (a) savings bank
 - (b) credit union
 - (c) life insurance company
 - (d) pension fund

Answer: D

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

93. A _____ is a type of financial intermediary that pools savings of individuals and makes them available to business and government demanders. Funds are obtained through the sale of shares.
- (a) savings bank
 - (b) credit union
 - (c) mutual fund
 - (d) savings and loans

Answer: C

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

94. Passage of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980 signaled the beginning of
- (a) lower interest rates on time deposits.
 - (b) the financial services revolution.
 - (c) automated teller machines.
 - (d) prohibition on interstate banking.

Answer: B

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

95. Most businesses raise money by selling their securities in a
- (a) public offering.
 - (b) private placement.
 - (c) direct placement.
 - (d) stock exchange.

Answer: A

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

96. All of the following are services provided by financial institutions EXCEPT
- (a) pay savers' interest on deposited funds.
 - (b) lend money to customers.
 - (c) buy the businesses of customers.
 - (d) invest customers' savings in stocks and bonds.

Answer: C

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Institutions

97. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

98. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

99. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

100. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

101. 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

Level of Difficulty: 1

Learning Goal: 5

Topic: Financial Markets

102. Most money market transactions are made in
- (a) common stock.
 - (b) marketable securities.
 - (c) stocks and bonds.
 - (d) preferred stock.

Answer: B

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

103. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions and Markets

104. A _____ accepts both demand and time deposits and primarily makes loans directly to both individual and business borrowers or through the financial markets.
- (a) savings bank
 - (b) credit union
 - (c) mutual fund
 - (d) commercial bank

Answer: D

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions

105. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

106. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Institutions and Markets

107. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

108. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

109. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

110. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

111. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

112. 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

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

113. Long-term debt instruments used by both government and business are known as

- (a) stocks.
- (b) bills.
- (c) bonds.
- (d) equities.

Answer: C

Level of Difficulty: 2

Learning Goal: 5

Topic: Financial Markets

114. 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
Level of Difficulty: 3
Learning Goal: 5
Topic: Financial Markets
115. 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
Level of Difficulty: 3
Learning Goal: 5
Topic: Financial Markets
116. 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
Level of Difficulty: 3
Learning Goal: 5
Topic: Financial Markets
117. 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
Level of Difficulty: 3
Learning Goal: 5
Topic: Financial Markets
118. The tax deductibility of expenses _____ their after-tax cost.
- (a) increases
 - (b) reduces
 - (c) has no effect on
 - (d) has an undetermined effect on
- Answer: B
Level of Difficulty: 1
Learning Goal: 6
Topic: Business Taxes

119. A capital gain occurs when an asset has been held for
- (a) more than six months.
 - (b) less than six months.
 - (c) more than one year.
 - (d) any length of time.

Answer: D

Level of Difficulty: 1

Learning Goal: 6

Topic: Business Taxes

120. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

121. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

122. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

123. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

124. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

125. If a corporation sells certain assets 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

126. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

127. 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

Level of Difficulty: 2

Learning Goal: 6

Topic: Business Taxes

128. 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

Level of Difficulty: 3

Learning Goal: 6

Topic: Business Taxes

129. 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

Level of Difficulty: 3

Learning Goal: 6

Topic: Business Taxes

130. 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

Level of Difficulty: 3

Learning Goal: 6

Topic: Business Taxes

131. 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

Level of Difficulty: 4

Learning Goal: 6

Topic: Business Taxes

132. 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

Level of Difficulty: 2

Learning Goal: 4

Topic: Corporate Governance

133. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Corporate Governance

134. 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

Level of Difficulty: 4

Learning Goal: 4

Topic: Corporate Governance

■ Essay Questions

1. 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	=	<u>\$646,000</u>

Level of Difficulty: 3

Learning Goal: 6

Topic: Business Taxes

2. 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	—		

Level of Difficulty: 3

Learning Goal: 6

Topic: Business Taxes

3. 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.

Level of Difficulty: 4

Learning Goal: 6

Topic: Business Taxes