Student name:\_\_\_\_\_\_\_\_\_\_

**MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.
1)** Generally, among those who report directly to the \_\_\_\_\_\_\_\_ are the treasurer and the controller of a corporation.

 A) board of directors
 B) chairperson of the board
 C) chief executive officer
 D) president
 E) chief financial officer

**2)** A typical chain of command in a corporation is described by which one of the following statements?

 A) The information systems manager reports to the treasurer.
 B) The credit manager reports to the treasurer.
 C) The controller reports to the chief executive officer.
 D) The tax manager reports to the treasurer.
 E) The capital expenditures manager reports to the controller.

**3)** Answering which one of the following questions involves making a capital budgeting decision?

 A) How much debt should the firm borrow from a particular lender?
 B) Should the firm build a new production facility?
 C) Should the firm issue new equity to pay for its growth goals?
 D) How much inventory should the firm keep on hand?
 E) How much credit should the firm extend to a particular customer?

**4)** Which one of the following statements is accurate?

 A) Net working capital equals current assets plus current liabilities.
 B) Current liabilities are debts that must be repaid in 18 months or less.
 C) Current assets are assets with short lives, such as accounts receivable.
 D) Long-term debt is defined as a residual claim on a firm’s assets.
 E) Tangible assets are fixed assets such as patents.

**5)** Among the typical responsibilities of the corporate controller is:

 A) capital expenditures management.
 B) cash management.
 C) tax reporting.
 D) financial planning.
 E) credit management.

**6)** \_\_\_\_\_\_\_\_ is typically the responsibility of the corporate treasurer.

 A) Financial planning
 B) Cost accounting
 C) Tax reporting
 D) Information systems
 E) Financial accounting

**7)** A firm’s \_\_\_\_\_\_\_\_ define(s) its capital structure.

 A) mixture of various types of production equipment
 B) investment selections for its excess cash reserves
 C) combination of cash and cash equivalents
 D) combination of accounts appearing on the left side of its balance sheet
 E) proportions of financing from debt and equity

**8)** The focus of short-term finance is on:

 A) the timing of cash flows.
 B) acquiring and selling fixed assets.
 C) financing long-term projects.
 D) capital budgeting.
 E) issuing additional shares of common stock.

**9)** Net working capital includes:

 A) copyrights.
 B) manufacturing equipment.
 C) common stock.
 D) long-term debt.
 E) inventory.

**10)** \_\_\_\_\_\_\_\_ is defined as planning and managing a firm’s long-term assets.

 A) Working capital management
 B) Cash management
 C) Cost accounting management
 D) Capital budgeting
 E) Capital structure management

**11)** An amount the firms owes, which it must repay within twelve months, is called a(n):

 A) current liability.
 B) long-term debt.
 C) intangible asset.
 D) accounts receivable.
 E) current asset.

**12)** The business entity that is typically the *least* expensive to form is the:

 A) limited liability company.
 B) joint stock company.
 C) general partnership.
 D) limited partnership.
 E) sole proprietorship.

**13)** A \_\_\_\_\_\_\_\_ is a business owned by a single individual.

 A) corporation
 B) sole proprietorship
 C) general partnership
 D) limited partnership
 E) limited liability company

**14)** Regarding a sole proprietorship, which one of the following statements is accurate?

 A) It is more difficult to form than other forms of business.
 B) Its business profits are taxed twice at the federal level.
 C) Its business profits are taxed separately from the personal income of the owner.
 D) The owner may be forced to sell his or her personal assets to pay the company's debts.
 E) It has an unlimited life span.

**15)** Regarding a sole proprietorship, which one of the following statements is accurate?

 A) The ability to raise capital is limited by the owner’s personal wealth.
 B) It pays taxes at the corporate tax rate.
 C) Ownership of the firm is easy to transfer to another individual.
 D) It must pay income taxes separately from the taxes paid by the owner.
 E) The legal costs to form it are usually substantial.

**16)** The primary advantage of being a limited partner rather than a general partner is:

 A) being entitled to a larger portion of the partnership’s income.
 B) having responsibility for day-to-day management of the business.
 C) earning profits that are free from income taxation.
 D) the ability to have overall control of the partnership.
 E) one’s personal financial liability is limited to the amount of capital invested.

**17)** A general partner:

 A) has less legal liability than a limited partner.
 B) can end the partnership by withdrawing.
 C) faces double taxation of profits whereas a limited partner does not.
 D) cannot lose more than the amount of his or her equity investment.
 E) is the term applied only to corporations that invest in partnerships.

**18)** A partnership:

 A) is taxed in the same fashion that a corporation is taxed.
 B) terminates upon the death of any limited partner.
 C) creates for all general partners an unlimited liability for the partnership's debts.
 D) has the same ability as a corporation to raise capital.
 E) allows for easy transfer of ownership from one general partner to another.

**19)** One advantage of a partnership is the:

 A) personal liability for all of the firm’s debts.
 B) limited life of the entity.
 C) limited liability protection for all of the partners.
 D) relatively low cost of formation.
 E) ease of transferring full ownership to others.

**20)** One disadvantage of the corporate form of business ownership is the:

 A) limited liability protection provided for all owners.
 B) firm’s ability to raise cash.
 C) unlimited life of the firm.
 D) difficulties encountered when changing ownership.
 E) double taxation of business profits.

**21)** Which one of the following statements is correct?

 A) Both partnerships and corporations are subject to double taxation.
 B) Sole proprietorships and partnerships are taxed in a similar fashion.
 C) Partnerships are the most complicated type of business to form.
 D) Both partnerships and corporations have limited liability for all owners.
 E) All types of business formations have limited lives.

**22)** The articles of incorporation:

 A) can be used to remove the firm’s management.
 B) are amended annually by the firm’s stockholders.
 C) set forth the rights granted to shareholders.
 D) set forth the rules by which the corporation regulates its existence.
 E) can set forth the conditions under which the firm can avoid double taxation.

**23)** Corporate bylaws:

 A) establish the name of the corporation.
 B) establish the rights granted to its shareholders.
 C) set forth the purpose of the firm.
 D) establish the rules by which the corporation regulates its existence.
 E) set forth the number of members of the initial board of directors.

**24)** Regarding corporations, which one of the following statements is accurate?

 A) After a predetermined number of years, ownership can no longer be transferred.
 B) The ability to raise capital is limited by the personal wealth of the owners.
 C) Primary shareholders have unlimited liability for corporate debts.
 D) The entity can outlive all of its initial owners.
 E) When the last original owner dies or withdraws, the entity is terminated.

**25)** If a business is formed as a corporation, ownership of the business:

 A) must be granted with equal rights assigned to each and every shareholder.
 B) can be transferred an unlimited number of times.
 C) can only be transferred with the approval of the board of directors.
 D) is controlled by the corporate officers.
 E) must be held by non-management owners.

**26)** The owners of a limited liability company typically would prefer to:

 A) be taxed like a corporation.
 B) have liability exposure similar to that of a sole proprietor.
 C) be taxed personally on all business income.
 D) have liability exposure similar to that of a general partner.
 E) be taxed like a corporation, and have liability like a partnership.

**27)** In a general partnership, the general partners have \_\_\_\_\_ liability for the firm’s debts and have \_\_\_\_\_ control over day-to-day operations.

 A) limited; no
 B) unlimited; total
 C) limited; total
 D) unlimited; no
 E) unlimited; limited

**28)** Which one of the following business types is best for raising large amounts of capital?

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

**29)** Which type of business organization has the same rights and privileges accorded to a legal person?

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

**30)** A \_\_\_\_\_\_\_\_ is a business formed by two or more individuals who each have unlimited personal liability for all of the firm’s debts.

 A) corporation
 B) sole proprietorship
 C) general partnership
 D) limited partnership
 E) limited liability company

**31)** The \_\_\_\_\_\_\_\_ describes the fraction of the work and cash to be contributed to a partnership by each member of that partnership.

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

**32)** A(n) \_\_\_\_\_\_\_\_ is a business created as a distinct legal entity, separate from its owners.

 A) corporation
 B) sole proprietorship
 C) general partnership
 D) limited partnership
 E) unlimited liability company

**33)** In a limited partnership, each limited partner’s liability for the partnership’s debts is:

 A) limited to his or her personal net worth.
 B) limited to the amount he or she invested into the partnership.
 C) limited to his or her total earnings received from the partnership.
 D) unlimited.
 E) limited to the total amount invested by all partners.

**34)** A \_\_\_\_\_\_\_\_ provides each owner with limited liability, and is operated and taxed like a partnership.

 A) limited liability company
 B) general partnership
 C) limited proprietorship
 D) limited partnership
 E) corporation

**35)** The profits earned by a partnership are:

 A) fully distributed as taxable income to the partners.
 B) distributed to general partners after interest is paid to limited partners.
 C) distributed to the partners after the partnership pays its income taxes.
 D) generally reinvested in the firm to fund future growth, rather than being distributed to owners.
 E) generally held by the partnership for several years before being distributed as dividend payments.

**36)** Financial managers primarily create firm value by:

 A) maximizing current dividends.
 B) investing in assets that generate cash in excess of their cost.
 C) lowering the earnings per share.
 D) increasing the firm’s market share.
 E) maximizing current sales.

**37)** Accounting profits and cash flows are generally:

 A) equal because they reflect current laws and accounting standards.
 B) equal because accounting profits reflect the timing of cash flows.
 C) unequal because of how income is recognized according to GAAP.
 D) unequal because cash inflows must occur before revenue recognition.
 E) equal because of the requirements of GAAP.

**38)** Which one of thefollowing transactions will result in a cash outflow from the corporation?

 A) Selling an asset
 B) Paying income taxes
 C) Issuing common stock
 D) Borrowing from a lender
 E) Retaining profit earned by the firm

**39)** A firm creates value by:

 A) having a greater cash inflow from its stockholders than its outflow to them.
 B) paying more cash to its creditors and stockholders than the amount it received from them.
 C) borrowing long-term debt.
 D) generating sales whether or not payment is received for all of those sales.
 E) purchasing assets that create cash inflows equal to the cost of those assets.

**40)** If a firm is profitable, it follows that:

 A) its cash inflows exceed its cash outflows.
 B) its sales exceed its costs.
 C) its cash flows are known with certainty.
 D) it has sufficient cash to pay its bills in a timely manner.
 E) the timing of its cash flows is irrelevant.

**41)** Which one of the following statements is accurate?

 A) Individuals generally prefer later cash flows rather than current cash flows.
 B) The value of an investment depends on the size, timing, and risk of the investment’s cash flows.
 C) When selecting one of two projects, managers should select the project with the higher total expected cash flow.
 D) Most investors prefer greater risk rather than less risk.
 E) Accountants record sales and expenses after the related cash flows occur.

**42)** A firm is considering a new project. Analysts at the firm would be justified in having the greatest level of certainty in the:

 A) amount of the project’s cash inflow in Year 3.
 B) timing of the last cash inflow from the project.
 C) project’s initial cost.
 D) risk of a pessimistic scenario occurring.
 E) amount of the cash inflow from the project in Year 1.

**43)** Financial managers should primarily strive to:

 A) minimize costs while increasing current dividends.
 B) maximize the current profits of the firm.
 C) maximize the current value per share of existing stock.
 D) maximize current dividends even if doing so adds financial distress costs to the firm.
 E) maximize current market share in every market in which the firm participates.

**44)** Financial managers should make decisions in such a way as to increase the:

 A) size of the firm.
 B) growth rate of the firm.
 C) marketability of the managers.
 D) market value of the existing owners’ equity.
 E) firm’s current sales.

**45)** Which one of the following actions by a financial manager creates an agency problem?

 A) Borrowing money, when doing so creates value for the firm
 B) Lowering selling prices, which will result in increased firm value
 C) Agreeing to expand the company at the expense of stockholders’ value
 D) Agreeing to pay management bonuses based on the market value of the firm’s stock
 E) Refusing to spend current cash on an unprofitable project

**46)** The primary goal of financial management is to:

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

**47)** Of the following choices, \_\_\_\_\_\_\_\_ is the best way to increase current shareholder value.

 A) maximizing the firm’s amount of available cash
 B) increasing the current value of the overall firm
 C) postponing all new projects
 D) minimizing the overall size of the firm
 E) decreasing the number of employees

**48)** A financial manager should make decisions based on:

 A) the effects those decisions will have on current profits.
 B) the best interests of the manager and his or her peers.
 C) the welfare of the current shareholders.
 D) minimizing the firm's tax liability.
 E) their personal goals and ambitions.

**49)** A(n) \_\_\_\_\_\_\_\_ is defined as a conflict of interest between the stockholders and managers of a firm.

 A) stockholders’ liability
 B) corporate breakdown
 C) agency problem
 D) corporate activist
 E) legal liability

**50)** Of the following choices, \_\_\_\_\_\_\_\_ is most likely to create an agency problem.

 A) increasing the dividend payments to shareholders
 B) paying off debt in a timely manner
 C) increasing the sales of a profitable division
 D) abandoning a profitable project because it involves some risk
 E) selling an unprofitable division of the firm

**51)** Of the following choices, \_\_\_\_\_\_\_\_ is *least* likely to convince managers to work in the best interest of the stockholders.

 A) being threatened with a takeover of the firm by unsatisfied stockholders
 B) implementing a stock option plan
 C) raising managers’ salaries based on their length of service
 D) tying management compensation to the market value of the firm’s stock
 E) receiving a threat of a proxy fight

**52)** Which form of business structure typically has the greatest potential for agency problems?

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

**53)** A proxy fight occurs when:

 A) the board of directors disagree on the members of the management team.
 B) a group solicits voting rights to replace the board of directors.
 C) a competitor offers to sell its ownership interest in the firm.
 D) the firm files for bankruptcy.
 E) the firm is declared insolvent.

**54)** Ultimately, the \_\_\_\_\_\_\_\_ control(s) the corporation.

 A) board of directors
 B) stockholders
 C) president
 D) chief executive officer
 E) chairperson of the board

**55)** Members of the board of directors are selected by:

 A) shareholder voting.
 B) company management.
 C) the firm’s chief executive officer.
 D) the largest five shareholders.
 E) the firm’s managers and employees.

**56)** What is the main reason that corporations grant stock options to managers? To:

 A) reduce agency costs.
 B) increase current profits.
 C) replace salary increases.
 D) reward long-term employment.
 E) replace promotions.

**57)** Of the following choices, which one best fits the description of an agency cost?

 A) The costs of increasing the dividend payment per share
 B) The benefits received from reducing production costs per unit
 C) The payment of corporate income taxes
 D) The payment required for an outside audit of the firm
 E) The payment of interest on a firm’s debts

**58)** Which one of the following parties is considered a stakeholder of a firm?

 A) Customer
 B) Short-term creditor
 C) Long-term creditor
 D) Preferred stockholder
 E) Common stockholder

**59)** A stakeholder is any person or entity:

 A) owning shares of stock of a corporation.
 B) owning bonds or other long-term debt issued by a corporation.
 C) that initially started a firm and currently has management control over that firm.
 D) to whom the firm currently owes money.
 E) other than a stockholder or creditor who potentially has a financial interest in a firm.

**60)** One intent of the Sarbanes-Oxley Act of 2002 is to:

 A) prevent minority investors from making demands on corporations.
 B) protect corporate directors from frivolous lawsuits.
 C) guarantee the repayment of all future personal loans to corporate officers and directors.
 D) protect investors from corporate abuses.
 E) require all public corporations to “go dark” within the next twenty years.

**61)** The Sarbanes-Oxley Act requires public corporations to:

 A) assess the company’s internal control structure at least quarterly.
 B) distribute at least 90 percent of their profits as dividends on an annual basis.
 C) list any deficiencies in internal controls.
 D) file annual audit reports if the firm has “gone dark.”
 E) disclose all personal loans to corporate officers or directors made after 2002.

**62)** Insider trading is:

 A) prohibited by the Securities Act of 1933.
 B) prohibited by the Securities Exchange Act of 1934.
 C) impossible in today’s efficient markets.
 D) highly discouraged, but still legal.
 E) prohibited by the Sarbanes-Oxley Act of 2002.

**63)** The \_\_\_\_\_\_\_\_ established the basic regulatory framework for the public trading of securities in the United States.

 A) New York Stock Exchange, when it was founded,
 B) Securities Exchange Act of 1934
 C) Federal Reserve Bank, when it was first authorized by Congress,
 D) Securities Act of 1933 and the Securities Exchange Act of 1934
 E) Sarbanes-Oxley Act of 2002

**64)** The Securities Act of 1933 focuses on:

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

**65)** The intent of the registration statement required for all new securities by the Securities Act of 1933 is to:

 A) provide a governmental evaluation of the risks associated with those new securities.
 B) set the price at which the securities will be offered.
 C) guarantee the profitability of the new securities.
 D) prevent any insider trading.
 E) provide all necessary information to allow a potential investor to make an informed decision.

**66)** Which one of the following results have been reported as a consequence of a corporation “going dark?”

 A) Increased market liquidity and lower costs
 B) Lower audit costs and lower interest rates on bank loans
 C) Increased access to capital and lower costs associated with that capital
 D) Increased audit costs and stock price increases
 E) Limited access to capital markets and stock price declines

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.
67)** List and briefly describe the three basic areas addressed by a financial manager.

**68)** What advantages and disadvantages does the corporate form of organization have compared to sole proprietorships and general partnerships?

**69)** Why might a professional group select the LLC form of business over a general partnership or a corporate structure?

**70)** Why might a highly successful sole proprietor change the structure of his or her firm to the corporate form of ownership if that change results in the sharing of profits with other investors?

**71)** What should be the primary goal of the financial manager of a corporation? Explain why this is appropriate.

**Answer Key**Test name: chapter 1

1) E

2) B

3) B

4) C

5) C

6) A

7) E

8) A

9) E

10) D

11) A

12) E

13) B

14) D

15) A

16) E

17) B

18) C

19) D

20) E

21) B

22) C

23) D

24) D

25) B

26) C

27) B

28) C

29) D

30) C

31) D

32) A

33) B

34) A

35) A

36) B

37) C

38) B

39) B

40) B

41) B

42) C

43) C

44) D

45) C

46) B

47) B

48) C

49) C

50) D

51) C

52) D

53) B

54) B

55) A

56) A

57) D

58) A

59) E

60) D

61) C

62) B

63) D

64) C

65) E

66) E

67) The three areas are:
 a.Capital budgeting: The identification and management of investment opportunities that are worth more to the firm than they cost to acquire.
 b.Capital structure: The determination of the optimal mixture of current and long-term debt and equity used to finance a firm’s operations.
 c.Working capital management: The daily control over the firm’s short-term assets and liabilities.

68) The advantages of the corporate form of organization over sole proprietorships and general partnerships are the ease of transferring ownership, the owners’ limited liability for business debts, the ability to raise more capital, and the opportunity of an unlimited life for the business. The key disadvantages are double taxation and higher formation costs.

69) A limited liability company (LLC) limits the liability of each partner for the debts of the partnership to the amount that partner invested in the firm. Under a general partnership, each partner is fully liable for all of the partnership’s debts. An LLC avoids the double taxation of profits since the profits are distributed to partners and taxed as personal income. Thus, an LLC is taxed like a partnership while offering the limited liability to owners like a corporation.

70) A sole proprietorship has a limited life, limited access to additional capital, and unlimited liability for the owner. By switching to the corporate form, the sole proprietor can obtain additional capital while reducing his or her potential liability to the amount he or she invested in the firm. Also, the sole proprietor can sell a portion of the business enabling him or her to diversify their holdings while still maintaining majority control if desired. The primary downside of the change is the incurrence of double taxation.

71) The appropriate goal is to maximize the current value of the outstanding stock. This goal focuses on enhancing the returns to the current stockholders who are the owners of the firm. Other goals, such as maximizing sales or earnings, focus too narrowly on accounting profits and ignore the importance of market values in managerial finance.