TEXTBOOK TESTBANKS

Test Bank for Fundamentals of Corporate Finance 8th BREALEY

TEST BANK SAMPLE PREVIEW

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Chapter 01 Test Bank

CORRECT ANSWERS ARE LOCATED IN THE 2ND HALF OF THIS DOC.

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) To obtain the necessary money a company sells financial assets or securities.
   - ⊙ true
   - ⊙ false

2) The liability of sole proprietors is limited to the amount of their investment in the company.
   - ⊙ true
   - ⊙ false

3) General partners have limited personal liability for business debts in a limited partnership.
   - ⊙ true
   - ⊙ false

4) The corporate form of business organization is often accompanied by separation of ownership and management.
   - ⊙ true
   - ⊙ false

5) A major disadvantage of partnerships is that they have "double taxation" of profits.
   - ⊙ true
   - ⊙ false

6) Capital budgeting decisions are used to determine how to raise the cash necessary for investments.
   - ⊙ true
   - ⊙ false

7) As your firm grows, you may decide to form a corporation. You may incorporate your firm federally, under the Canadian Business Corporation Act, or provincially, under the relevant provincial laws.
- ⊙ true
- ⊙ false

8) The duties of a corporate controller typically include the preparation of financial statements.
- ⊙ true
- ⊙ false

9) A successful investment is one that increases the value of the firm.
- ⊙ true
- ⊙ false

10) The primary goal of any company should be to maximize current period profit.
- ⊙ true
- ⊙ false

11) Ethical decision making in business can be viewed as a long-term investment in reputation.
- ⊙ true
- ⊙ false

12) Agency problems act as a hindrance to the goal of maximizing firm value.
- ⊙ true
- ⊙ false

13) If employee compensation plans are not designed properly, they can create incentives for errant behaviour by management.
- ⊙ true
- ⊙ false

14) Poorly performing companies are also more likely to be taken over by another firm. After the takeover, the old management team may find itself out on the street.
- ⦾ true
- ⦾ false

15) Managers are subject to the scrutiny of specialists. Their actions are monitored by the security analyst who advises investors to buy, hold, or sell the company's shares.
- ⦾ true
- ⦾ false

16) The agency problem is mitigated in practice through several devices.
- ⦾ true
- ⦾ false

17) In some ways the financing decision is less important than the investment decision.
- ⦾ true
- ⦾ false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

18) Which of the following represents a financing decision?
- A) a decision to borrow $10 million through a bank loan.
- B) a decision to invest in the common stock of another corporation.
- C) a decision to buy a new mainframe computer.
- D) a decision to pay $1 million of accounts payable.

19) For small firms, shareholders and management may be one and the same. But for large companies, separation of ownership and management is:
- A) a practical necessity.
- B) not a necessity.
- C) a liability.
- D) a fraudulent move.

20) Which of the following would not be considered a real asset?
   A) a corporate bond
   B) a machine
   C) a patent
   D) a factory

21) Which of the following would be considered an advantage of the sole proprietorship form of organization?
   A) Wide access to capital markets
   B) Unlimited liability
   C) A pool of expertise
   D) Profits taxed at only one level

22) Sole proprietorships resolve the issue of agency problems 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.

23) When managers' compensation plans are tied in a meaningful manner to the profits 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.

24) 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

25) Which of the following is *not* an advantage 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.

26) 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.

27) In the case of a professional corporation, ________ has/have limited liability.

A) only the professionals
B) only the business
C) both the professionals and the business
D) neither the professionals nor the business

28) 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 market decision.

29) In a large corporation, budget preparation would most likely be conducted by the:

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

30) Which of the following groups is least likely to be considered a stakeholder of the firm?
- A) government
- B) bondholders
- C) competitors
- D) employees

31) What are the two critical decisions that have to be made by the financial manager?
- A) Investment and financing.
- B) Short term and long term.
- C) Debt and equity.
- D) All of the choices are correct.

32) Profit-sharing plans may be beneficial when used to:
- A) reduce the impact of corporate income taxes.
- B) improve managers' incentives for effective decision making.
- C) divert financial resources from shareholders.
- D) reduce the payment of cash dividends.

33) One continuing problem with managerial incentive-compensation plans is that:
- A) the plans increase agency problems.
- B) managers prefer guaranteed salaries.
- C) effectiveness of the plans is difficult to evaluate.
- D) the plans do not reward shareholders.

34) Which of the following is *least* likely to represent an agency problem?
- A) Lavish spending on expense accounts.
- B) Plush remodeling of the executive suite.
- C) Excessive investment in "safe" projects.
- D) Executive incentive compensation plans.

35) 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.

36) The short-term decisions of financial managers are comprised of:
   A) capital structure decisions.
   B) investment decisions.
   C) financing decisions.
   D) both investment and financing decisions.

37) Which 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.

38) A corporation's board of directors:
   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.

39) One common reason for partnerships to convert to a corporate form of organization is that the partnership:
   A) faces rapidly growing financing requirements.
   B) wishes to avoid double taxation of profits.
   C) has issued all of its allotted shares.
   D) agreement expires after ten years of use.

40) The overall goal of capital budgeting projects should be to:
- A) decrease the firm's reliance upon 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.

41) Ethical decision making by management has a payoff for shareholders in terms of:
- A) improved capital structure.
- B) enhanced reputation value.
- C) increased managerial benefits.
- D) higher dividend payments.

42) 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.

43) Firms can alter their capital structure by:
- A) not accepting any capital budgeting projects.
- B) investing in non-tangible assets.
- C) issuing stock to repay debt.
- D) becoming a limited liability company.

44) 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.

45) A managerial objective to increase market share is more likely to be successful in the long run if the firm is:
- A) selling shares in the secondary market.
- B) the low-cost producer in the industry.
- C) managed by the board of directors.
- D) investing in capital budgeting projects.

46) 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 difference between cash inflows and cost.
- D) finance all capital budgeting projects with debt.

47) Which of the following is *most likely* 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) The primary goal of corporate management should be to:
- A) maximize the number of shareholders.
- B) maximize the firm's profit.
- C) minimize the firm's costs.
- D) maximize the shareholders' wealth.

49) When a corporation decides to issue long-term debt in order to pay for the acquisition of real assets, it has made a:
- A) capital budgeting decision.
- B) financing decision.
- C) money market decision.
- D) secondary market decision.

50) A corporate board of directors should provide support for the top management team:
   A) when management requests it.
   B) in all decisions related to cash dividends.
   C) only when the board has confidence in management's actions.
   D) if shareholders are pleased with the firm's performance.

51) When the management of a business is conducted by individuals other than the owners, the business is more likely to be a:
   A) corporation.
   B) sole proprietorship.
   C) partnership.
   D) general partner.

52) "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 on dividends at the personal level.
   D) the fact that marginal tax rates are doubled for corporations.

53) One corporate activity that is specifically reserved for the board of directors is the:
   A) declaration of dividends.
   B) custody of records.
   C) preparation of budgets.
   D) day-to-day operation of the firm.

54) By organizing itself as a corporation, a business may be able to attract:
   A) investors.
   B) partners.
   C) proprietors.
   D) agents.

55) How may a reduction in cash dividends be in the best interests of current shareholders?

- A) dividends are taxed at twice the rate of other gains.
- B) the firm will have available cash to increase current investment and future profits.
- C) reduced dividends increase managerial compensation, thus increasing their motivation.
- D) a reduction of cash dividends *cannot* be in the best interests of current shareholders.

56) 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.

57) Which of the following would be considered a capital budgeting decision?

- A) planning to issue common stock rather than issuing preferred stock
- B) a decision to expand into a new line of products, at a cost of $500 million
- C) repurchasing shares of common stock
- D) issuing debt in the form of long-term bonds

58) The financial manager must determine a value to uncertain cash flows. The variables involved in this determination are:

- A) amount
- B) timing
- C) risk
- D) All of the choices are involved in this determination.

59) Long-term financing arrangements occur in the:

- A) money markets.
- B) capital markets.
- C) secondary markets.
- D) primary markets.

60) A first step in determining managerial objectives is to:
   A) develop appropriate compensation policies.
   B) eliminate agency problems.
   C) serve the needs of the customer.
   D) select an appropriate capital structure.

61) A board of directors is elected as a representative of the corporation's:
   A) top management.
   B) stakeholders.
   C) shareholders.
   D) customers.

62) 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) shares are widely traded.
   D) products or services are available to the public.

63) 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.

64) Unlimited liability is faced by the owners of:
   A) only corporations.
   B) only partnerships and corporations.
   C) only sole proprietorships and partnerships.
   D) all forms of business organization.

65) Agency problems can best be characterized as a(n):
- A) dislike of firm's bondholders by its equity holders.
- B) differing incentives between managers and owners.
- C) spending corporate resources.
- D) friction between the primary and secondary markets.

66) A corporation is characterized:
- A) as a legal entity unto itself (may sue or be sued, engage in contracts, acquire property).
- B) as a non-profitable entity.
- C) by having sufficient funds to fulfill their needs.
- D) by simplicity of decision making.

67) When a corporation fails, the maximum that can be lost by an investor protected by limited liability is:
- A) the amount of the initial investment.
- B) the amount of the profit on the investment.
- C) the amount necessary to pay the corporation's debts.
- D) the amount of the investor's personal wealth.

68) The shareholders in a sole proprietorship are represented by:
- A) the owner of the firm.
- B) the general partner of the firm.
- C) the board of directors of the firm.
- D) sole proprietorships have no shareholders.

69) Whom of the following is not a financial manager?
- A) the treasurer.
- B) the controller.
- C) the chief financial officer (CFO).
- D) the marketing manager.

70) 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.

71) The term "corporate stakeholder" typically refers to:
- A) a company's customers.
- B) anyone with a financial interest in the firm.
- C) the equity holders of the firm.
- D) the management and board of directors of the firm.

72) Which of the following statements generally cannot be correct for an investor who faces unlimited liability on an investment?
- A) The investor owns stock in the firm.
- B) The investor has no partners.
- C) The investor is subject to double taxation.
- D) The investor is responsible for managing the firm.

73) An example of a firm's financing decision would include:
- A) acquisition of a competitive firm.
- B) how much to pay for a specific asset.
- C) the issuance of ten-year versus twenty-year bonds.
- D) whether or not to increase the price of its products.

74) Which of the following is *least* likely to be discussed in the articles of incorporation?
- A) The maximum number of shares that can be issued.
- B) The purpose of the business.
- C) The price range of the shares of stock.
- D) The number of members of the board of directors.

75) Within the realm of ethical decision making, managers should attempt to maximize:
A) the market value of the shareholders' wealth.
B) their compensation plans.
C) their firm's market share.
D) the profits of the firm.

76) A financial manager facing a capital budgeting decision must decide whether to:
A) issue stock or debt securities.
B) use the money market or capital market.
C) use primary markets or secondary markets.
D) buy new machinery or repair the old.

77) The term "capital structure" refers to:
A) the manner in which a firm obtains its long-term sources of funding.
B) the length of time needed to repay debt.
C) whether the firm invests in capital budgeting projects.
D) which specific assets the firm should invest in.

78) Capital investment decisions are also known as:
A) capital budgeting
B) cash flow management
C) capital assets
D) capitalization

79) When do today's capital investments generate returns?
A) In the future
B) In the past
C) Today
D) All time periods presented are acceptable.

80) The financial management is characterized by which two decisions?
   A) Purchase of real assets and sale of financial assets
   B) Purchase of real assets and purchase of financial assets
   C) Sale of real assets and sale of financial assets
   D) Sale of real assets and purchase of financial assets

81) Which type of corporation has more flexibility when it comes to raising financing?
   A) Public
   B) Private
   C) Income trust
   D) Hybrid

82) The reason profit maximization is not a well-defined corporate objective is that:
   A) it leaves open the question of which year's profits.
   B) decreasing current returns is used in order to free up cash and increase future profits.
   C) different accountants will calculate profits differently.
   D) All options are reasons why profit maximization is not a well-defined corporate objective.

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

83) What general factors may influence the decision of whether to organize as a sole proprietorship, a partnership, or a corporation?

84) Discuss why corporations typically exhibit separation of ownership and management, as distinguished from sole proprietorships or partnerships.

85) Why is limited liability such an important aspect to investors?

86) Provide at least three examples each of real and financial assets that might appear on the balance sheet of General Motors.

87) Distinguish between a firm's capital budgeting decision and financing decision.

88) Discuss the interrelationship between a firm's financing and capital structure decisions.

89) Provide examples of managerial goals other than the maximization of market value.

90) Explain why managers should use ethical decision making as a way to increase the profitability of a firm.

91) Describe agency problems in general and offer at least three examples from corporations.

92) What are the two major decisions made by a financial manager?

93) What does "real asset" mean? What is a "financial asset"?

94) How do corporations ensure that managers' and shareholders' interests coincide?

95) Tabulate and compare the differences among corporations, proprietorships and partnerships.

96) Are all investment decisions made by the financial manager multi-billion-dollar investment?

97) Briefly discuss income trusts.

98) What specific arrangements can be used to ensure management is working towards shareholders' goals?

99) Small investment decisions are unimportant and insignificant. Why or why not?

Chapter 01 Test Bank

Answer Key

Test name: Chapter 01 Test Bank

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

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

Chapter 01 Test Bank

78) A
79) A
80) A
81) A
82) D
83) Short Answer
84) Short Answer
85) Short Answer
86) Short Answer
87) Short Answer
88) Short Answer
89) Short Answer
90) Short Answer
91) Short Answer
92) Short Answer
93) Short Answer
94) Short Answer
95) Short Answer
96) Short Answer
97) Short Answer
98) Short Answer
99) Short Answer