

*Test Bank for Fundamentals of
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Answers are located at the end of each chapter.

- 1) Financial analysts are involved in monitoring the risk associated with investment projects and financing decisions.
 - Ⓐ true
 - Ⓑ false

- 2) Established firms can create value by developing long-term relationships and maintaining a good reputation.
 - Ⓐ true
 - Ⓑ false

- 3) Which one of the following gives a corporation its permanence?
 - A) Founder Equity
 - B) Limited liability
 - C) Corporation taxation
 - D) Separation of ownership and control

- 4) A manager's compensation plan that offers financial incentives for increases in quarterly profitability may create agency problems in that:
 - A) the managers are not motivated by personal gain.
 - B) the board of directors may claim the credit.
 - C) short-term, not long-term profits become the focus.
 - D) investors desire stable profits.

- 5) Which of the following is a *capital budgeting* decision?
 - A) Should the firm borrow money from a bank or sell bonds?
 - B) Should the firm shut down an unprofitable factory?
 - C) Should the firm buy or lease a new machine that it is committed to acquiring?
 - D) Should the firm issue preferred stock or common stock?

- 6) The separation of ownership and management is one distinctive feature of both corporations and sole proprietors.
- ☐ true
 - ☐ false
- 7) Which one of these is *not* considered to be a security?
- A) Shares of GE stock
 - B) A bond traded in the financial market
 - C) A mortgage loan issued and held by a bank
 - D) A convertible bond issued to the public
- 8) A successful investment is one that increases the value of the firm.
- ☐ true
 - ☐ false
- 9) Which one of these statements is correct?
- A) Financial managers have a fiduciary duty to stockholders.
 - B) Financial managers are concerned only with funds that flow to investors.
 - C) The chief financial officer generally reports directly to the corporate treasurer.
 - D) The corporate controller is primarily responsible for overseeing a firm's cash functions.
- 10) Investment banks like Morgan Stanley or Goldman Sachs:
- A) collect deposits and relend the cash to corporations and individuals.
 - B) help companies sell their securities to investors.
 - C) design and sell insurance policies for businesses.
 - D) lend to corporations and investors in commercial real estate.
- 11) In the case of a limited liability partnership, _____ has/have limited liability.
- A) only some of partners
 - B) only the managing partner
 - C) all of the partners
 - D) none of the partners

- 12) Which one of the following statements more accurately describes the controller than the treasurer?
- A) Reports directly to the chief executive officer
 - B) Monitors capital expenditures to make sure that they are not misappropriated
 - C) Responsible for investing the firm's spare cash
 - D) Responsible for arranging any issue of common stock
- 13) Capital budgeting decisions are used to determine how to raise the cash necessary for investments.
- ☐ true
 - ☐ false
- 14) A well-designed compensation package can help a firm achieve its goal of maximizing market value.
- ☐ true
 - ☐ false
- 15) Which one of these determines the minimum acceptable rate of return on a capital investment?
- A) The alternative investment opportunities available to investors
 - B) The profit margin of the existing firm
 - C) The rate of return on the firm's outstanding shares
 - D) The rate of return on risk-free debt securities
- 16) Corporate managers are expected to make corporate decisions that are in the best interest of:
- A) top corporate management.
 - B) the corporation's board of directors.
 - C) the corporation's shareholders.
 - D) all corporate employees.

- 17) Which one of these is a disadvantage of the corporate form of business?
- A) Access to capital
 - B) Unlimited personal liability for owners
 - C) Limited firm life
 - D) Legal requirements
- 18) Financial assets have value because they are claims on the firm's real assets and the cash that those assets will produce.
- ☐ true
 - ☐ false
- 19) Ethical decision making in business:
- A) reduces the firm's profits.
 - B) requires adherence to implied rules as well as written rules.
 - C) is not in the best interests of shareholders.
 - D) is less important than good capital budgeting decisions.
- 20) Corporate investors are responsible for deciding whether to reinvest in the firm's operations or take the profits as a distribution.
- ☐ true
 - ☐ false
- 21) Financial managers should only accept investment projects that:
- A) increase the current profits of the firm.
 - B) can increase the firm's market share.
 - C) earn a higher rate of return than the firm currently earns on its existing projects.
 - D) earn a higher rate of return than shareholders can get by investing on their own.
- 22) Which of the following is a disadvantage to incorporating a business?
- A) Easier access to financial markets
 - B) Limited liability
 - C) Becoming a permanent legal entity
 - D) Profits taxed at the corporate level and the shareholder level

- 23) When a corporation fails, the maximum that can be lost by an individual shareholder is:
- A) the amount of their initial investment.
 - B) the amount of their share of the profits.
 - C) their proportionate share required to pay the corporation's debts.
 - D) the amount of their personal wealth.
- 24) Real assets can be intangible assets.
- ☐ true
 - ☐ false
- 25) A corporate board of directors should provide support for the top management team:
- A) under all circumstances.
 - B) in all decisions related to cash dividends.
 - C) only when the board approves of management's actions.
 - D) under no circumstances; it is an adversarial system.
- 26) An IOU ("I owe you") from your brother-in-law is a financial asset.
- ☐ true
 - ☐ false
- 27) Shareholders welcome higher short-term profits even when they damage long-term profits.
- ☐ true
 - ☐ false
- 28) Corporations that issue financial securities such as stock or debt obligations to the public do so primarily to:
- A) increase sales.
 - B) become profitable.
 - C) increase their access to funds.
 - D) avoid double taxation of their profits.

- 29) Sole proprietorships resolve the issue of agency problems primarily by:
- A) avoiding excessive expense accounts.
 - B) discharging those who violate the rules.
 - C) allowing owners to share the cost of their actions with others.
 - D) forcing owners to bear the full cost of their actions.
- 30) In a partnership form of organization, income tax liability, if any, is incurred by:
- A) the partnership itself.
 - B) the partners individually.
 - C) both the partnership and the partners.
 - D) neither the partnership nor the partners.
- 31) Which of the following is NOT a claim on the assets of a company?
- A) Bond
 - B) Patent
 - C) Promissory note
 - D) Loan
- 32) A corporate director:
- A) is selected by and can be removed by management.
 - B) can be voted out of power by the shareholders.
 - C) has a lifetime appointment to the board.
 - D) is selected by a vote of all corporate stakeholders.
- 33) Which one of the following can best be characterized as an agency problem?
- A) Differing opinions among directors as to the merits of paying a higher dividend
 - B) Differing incentives between managers and owners
 - C) Persistently late delivery times by a major supplier
 - D) Geological problems in the company's new gold mine
- 34) Sole proprietorships face the same agency problems as those associated with corporations.
- Ⓐ true
 - Ⓑ false

- 35) Unlimited liability is faced by the owners of:
- A) corporations.
 - B) partnerships and corporations.
 - C) sole proprietorships and general partnerships.
 - D) all forms of business organization.
- 36) Which one of the following forms of compensation is most apt to align the interests of managers and shareholders?
- A) A fixed salary
 - B) A salary that is linked to current company profits
 - C) A salary that is paid partly in the form of the company's shares
 - D) A salary that is linked to the company's market share
- 37) Which of the following organizations is least likely to use a professional corporation (PC) structure?
- A) Accountants
 - B) Doctors
 - C) Lawyers
 - D) Manufacturers
- 38) Which of the following is *least* likely to be discussed in the articles of incorporation?
- A) How the firm is to be financed
 - B) The purpose of the business
 - C) The price range of the shares of stock
 - D) How the board of directors is to be structured
- 39) Which of the following is NOT a requirement of the Sarbanes-Oxley Act of 2002?
- A) The compensation committee must be appointed by an outside director
 - B) The CEO and CFO must sign off personally on corporate accounting results
 - C) The board of directors must meet in executive session
 - D) More board of directors members are independent

- 40) The liability of sole proprietors is limited to the amount of their investment in the company.
- ☐ true
 - ☐ false
- 41) The Dodd-Frank financial reform law in 2010 granted shareholders a binding vote on executive compensation.
- ☐ true
 - ☐ false
- 42) A board of directors is elected as a representative of the corporation's:
- A) top management.
 - B) stakeholders.
 - C) shareholders.
 - D) customers.
- 43) Agency problems can *least* be controlled by:
- A) establishing good internal controls and procedures.
 - B) designing compensation packages that align manager's goals with those of the shareholders.
 - C) good systems of corporate governance.
 - D) electing senior managers to the board of directors.
- 44) General partners have limited personal liability for business debts in a limited partnership.
- ☐ true
 - ☐ false
- 45) Which one of these best defines the objective of a well-functioning financial market?
- A) Establishing accurate security prices
 - B) Creating higher security prices
 - C) It is not in the best interests of shareholders.
 - D) Increasing shareholder value by any means possible

- 46) A chief financial officer would typically:
- A) report to the treasurer, but supervise the controller.
 - B) report to the controller, but supervise the treasurer.
 - C) report to both the treasurer and controller.
 - D) supervise both the treasurer and controller.
- 47) Which of the following appears to be the most appropriate goal for corporate management?
- A) Maximizing market value of the company's shares
 - B) Maximizing the company's market share
 - C) Maximizing the current profits of the company
 - D) Minimizing the company's liabilities
- 48) Which one of the following would correctly differentiate general partners from limited partners in a limited partnership?
- A) General partners have more job experience.
 - B) General partners have an ownership interest.
 - C) General partners are subject to double taxation.
 - D) General partners have unlimited personal liability.
- 49) A firm with spare cash:
- A) should always reinvest it in new equipment.
 - B) should pay it out to shareholders unless the firm can earn a higher rate of return on the cash than the shareholders can earn by investing in the capital market.
 - C) should invest it in the safest projects available.
 - D) should always invest it in U.S. equities since these securities have a higher rate of return than Treasury bills.
- 50) Which of the firm's financial managers is most likely to be involved with obtaining financing for the firm?
- A) Treasurer
 - B) Controller
 - C) Chief operating officer
 - D) Board of directors

- 51) Which one of these is a capital budgeting decision?
- A) Deciding between issuing stock or debt securities
 - B) Deciding whether or not the firm should go public
 - C) Deciding if the firm should repurchase some of its outstanding shares
 - D) Deciding whether to buy a new machine or repair the old machine
- 52) A financial analyst in a corporation may be involved with all of the following *EXCEPT*:
- A) analyzing a new investment project.
 - B) monitoring risk.
 - C) managing investment of the company's cash.
 - D) purchasing the firm's plant and equipment.
- 53) Deltas's issuance of a \$1.0 billion bond is a financing decision.
- ☐ true
 - ☐ false
- 54) While control of large public companies in the United States is exercised through the board of directors and pressure from the stock market; in many other countries the stock market is less important and control shifts to major stockholders, typically banks and other companies.
- ☐ true
 - ☐ false
- 55) Facebook's decision to spend \$700 million to acquire Instagram is an investment decision.
- ☐ true
 - ☐ false
- 56) Which one of the following is a real asset?
- A) A patent
 - B) A personal IOU
 - C) zero-coupon bond
 - D) A share of stock

- 57) A block holder is commonly defined as an investor who:
- A) owns 5% or more of a firm's outstanding shares.
 - B) invests in more than one firm within the same industry.
 - C) is another corporation.
 - D) is also one of the firm's managers or directors.
- 58) One continuing problem with managerial incentive compensation plans is that:
- A) the plans increase agency problems.
 - B) managers prefer guaranteed salaries.
 - C) their effectiveness is difficult to evaluate.
 - D) the plans do not reward shareholders.
- 59) When managers' compensation plans are tied in a meaningful manner to the value of the firm, agency problems:
- A) can be reduced.
 - B) will be created.
 - C) are shifted to other stakeholders.
 - D) are eliminated entirely from the firm.
- 60) Which of the following statements best distinguishes the difference between real and financial assets?
- A) Real assets have less value than financial assets.
 - B) Real assets are tangible; financial assets are not.
 - C) Financial assets represent claims to income that are generated by real assets.
 - D) Financial assets appreciate in value; real assets depreciate in value.
- 61) Ethical decision making by management has a payoff for shareholders in terms of:
- A) improved capital structure.
 - B) enhanced firm reputation value.
 - C) increased managerial benefits.
 - D) higher current dividend payments.

62) The separation of ownership and management is one distinctive feature of corporations.

- ☐ true
- ☐ false

63) The legal "life" of a corporation is:

- A) coincidental with that of its CEO.
- B) equal to the life of its board of directors.
- C) permanent, as long as shareholders don't change.
- D) permanent, regardless of current ownership.

64) If a project's value is less than its required investment, then the project is financially attractive.

- ☐ true
- ☐ false

65) Boards of directors are generally appointed by the firm's senior officers.

- ☐ true
- ☐ false

66) A corporation is considered to be closely held when:

- A) only a few shareholders exist.
- B) the market value of the shares is stable.
- C) it operates in a small geographic area.
- D) management also serves as the board of directors.

67) Maximizing profits is the same as maximizing the value of the firm.

- ☐ true
- ☐ false

- 68) Firms can alter their capital structure by:
- A) not accepting any new capital budgeting projects.
 - B) investing in intangible assets.
 - C) issuing stock to repay debt.
 - D) becoming a limited liability company.
- 69) "Double taxation" refers to:
- A) all partners paying equal taxes on profits.
 - B) corporations paying taxes on both dividends and retained earnings.
 - C) paying taxes on profits at the corporate level and dividends at the personal level.
 - D) the fact that marginal tax rates are doubled for corporations.
- 70) Which one of the following is a financial asset?
- A) A corporate bond
 - B) A machine
 - C) A patent
 - D) A factory
- 71) A firm decides to pay for a small investment project through a \$1 million increase in short-term bank loans. This is best described as an example of a(n):
- A) financing decision.
 - B) investment decision.
 - C) capital budgeting decision.
 - D) capital expenditure decision.
- 72) Which of the following is *least* likely to represent an agency problem?
- A) Lavish spending on expense accounts
 - B) Plush remodelling of the executive suite
 - C) Excessive avoidance of taxes
 - D) Executive incentive compensation plans

- 73) The best criterion for success in a capital budgeting decision would be to:
- A) minimize the cost of the investment.
 - B) maximize the number of capital budgeting projects.
 - C) maximize the value added to the firm.
 - D) finance all capital budgeting projects with debt.
- 74) Which form of organization provides limited liability for the firm but yet allows the professionals working within that firm to be sued personally?
- A) Limited liability partnership
 - B) Limited liability company
 - C) Sole proprietorship
 - D) Professional corporation
- 75) The primary goal of corporate management should be to:
- A) maximize the number of shareholders.
 - B) maximize the firm's profits.
 - C) minimize the firm's costs.
 - D) maximize the shareholders' wealth.
- 76) The short-term decisions of financial managers are comprised of:
- A) capital structure decisions only.
 - B) investment decisions only.
 - C) financing decisions only.
 - D) both investment and financing decisions.
- 77) Which one of the following would be considered a capital budgeting decision?
- A) Planning to issue common stock rather than issuing preferred stock
 - B) Deciding to expand into a new line of products, at a cost of \$5 million
 - C) Repurchasing shares of common stock
 - D) Issuing debt in the form of long-term bonds

- 78) A common problem for closely held corporations is:
- A) the lack of access to substantial amounts of capital.
 - B) the restriction that shareholders receive only one vote each.
 - C) the separation of ownership and management.
 - D) an abundance of agency problems.
- 79) Which of the following groups is *least* likely to be considered a stakeholder of the firm?
- A) Government
 - B) Customers
 - C) Competitors
 - D) Employees
- 80) The overall goal of capital budgeting projects should be to:
- A) decrease the firm's reliance on debt.
 - B) increase the firm's sales.
 - C) increase the firm's outstanding shares of stock.
 - D) increase the wealth of the firm's shareholders.
- 81) When the management of a business is conducted by individuals other than the sole owners, the business is most likely to be a:
- A) corporation.
 - B) sole proprietorship.
 - C) partnership.
 - D) general partner.
- 82) In a firm having both a treasurer and a controller, which of the following would most likely be handled by the controller?
- A) Internal auditing
 - B) Credit management
 - C) Banking relationships
 - D) Insurance

- 83) A major disadvantage of partnerships is that they have double taxation of profits.
- ☐ true
 - ☐ false
- 84) In which type of organizational structure is the agency problem least likely to exist?
- A) Limited liability corporation
 - B) Partnership
 - C) Professional corporation
 - D) Sole proprietorship
- 85) GlaxoSmithKline's spending of \$3.6 billion on research and development of new drugs is a capital budgeting decision but not a financing decision.
- ☐ true
 - ☐ false
- 86) Short selling involves selling a security:
- A) you do not own.
 - B) that you have owned for less than one year.
 - C) at a price below current market value.
 - D) for less than you originally paid to purchase it.
- 87) An example of a firm's financing decision would be:
- A) acquiring a competitive firm.
 - B) determining how much to pay for a specific asset.
 - C) issuing 10-year versus 20-year bonds.
 - D) deciding whether or not to increase the price of its products.
- 88) Which of the following is a real asset?
- A) A patent
 - B) A share of stock issued by Bank of New York
 - C) An IOU ("I owe you") from your brother-in-law
 - D) A mortgage loan taken out to help pay for a new home

- 89) Which of these duties are responsibilities of the corporate treasurer?
- A) Financial statements and taxes
 - B) Cash management and tax reporting
 - C) Cash management and banking relationships
 - D) Raising capital and financial statements
- 90) The term "capital structure" refers to:
- A) the mix of long-term debt and equity financing.
 - B) the length of time needed to repay debt.
 - C) whether or not the firm invests in capital budgeting projects.
 - D) the types of assets a firm acquires.
- 91) Which one of these statements correctly applies to a limited partnership?
- A) All partners share the daily management duties.
 - B) All partners enjoy limited personal liability.
 - C) General partners have unlimited personal liability.
 - D) Taxes are imposed at both the firm and the personal level on profits earned.
- 92) Corporations are referred to as public companies when their:
- A) shareholders have no tax liability.
 - B) shares are held by the federal or state government.
 - C) stock is publicly traded.
 - D) products or services are available to the public.
- 93) Which one of these statements is correct?
- A) A dollar received next year has the same value as a dollar received today.
 - B) Risky cash flows are more valuable than certain cash flows.
 - C) Smart investment decisions create more value than smart financing decisions.
 - D) Corporate governance is irrelevant.

94) In a large corporation, preparation of the firm's financial statements would most likely be conducted by the:

- A) treasurer.
- B) controller.
- C) chief financial officer.
- D) financial manager.

95) A firm's reputation:

- A) has no value.
- B) is an important firm asset.
- C) is irrelevant to shareholders.
- D) can be easily restored once damaged.

96) The primary goal of any company should be to maximize current period profits.

- ☐ true
- ☐ false

97) Making good investment and financing decisions is the chief task of the financial manager.

- ☐ true
- ☐ false

Answer Key

Test name: Chapter 01

- 1) TRUE
- 2) TRUE
- 3) D
- 4) C
- 5) B
- 6) FALSE
- 7) C
- 8) TRUE
- 9) A
- 10) B
- 11) C
- 12) B
- 13) FALSE
- 14) TRUE
- 15) A
- 16) C
- 17) D
- 18) TRUE
- 19) B
- 20) FALSE
- 21) D
- 22) D
- 23) A
- 24) TRUE
- 25) C
- 26) TRUE
- 27) FALSE
- 28) C
- 29) D
- 30) B
- 31) B
- 32) B
- 33) B
- 34) FALSE
- 35) C
- 36) C
- 37) D

- 38) C
- 39) A
- 40) FALSE
- 41) FALSE
- 42) C
- 43) D
- 44) FALSE
- 45) A
- 46) D
- 47) A
- 48) D
- 49) B
- 50) A
- 51) D
- 52) D
- 53) TRUE
- 54) TRUE
- 55) TRUE
- 56) A
- 57) A
- 58) C
- 59) A
- 60) C
- 61) B
- 62) TRUE
- 63) D
- 64) FALSE
- 65) FALSE
- 66) A
- 67) FALSE
- 68) C
- 69) C
- 70) A
- 71) A
- 72) D
- 73) C
- 74) D
- 75) D
- 76) D
- 77) B

- 78) A
- 79) C
- 80) D
- 81) A
- 82) A
- 83) FALSE
- 84) D
- 85) TRUE
- 86) A
- 87) C
- 88) A
- 89) C
- 90) A
- 91) C
- 92) C
- 93) C
- 94) B
- 95) B
- 96) FALSE
- 97) TRUE