

Chapter 01

Introduction to Financial Management

Multiple Choice Questions

1. Tim has been promoted and is now in charge of all fixed asset purchases. In other words, Tim is in charge of:
 - A. capital structure management.
 - B. asset allocation.
 - C. risk management.
 - D. capital budgeting.
 - E. working capital management.

2. Stadford, Inc. is financed with 40 percent debt and 60 percent equity. This mixture of debt and equity is referred to as the firm's:
 - A. capital structure.
 - B. capital budget.
 - C. asset allocation.
 - D. working capital.
 - E. risk structure.

3. Lester's BBQ has \$121,000 in current assets and \$109,000 in current liabilities. These values as referred to as the firm's:

- A. capital structure.
- B. cash equivalents.
- C. working capital.
- D. net assets.
- E. fixed accounts.

4. Margie opened a used bookstore and is both the 100 percent owner and the store's manager. Which type of business entity does Margie own if she is personally liable for all the store's debts?

- A. Sole proprietorship
- B. Limited partnership
- C. Corporation
- D. Joint stock company
- E. General partnership

5. Will and Bill both enjoy sunshine, water, and surfboards. Thus, the two friends decided to create a business together renting surfboards, paddle boats, and inflatable devices in California. Will and Bill will equally share in the decision making and in the profits or losses. Which type of business did they create if they both have full personal liability for the firm's debts?

- A. Sole proprietorship
- B. Limited partnership
- C. Corporation
- D. Joint stock company
- E. General partnership

6. Todd and Cathy created a firm that is a separate legal entity and will share ownership of that firm on a 50-50 basis. Which type of entity did they create if they have no personal liability for the firm's debts?
- A. Limited partnership
 - B. Corporation
 - C. Sole proprietorship
 - D. General partnership
 - E. Public company
7. The potential conflict of interest between a firm's owners and its managers is referred to as which type of conflict?
- A. Organizational
 - B. Structural
 - C. Formation
 - D. Agency
 - E. Territorial
8. The federal government has a tax claim on the cash flows of The Window Store. This claim is defined as a claim by one of the firm's:
- A. residual owners.
 - B. shareholders.
 - C. financiers.
 - D. provisional partners.
 - E. stakeholders.

9. The "say on pay" portion of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires corporations to do which one of the following?

- A. Give the chair of the board the final say on executive pay
- B. Give the firm's creditors a nonbinding say on executive pay
- C. Give the firm's creditors a binding say on executive pay
- D. Give shareholders a nonbinding vote on executive pay
- E. Give shareholders a binding vote on executive pay

10. Beginning in 2011, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires corporations with a market value over _____ to allow a nonbinding shareholder vote on executive pay.

- A. \$25,000,000
- B. \$50,000,000
- C. \$75,000,000
- D. \$100,000
- E. \$750,000

11. Jamie is employed as a commercial loan officer for a regional bank centered in the midwestern section of the U.S. Her job falls into which one of the following areas of finance?

- A. International finance
- B. Financial institutions
- C. Corporate finance
- D. Capital management
- E. Investments

12. If you accept a job as a domestic security analyst for a brokerage firm, you are most likely working in which one of the following financial areas?

- A. International finance
- B. Private placements
- C. Corporate finance
- D. Capital management
- E. Investments

13. Which one of the following occupations best fits into the international area of finance?

- A. Bank teller
- B. Treasury bill analyst
- C. Currency trader
- D. Insurance risk manager
- E. Local bank manager

14. Which of the following individuals commonly use finance in the course of their job?

- I. Chief financial officers
- II. Accountants
- III. Security analysts
- IV. Strategic managers

- A. I and II only
- B. III and IV only
- C. I and III only
- D. I, II, and III only
- E. I, II, III, and IV

15. Which one of the following functions should be assigned to the treasurer rather than the controller?

- A. Data processing
- B. Cost accounting
- C. Tax management
- D. Cash management
- E. Financial accounting

16. Which one of the following correctly defines a common chain of command within a corporation?

- A. The controller reports directly to the corporate treasurer.
- B. The treasurer reports directly to the board of directors.
- C. The chief financial officer reports directly to the board of directors.
- D. The credit manager reports directly to the controller.
- E. The controller reports directly to the chief financial officer.

17. Capital budgeting includes the evaluation of which of the following?

- A. Size of future cash flows only
- B. Size and timing of future cash flows only
- C. Timing and risk of future cash flows only
- D. Risk and size of future cash flows only
- E. Size, timing, and risk of future cash flows

18. Which one of the following is a working capital decision?

- A. How should the firm raise additional capital to fund its expansion?
- B. What debt-equity ratio is best suited to the firm?
- C. What is the cost of debt financing?
- D. Which type of debt is best suited to finance the inventory?
- E. How much cash should the firm keep in reserve?

19. Which one of the following is a capital structure decision?

- A. Determining the optimal inventory level
- B. Establishing the preferred debt-equity level
- C. Selecting new equipment to purchase
- D. Setting the terms of sale for credit sales
- E. Determining when suppliers should be paid

20. Working capital management includes which one of the following?

- A. Deciding which new projects to accept
- B. Deciding whether to purchase a new machine or fix a current machine
- C. Determining which customers will be granted credit
- D. Determining how many new shares of stock should be issued
- E. Establishing the target debt-equity ratio

21. The daily financial operations of a firm are primarily controlled by managing the:

- A. total debt level.
- B. working capital.
- C. capital structure.
- D. capital budget.
- E. long-term liabilities.

22. A sole proprietorship:

- A. provides limited liability for its owner.
- B. involves significant legal costs during the formation process.
- C. has an unlimited life.
- D. has its profits taxed as personal income.
- E. can generally raise significant capital from nonowner sources.

23. Which one of the following forms of business organization offers liability protection to some of its owners but not to all of its owners?

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

24. Maria is the sole proprietor of an antique store that she has operated at the same location for the past 16 years. The store rents the space in which it is located but does own all of the inventory and fixtures. The store has an outstanding loan with the local bank but no other debt obligations. There are no specific loan covenants or assets pledged as security for the loan. Due to a sudden and unexpected downturn in the economy, the store is unable to generate sufficient funds to pay the loan payments due to the bank. Which of the following options does the bank have to collect the money it is owed?

- I. Sell the inventory and use the cash raised to apply to the debt
- II. Sell the store fixtures and use the cash raised to apply to the debt
- III. Take funds from Maria's personal account at the bank to pay the store's debt
- IV. Sell any assets Maria personally owns and apply the proceeds to the store's debt

- A. I only
- B. III only
- C. I and II only
- D. I, II, and III only
- E. I, II, III, and IV

25. Which one of the following statements correctly applies to a sole proprietorship?

- A. The business entity has an unlimited life.
- B. The ownership can easily be transferred to another individual.
- C. The owner enjoys limited liability for the firm's debts.
- D. Debt financing is easy to arrange in the firm's name.
- E. Obtaining additional equity is dependent on the owner's personal finances.

26. Which one of the following applies to a general partnership?
- A. The firm's operations must be controlled by a single partner.
 - B. Any one of the partners can be held solely liable for all of the partnership's debt.
 - C. The profits of the firm are taxed as a separate entity.
 - D. Each partner's liability for the firm's debts is limited to each partner's investment in the firm.
 - E. The profits of a general partnership are taxed the same as those of a corporation.
27. In a general partnership, each partner is personally liable for:
- A. the partnership debts that he or she created.
 - B. his or her proportionate share of all partnership debts regardless of which partner incurred that debt.
 - C. the total debts of the partnership, even if he or she was unaware of those debts.
 - D. the debts of the partnership up to the amount he or she invested in the firm.
 - E. all personal and partnership debts incurred by any partner, even if he or she was unaware of those debts.
28. Which one of the following is an advantage of being a limited partner?
- A. Nontaxable share of any profits
 - B. Control over the daily operations of the firm
 - C. Losses limited to capital invested
 - D. Unlimited profits without risk of incurring a loss
 - E. Active market for ownership interest

29. Which one of the following statements about a limited partnership is correct?

- A. All partners have their losses limited to their capital investment in the partnership.
- B. All partners are treated equally.
- C. There must be at least one general partner.
- D. Equity financing is easy to obtain and unlimited.
- E. Any partner can transfer his or her ownership interest without ending the partnership.

30. A corporation:

- A. is ultimately controlled by its board of directors.
- B. is a legal entity separate from its owners.
- C. is prohibited from entering into contractual agreements.
- D. has its identity defined by its bylaws.
- E. has its existence regulated by the rules set forth in its charter.

31. Which one of the following is contained in the corporate bylaws?

- A. Procedures for electing corporate directors
- B. State of incorporation
- C. Number of authorized shares
- D. Intended life of the corporation
- E. Business purpose of the corporation

32. Which of the following are advantages of the corporate form of organization?

- I. Ability to raise large sums of equity capital
- II. Ease of ownership transfer
- III. Profits taxed at the corporate level
- IV. Limited liability for all owners

- A. I and II only
- B. III and IV only
- C. II, III, and IV only
- D. I, II, and IV only
- E. I, II, III, and IV

33. Corporate shareholders:

- A. are proportionately liable for the firm's debts.
- B. are protected from all losses.
- C. have the ability to change the corporation's bylaws.
- D. receive tax-free distributions since all profits are taxed at the corporate level.
- E. have basically no control over the actual corporation.

34. A limited liability company:

- A. is a hybrid between a sole proprietorship and a partnership.
- B. prefers its profits be taxed as personal income to its owners.
- C. that meets the IRS criteria to be an LLC will be taxed like a corporation.
- D. provides limited liability for some, but not all, of its owners.
- E. cannot be created for professional service firms, such as accountants and attorneys.

35. Limited liability companies are primarily designed to:
- A. allow a portion of their owners to enjoy limited liability while granting the other portion of their owners control over the entity.
 - B. provide the benefits of the corporate structure to foreign-based entities.
 - C. spin off a wholly owned subsidiary.
 - D. allow companies to reorganize themselves through the bankruptcy process.
 - E. provide limited liability while avoiding double taxation.
36. The primary goal of financial management is to maximize which one of the following for a corporation?
- A. Current profits
 - B. Market share
 - C. Number of shares outstanding
 - D. Market value of existing stock
 - E. Revenue growth
37. Which one of the following best matches the primary goal of financial management?
- A. Increasing the dollar amount of each sale
 - B. Increasing traffic flow within the firm's stores
 - C. Transforming fixed costs into variable costs
 - D. Increasing the firm's liquidity
 - E. Increasing the market value of the firm

38. The goal of financial management is to increase the:
- A. future value of the firm's total equity.
 - B. book value of equity.
 - C. dividends paid per share.
 - D. current market value per share.
 - E. number of shares outstanding.
39. What is the goal of financial management for a sole proprietorship?
- A. Maximize net income given the current resources of the firm
 - B. Decrease long-term debt to reduce the risk to the owner
 - C. Minimize the tax impact on the proprietor
 - D. Maximize the market value of the equity
 - E. Minimize the reliance on fixed costs
40. The Sarbanes-Oxley Act in 2002 was prompted by which one of the following from the 1990s?
- A. Increased stock market volatility
 - B. Corporate accounting and financial fraud
 - C. Increased executive compensation
 - D. Increased foreign investment in U.S. stock markets
 - E. Increased use of tax loopholes

41. The Sarbanes-Oxley Act of 2002 has:

- A. reduced the annual compliance costs of all publicly traded firms in the U.S.
- B. decreased senior management's involvement in the corporate annual report.
- C. greatly increased the number of U.S. firms that are going public for the first time.
- D. decreased the number of U.S. firms going public on foreign exchanges.
- E. made officers of publicly traded firms personally responsible for the firm's financial statements.

42. Which one of the following best describes the primary intent of the Sarbanes-Oxley Act of 2002?

- A. Increase the costs of going public
- B. Increase protection against corporate fraud
- C. Limit secondary issues of corporate securities
- D. Decrease the number of publicly traded firms
- E. Increase the number of firms that "go dark"

43. The Sarbanes-Oxley Act:

- A. makes the officers of a public corporation personally responsible for the firm's financial statements.
- B. requires all corporations to fully disclose its financial dealings to the general public.
- C. places the responsibility for a firm's financial statements solely on the chief financial officer.
- D. requires that the board of directors be solely responsible for the firm's financial dealings.
- E. places total responsibility for the financial statements of a firm on the auditor who certifies the statements.

44. Which one of the following situations is most apt to create an agency conflict?
- A. Compensating a manager based on his or her division's net income
 - B. Giving all employees a bonus if a certain level of efficiency is maintained
 - C. Hiring an independent consultant to study the operating efficiency of the firm
 - D. Rejecting a profitable project to protect employee jobs
 - E. Selling an underproducing segment of the firm
45. Which one of the following is most apt to create a situation where an agency conflict could arise?
- A. Increasing the size of a firm's operations
 - B. Downsizing a firm
 - C. Separating management from ownership
 - D. Decreasing employee turnover
 - E. Reducing both management and nonmanagement salaries
46. Which one of the following is most apt to align management's priorities with shareholders' interests?
- A. Increasing employee retirement benefits
 - B. Compensating managers with shares of stock that must be held for three years before the shares can be sold
 - C. Allowing a manager to decorate his or her own office once he or she has been in that office for a period of three years or more
 - D. Increasing the number of paid holidays that long-term employees are entitled to receive
 - E. Allowing employees to retire early with full retirement benefits

47. Which of the following are effective means of aligning management goals with shareholder interests?

- I. Employee stock options
- II. Threat of a takeover
- III. Management bonuses tied to performance goals
- IV. Threat of a proxy fight

- A. I and III only
- B. II and IV only
- C. I, II, and III only
- D. I, III, and IV only
- E. I, II, III, and IV

48. Marti had an unexpected surprise when she ate her Lotsa Good cereal this morning. She found a piece of metal mixed in her cereal. The potential claim that Marti has against this firm is that of a(n):

- A. general creditor.
- B. debtholder.
- C. shareholder.
- D. stakeholder.
- E. agent.

49. Which one of the following transactions occurred in the primary market?
- A. Maria gave 100 shares of Alto stock to her best friend.
 - B. Gene purchased 300 shares of Alto stock from Ted.
 - C. South Wind Products sold 1,000 shares of newly issued stock to Mike.
 - D. Terry sold 3,000 shares of Uno stock to his brother.
 - E. The president of Trecco, Inc. sold 500 shares of Trecco stock to his son.
50. Valerie bought 200 shares of Able stock today. Able stock has been trading for some time on the NYSE. Valerie's purchase occurred in which market?
- A. Dealer market
 - B. Over-the-counter market
 - C. Secondary market
 - D. Primary market
 - E. Tertiary market
51. Which one of the following statements is correct?
- A. All secondary markets are dealer markets.
 - B. All secondary markets are broker markets.
 - C. All stock trades between existing shareholders are secondary market transactions.
 - D. All stock transactions are secondary market transactions.
 - E. All Dutch auction sales are secondary market transactions.

52. Ted currently owns 100 shares of a publicly traded stock that he would like to sell. Which one of the following provides the most efficient means for Ted to sell his shares?

- A. Issuer-sponsored Dutch auction
- B. Proxy statement
- C. Private placement transaction
- D. Stakeholder purchase
- E. Secondary market transaction

53. Which one of the following parties can sell shares of ABC stock in the primary market?

- A. ABC company
- B. Any corporation, other than the ABC company
- C. Institutional shareholder
- D. Private individual shareholder
- E. Any of these

54. Which one of the following statements related to securities dealers is correct?

- A. Dealers match buyers with sellers.
- B. Dealers buy and sell from their own inventory.
- C. Dealers operate on a physical trading floor.
- D. Dealers operate exclusively in auction markets.
- E. Dealers are limited to trading nonlisted stocks.

55. An auction market:

- A. is an electronic means of exchanging securities.
- B. has a physical trading floor.
- C. handles primary market transactions exclusively.
- D. is also referred to as an OTC market.
- E. is dealer based.

56. Which one of the following statements is correct?

- A. NASDAQ has more listed stocks than does the NYSE.
- B. The NYSE is a dealer market.
- C. NASDAQ is an auction market.
- D. NASDAQ has the most stringent listing requirements of any U.S. exchange.
- E. The trading floor for NASDAQ is located in Chicago.

57. Which one of the following is a general characteristic of a securities broker?

- A. Trades from his or her own inventory
- B. Trades only foreign securities
- C. Trades listed securities in an auction market
- D. Trades electronically from any geographic location
- E. Is the principal trader of debt securities

58. Which one of the following statements is correct?

- A. All of the major stock exchanges are U.S. based.
- B. The NYSE was created by the National Association of Securities Dealers in the early 1970s.
- C. The American Stock Exchange is a dealer market.
- D. OTC markets have a physical trading floor generally located in either New York City or Chicago.
- E. The primary purpose of the NYSE is to match buyers with sellers.

Essay Questions

59. Give an example of a situation where the management of a firm is acting in a manner that is contrary to the principal goal of financial management.

60. List three decisions that a financial manager makes that would fall under the category of working capital management.

61. Explain the primary goal of the Sarbanes-Oxley Act in 2002 and discuss whether or not this act appears to be effectively meeting that goal.

62. Explain what capital structure management is and give three examples of capital structure decisions.

63. Todd wants to start his own business and is debating between organizing the business as a sole proprietorship or a corporation. Explain the pros and cons of both forms of business organization.

64. Give an example of a potential agency problem for a corporation and identify means by which the firm can help reduce or eliminate that problem.

65. Which type of financial market, dealer or auction, is best suited to expanding internationally and why?

66. Assume a firm has both a controller and a treasurer. Identify the types of responsibilities each should have and explain why their duties should be separated as you suggest.

Chapter 01 Introduction to Financial Management **Answer Key**

Multiple Choice Questions

1. Tim has been promoted and is now in charge of all fixed asset purchases. In other words, Tim is in charge of:
- A. capital structure management.
 - B. asset allocation.
 - C. risk management.
 - D.** capital budgeting.
 - E. working capital management.

Refer to Section 1.2.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Capital budgeting

2. Stadford, Inc. is financed with 40 percent debt and 60 percent equity. This mixture of debt and equity is referred to as the firm's:

- A. capital structure.
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3. Lester's BBQ has \$121,000 in current assets and \$109,000 in current liabilities. These values as referred to as the firm's:

- A. capital structure.
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Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

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Topic: Working capital

4. Margie opened a used bookstore and is both the 100 percent owner and the store's manager. Which type of business entity does Margie own if she is personally liable for all the store's debts?

- A.** Sole proprietorship
- B. Limited partnership
- C. Corporation
- D. Joint stock company
- E. General partnership

Refer to Section 1.3.

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Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Sole proprietorship

5. Will and Bill both enjoy sunshine, water, and surfboards. Thus, the two friends decided to create a business together renting surfboards, paddle boats, and inflatable devices in California. Will and Bill will equally share in the decision making and in the profits or losses. Which type of business did they create if they both have full personal liability for the firm's debts?

- A. Sole proprietorship
- B. Limited partnership
- C. Corporation
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Blooms: Remember

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Topic: General partnership

6. Todd and Cathy created a firm that is a separate legal entity and will share ownership of that firm on a 50-50 basis. Which type of entity did they create if they have no personal liability for the firm's debts?

- A. Limited partnership
- B. Corporation**
- C. Sole proprietorship
- D. General partnership
- E. Public company

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AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Corporation

7. The potential conflict of interest between a firm's owners and its managers is referred to as which type of conflict?

- A. Organizational
- B. Structural
- C. Formation
- D. Agency**
- E. Territorial

Refer to Section 1.5.

AACSB: Ethics

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

8. The federal government has a tax claim on the cash flows of The Window Store. This claim is defined as a claim by one of the firm's:

- A. residual owners.
- B. shareholders.
- C. financiers.
- D. provisional partners.
- E. stakeholders.

Refer to Section 1.5.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Stakeholder

9. The "say on pay" portion of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires corporations to do which one of the following?

- A. Give the chair of the board the final say on executive pay
- B. Give the firm's creditors a nonbinding say on executive pay
- C. Give the firm's creditors a binding say on executive pay
- D.** Give shareholders a nonbinding vote on executive pay
- E. Give shareholders a binding vote on executive pay

Refer to the opening section of Chapter 1.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: Chapter 1 Opener

Topic: "Say on pay"

10. Beginning in 2011, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires corporations with a market value over _____ to allow a nonbinding shareholder vote on executive pay.

- A. \$25,000,000
- B. \$50,000,000
- C.** \$75,000,000
- D. \$100,000
- E. \$750,000

Refer to the opening section of Chapter 1.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: Chapter 1 Opener

Topic: Salary limit

11. Jamie is employed as a commercial loan officer for a regional bank centered in the midwestern section of the U.S. Her job falls into which one of the following areas of finance?

- A. International finance
- B.** Financial institutions
- C. Corporate finance
- D. Capital management
- E. Investments

Refer to Section 1.1.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.1

Topic: Finance areas

12. If you accept a job as a domestic security analyst for a brokerage firm, you are most likely working in which one of the following financial areas?

- A. International finance
- B. Private placements
- C. Corporate finance
- D. Capital management
- E.** Investments

Refer to Section 1.1.

AACSB: Analytic

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Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.1

Topic: Finance areas

13. Which one of the following occupations best fits into the international area of finance?

- A. Bank teller
- B. Treasury bill analyst
- C.** Currency trader
- D. Insurance risk manager
- E. Local bank manager

Refer to Section 1.1.

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Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.1

Topic: Finance areas

14. Which of the following individuals commonly use finance in the course of their job?

I. Chief financial officers

II. Accountants

III. Security analysts

IV. Strategic managers

A. I and II only

B. III and IV only

C. I and III only

D. I, II, and III only

E. I, II, III, and IV

Refer to Section 1.1.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.1

Topic: Finance applications

15. Which one of the following functions should be assigned to the treasurer rather than the controller?

- A. Data processing
- B. Cost accounting
- C. Tax management
- D.** Cash management
- E. Financial accounting

Refer to Section 1.2.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.2

Topic: Organizational chart

16. Which one of the following correctly defines a common chain of command within a corporation?

- A. The controller reports directly to the corporate treasurer.
- B. The treasurer reports directly to the board of directors.
- C. The chief financial officer reports directly to the board of directors.
- D. The credit manager reports directly to the controller.
- E.** The controller reports directly to the chief financial officer.

Refer to Section 1.2.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.2

Topic: Organizational chart

17. Capital budgeting includes the evaluation of which of the following?

- A. Size of future cash flows only
- B. Size and timing of future cash flows only
- C. Timing and risk of future cash flows only
- D. Risk and size of future cash flows only
- E.** Size, timing, and risk of future cash flows

Refer to Section 1.2.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Capital budgeting

18. Which one of the following is a working capital decision?
- A. How should the firm raise additional capital to fund its expansion?
 - B. What debt-equity ratio is best suited to the firm?
 - C. What is the cost of debt financing?
 - D. Which type of debt is best suited to finance the inventory?
 - E.** How much cash should the firm keep in reserve?

Refer to Section 1.2.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Working capital

19. Which one of the following is a capital structure decision?
- A. Determining the optimal inventory level
 - B.** Establishing the preferred debt-equity level
 - C. Selecting new equipment to purchase
 - D. Setting the terms of sale for credit sales
 - E. Determining when suppliers should be paid

Refer to Section 1.2.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

20. Working capital management includes which one of the following?
- A. Deciding which new projects to accept
 - B. Deciding whether to purchase a new machine or fix a current machine
 - C. Determining which customers will be granted credit**
 - D. Determining how many new shares of stock should be issued
 - E. Establishing the target debt-equity ratio

Refer to Section 1.2.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Working capital

21. The daily financial operations of a firm are primarily controlled by managing the:
- A. total debt level.
 - B. working capital.**
 - C. capital structure.
 - D. capital budget.
 - E. long-term liabilities.

Refer to Section 1.2.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Working capital

22. A sole proprietorship:

- A. provides limited liability for its owner.
- B. involves significant legal costs during the formation process.
- C. has an unlimited life.
- D. has its profits taxed as personal income.
- E. can generally raise significant capital from nonowner sources.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Sole proprietorship

23. Which one of the following forms of business organization offers liability protection to some of its owners but not to all of its owners?

- A. Sole proprietorship
- B. General partnership
- C. Limited partnership**
- D. Limited liability company
- E. Corporation

Refer to Section 1.3.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Limited partnership

24. Maria is the sole proprietor of an antique store that she has operated at the same location for the past 16 years. The store rents the space in which it is located but does own all of the inventory and fixtures. The store has an outstanding loan with the local bank but no other debt obligations. There are no specific loan covenants or assets pledged as security for the loan. Due to a sudden and unexpected downturn in the economy, the store is unable to generate sufficient funds to pay the loan payments due to the bank. Which of the following options does the bank have to collect the money it is owed?

- I. Sell the inventory and use the cash raised to apply to the debt
- II. Sell the store fixtures and use the cash raised to apply to the debt
- III. Take funds from Maria's personal account at the bank to pay the store's debt
- IV. Sell any assets Maria personally owns and apply the proceeds to the store's debt

- A. I only
- B. III only
- C. I and II only
- D. I, II, and III only
- E.** I, II, III, and IV

Refer to Section 1.3.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Sole proprietorship

25. Which one of the following statements correctly applies to a sole proprietorship?

- A. The business entity has an unlimited life.
- B. The ownership can easily be transferred to another individual.
- C. The owner enjoys limited liability for the firm's debts.
- D. Debt financing is easy to arrange in the firm's name.
- E.** Obtaining additional equity is dependent on the owner's personal finances.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Sole proprietorship

26. Which one of the following applies to a general partnership?

- A. The firm's operations must be controlled by a single partner.
- B.** Any one of the partners can be held solely liable for all of the partnership's debt.
- C. The profits of the firm are taxed as a separate entity.
- D. Each partner's liability for the firm's debts is limited to each partner's investment in the firm.
- E. The profits of a general partnership are taxed the same as those of a corporation.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

27. In a general partnership, each partner is personally liable for:
- A. the partnership debts that he or she created.
 - B. his or her proportionate share of all partnership debts regardless of which partner incurred that debt.
 - C. the total debts of the partnership, even if he or she was unaware of those debts.
 - D. the debts of the partnership up to the amount he or she invested in the firm.
 - E. all personal and partnership debts incurred by any partner, even if he or she was unaware of those debts.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: General partnership

28. Which one of the following is an advantage of being a limited partner?

- A. Nontaxable share of any profits
- B. Control over the daily operations of the firm
- C. Losses limited to capital invested**
- D. Unlimited profits without risk of incurring a loss
- E. Active market for ownership interest

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Limited partnership

29. Which one of the following statements about a limited partnership is correct?

- A. All partners have their losses limited to their capital investment in the partnership.
- B. All partners are treated equally.
- C. There must be at least one general partner.**
- D. Equity financing is easy to obtain and unlimited.
- E. Any partner can transfer his or her ownership interest without ending the partnership.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

30. A corporation:
- A. is ultimately controlled by its board of directors.
 - B.** is a legal entity separate from its owners.
 - C. is prohibited from entering into contractual agreements.
 - D. has its identity defined by its bylaws.
 - E. has its existence regulated by the rules set forth in its charter.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Corporation

31. Which one of the following is contained in the corporate bylaws?

- A.** Procedures for electing corporate directors
- B. State of incorporation
- C. Number of authorized shares
- D. Intended life of the corporation
- E. Business purpose of the corporation

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Corporate bylaws

32. Which of the following are advantages of the corporate form of organization?

- I. Ability to raise large sums of equity capital
- II. Ease of ownership transfer
- III. Profits taxed at the corporate level
- IV. Limited liability for all owners

- A. I and II only
- B. III and IV only
- C. II, III, and IV only
- D.** I, II, and IV only
- E. I, II, III, and IV

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Corporation

33. Corporate shareholders:

- A. are proportionately liable for the firm's debts.
- B. are protected from all losses.
- C.** have the ability to change the corporation's bylaws.
- D. receive tax-free distributions since all profits are taxed at the corporate level.
- E. have basically no control over the actual corporation.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Corporation

34. A limited liability company:

- A. is a hybrid between a sole proprietorship and a partnership.
- B.** prefers its profits be taxed as personal income to its owners.
- C. that meets the IRS criteria to be an LLC will be taxed like a corporation.
- D. provides limited liability for some, but not all, of its owners.
- E. cannot be created for professional service firms, such as accountants and attorneys.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

35. Limited liability companies are primarily designed to:
- A. allow a portion of their owners to enjoy limited liability while granting the other portion of their owners control over the entity.
 - B. provide the benefits of the corporate structure to foreign-based entities.
 - C. spin off a wholly owned subsidiary.
 - D. allow companies to reorganize themselves through the bankruptcy process.
 - E. provide limited liability while avoiding double taxation.

Refer to Section 1.3.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Limited liability company

36. The primary goal of financial management is to maximize which one of the following for a corporation?

- A. Current profits
- B. Market share
- C. Number of shares outstanding
- D.** Market value of existing stock
- E. Revenue growth

Refer to Section 1.4.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-02 Identify the goal of financial management.

Section: 1.4

Topic: Goal of financial management

37. Which one of the following best matches the primary goal of financial management?

- A. Increasing the dollar amount of each sale
- B. Increasing traffic flow within the firm's stores
- C. Transforming fixed costs into variable costs
- D. Increasing the firm's liquidity
- E.** Increasing the market value of the firm

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-02 Identify the goal of financial management.

Section: 1.4

Topic: Goal of financial management

38. The goal of financial management is to increase the:

- A. future value of the firm's total equity.
- B. book value of equity.
- C. dividends paid per share.
- D.** current market value per share.
- E. number of shares outstanding.

Refer to Section 1.4.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 01-02 Identify the goal of financial management.

Section: 1.4

Topic: Goal of financial management

39. What is the goal of financial management for a sole proprietorship?

- A. Maximize net income given the current resources of the firm
- B. Decrease long-term debt to reduce the risk to the owner
- C. Minimize the tax impact on the proprietor
- D.** Maximize the market value of the equity
- E. Minimize the reliance on fixed costs

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-02 Identify the goal of financial management.

Section: 1.4

Topic: Goal of financial management

40. The Sarbanes-Oxley Act in 2002 was prompted by which one of the following from the 1990s?
- A. Increased stock market volatility
 - B. Corporate accounting and financial fraud**
 - C. Increased executive compensation
 - D. Increased foreign investment in U.S. stock markets
 - E. Increased use of tax loopholes

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.4

Topic: Sarbox

41. The Sarbanes-Oxley Act of 2002 has:
- A. reduced the annual compliance costs of all publicly traded firms in the U.S.
 - B. decreased senior management's involvement in the corporate annual report.
 - C. greatly increased the number of U.S. firms that are going public for the first time.
 - D. decreased the number of U.S. firms going public on foreign exchanges.
 - E.** made officers of publicly traded firms personally responsible for the firm's financial statements.

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.4

Topic: Sarbox

42. Which one of the following best describes the primary intent of the Sarbanes-Oxley Act of 2002?
- A. Increase the costs of going public
 - B.** Increase protection against corporate fraud
 - C. Limit secondary issues of corporate securities
 - D. Decrease the number of publicly traded firms
 - E. Increase the number of firms that "go dark"

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.4

Topic: Sarbox

43. The Sarbanes-Oxley Act:

- A. makes the officers of a public corporation personally responsible for the firm's financial statements.
- B. requires all corporations to fully disclose its financial dealings to the general public.
- C. places the responsibility for a firm's financial statements solely on the chief financial officer.
- D. requires that the board of directors be solely responsible for the firm's financial dealings.
- E. places total responsibility for the financial statements of a firm on the auditor who certifies the statements.

Refer to Section 1.4.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.4

Topic: Sarbox

44. Which one of the following situations is most apt to create an agency conflict?

- A. Compensating a manager based on his or her division's net income
- B. Giving all employees a bonus if a certain level of efficiency is maintained
- C. Hiring an independent consultant to study the operating efficiency of the firm
- D. Rejecting a profitable project to protect employee jobs
- E. Selling an underproducing segment of the firm

Refer to Section 1.5.

AACSB: Ethics

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

45. Which one of the following is most apt to create a situation where an agency conflict could arise?

- A. Increasing the size of a firm's operations
- B. Downsizing a firm
- C. Separating management from ownership
- D. Decreasing employee turnover
- E. Reducing both management and nonmanagement salaries

Refer to Section 1.5.

AACSB: Ethics

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

46. Which one of the following is most apt to align management's priorities with shareholders' interests?
- A. Increasing employee retirement benefits
 - B. Compensating managers with shares of stock that must be held for three years before the shares can be sold**
 - C. Allowing a manager to decorate his or her own office once he or she has been in that office for a period of three years or more
 - D. Increasing the number of paid holidays that long-term employees are entitled to receive
 - E. Allowing employees to retire early with full retirement benefits

Refer to Section 1.5.

AACSB: Ethics

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

47. Which of the following are effective means of aligning management goals with shareholder interests?

- I. Employee stock options
- II. Threat of a takeover
- III. Management bonuses tied to performance goals
- IV. Threat of a proxy fight

- A. I and III only
- B. II and IV only
- C. I, II, and III only
- D. I, III, and IV only
- E.** I, II, III, and IV

Refer to Section 1.5.

AACSB: Ethics

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

48. Marti had an unexpected surprise when she ate her Lotsa Good cereal this morning. She found a piece of metal mixed in her cereal. The potential claim that Marti has against this firm is that of a(n):

- A. general creditor.
- B. debtholder.
- C. shareholder.
- D.** stakeholder.
- E. agent.

Refer to Section 1.5.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Stakeholder

49. Which one of the following transactions occurred in the primary market?

- A. Maria gave 100 shares of Alto stock to her best friend.
- B. Gene purchased 300 shares of Alto stock from Ted.
- C.** South Wind Products sold 1,000 shares of newly issued stock to Mike.
- D. Terry sold 3,000 shares of Uno stock to his brother.
- E. The president of Trecco, Inc. sold 500 shares of Trecco stock to his son.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Primary market

50. Valerie bought 200 shares of Able stock today. Able stock has been trading for some time on the NYSE. Valerie's purchase occurred in which market?

- A. Dealer market
- B. Over-the-counter market
- C. Secondary market**
- D. Primary market
- E. Tertiary market

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Secondary market

51. Which one of the following statements is correct?

- A. All secondary markets are dealer markets.
- B. All secondary markets are broker markets.
- C.** All stock trades between existing shareholders are secondary market transactions.
- D. All stock transactions are secondary market transactions.
- E. All Dutch auction sales are secondary market transactions.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Secondary market

52. Ted currently owns 100 shares of a publicly traded stock that he would like to sell. Which one of the following provides the most efficient means for Ted to sell his shares?

- A. Issuer-sponsored Dutch auction
- B. Proxy statement
- C. Private placement transaction
- D. Stakeholder purchase
- E.** Secondary market transaction

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

53. Which one of the following parties can sell shares of ABC stock in the primary market?

- A.** ABC company
- B. Any corporation, other than the ABC company
- C. Institutional shareholder
- D. Private individual shareholder
- E. Any of these

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Primary market

54. Which one of the following statements related to securities dealers is correct?

- A. Dealers match buyers with sellers.
- B.** Dealers buy and sell from their own inventory.
- C. Dealers operate on a physical trading floor.
- D. Dealers operate exclusively in auction markets.
- E. Dealers are limited to trading nonlisted stocks.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Dealers

55. An auction market:

- A. is an electronic means of exchanging securities.
- B.** has a physical trading floor.
- C. handles primary market transactions exclusively.
- D. is also referred to as an OTC market.
- E. is dealer based.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Auction market

56. Which one of the following statements is correct?

- A. NASDAQ has more listed stocks than does the NYSE.
- B. The NYSE is a dealer market.
- C. NASDAQ is an auction market.
- D. NASDAQ has the most stringent listing requirements of any U.S. exchange.
- E. The trading floor for NASDAQ is located in Chicago.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: NASDAQ

57. Which one of the following is a general characteristic of a securities broker?

- A. Trades from his or her own inventory
- B. Trades only foreign securities
- C. Trades listed securities in an auction market
- D. Trades electronically from any geographic location
- E. Is the principal trader of debt securities

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

58. Which one of the following statements is correct?
- A. All of the major stock exchanges are U.S. based.
 - B. The NYSE was created by the National Association of Securities Dealers in the early 1970s.
 - C. The American Stock Exchange is a dealer market.
 - D. OTC markets have a physical trading floor generally located in either New York City or Chicago.
 - E. The primary purpose of the NYSE is to match buyers with sellers.

Refer to Section 1.6.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Stock exchanges

Essay Questions

59. Give an example of a situation where the management of a firm is acting in a manner that is contrary to the principal goal of financial management.

The primary goal of financial management is to maximize the current value of the existing stock. Any management action that is contrary to this goal would be an acceptable answer.

Feedback: The primary goal of financial management is to maximize the current value of the existing stock. Any management action that is contrary to this goal would be an acceptable answer.

AACSB: Ethics

Blooms: Analyze

Difficulty: 1 Easy

Learning Objective: 01-02 Identify the goal of financial management.

Section: 1.4

Topic: Goal of financial management

60. List three decisions that a financial manager makes that would fall under the category of working capital management.

Working capital management is the management of a firm's current accounts. Decisions related to these accounts include, but are not limited to, determining which customers will receive credit and what the credit terms will be, determining which inventory to purchase and how much inventory to keep on hand, deciding when to pay a supplier, and deciding how best to manage the firm's cash.

Feedback: Working capital management is the management of a firm's current accounts. Decisions related to these accounts include, but are not limited to, determining which customers will receive credit and what the credit terms will be, determining which inventory to purchase and how much inventory to keep on hand, deciding when to pay a supplier, and deciding how best to manage the firm's cash.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Working capital

61. Explain the primary goal of the Sarbanes-Oxley Act in 2002 and discuss whether or not this act appears to be effectively meeting that goal.

The primary goal of the Sarbanes-Oxley Act was to strengthen the protection against corporate accounting fraud and financial malpractice. The act is probably effective for those firms that are currently listed on U.S. exchanges. On the other hand, the act has caused some firms to "go dark," avoid public offerings, or be listed on foreign exchanges rather than U.S. exchanges.

Feedback: The primary goal of the Sarbanes-Oxley Act was to strengthen the protection against corporate accounting fraud and financial malpractice. The act is probably effective for those firms that are currently listed on U.S. exchanges. On the other hand, the act has caused some firms to "go dark," avoid public offerings, or be listed on foreign exchanges rather than U.S. exchanges.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.2

Topic: Sarbox

62. Explain what capital structure management is and give three examples of capital structure decisions.

Capital structure management relates to the debt-equity mix of a firm. Decisions in this area include, but are not limited to, decisions related to the target debt-equity mix, the source of debt financing, the methods used to issue debt and equity, and how debtholders and shareholders should be compensated.

Feedback: Capital structure management relates to the debt-equity mix of a firm. Decisions in this area include, but are not limited to, decisions related to the target debt-equity mix, the source of debt financing, the methods used to issue debt and equity, and how debtholders and shareholders should be compensated.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Capital structure

63. Todd wants to start his own business and is debating between organizing the business as a sole proprietorship or a corporation. Explain the pros and cons of both forms of business organization.

Sole proprietorship:

Pros: Easy to form, least regulated, owner receives all the profits as personal income (in some instances this might be a con), difficult to transfer ownership

Cons: Unlimited personal liability, limited life, equity limited to personal resources

Corporate:

Pros: Unlimited life, limited liability, own legal identity, relatively easy transfer of ownership if publicly traded, easier access to capital

Cons: More difficult to form, more regulation, double taxation

Feedback: For a sole proprietorship, pros include easy to form, least regulated, owner receives all the profits as personal income (in some instances this might be a con), difficult to transfer ownership; cons include unlimited personal liability, limited life, equity limited to personal resources. For a corporation, pros include unlimited life, limited liability, own legal identity, relatively easy transfer of ownership if publicly traded, easier access to capital; cons include more difficult to form, more regulation, double taxation.

AACSB: Reflective Thinking

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.3

Topic: Forms of business organization

64. Give an example of a potential agency problem for a corporation and identify means by which the firm can help reduce or eliminate that problem.

Student answers will vary but most should address the potential conflict between the managers and the owners of a firm. The primary means of eliminating that potential conflict is to reward managers when they adopt policies preferred by shareholders and punish managers who ignore shareholder interests.

Feedback: Student answers will vary but most should address the potential conflict between the managers and the owners of a firm. The primary means of eliminating that potential conflict is to reward managers when they adopt policies preferred by shareholders and punish managers who ignore shareholder interests.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-04 Describe the conflicts of interest that can arise between managers and owners.

Section: 1.5

Topic: Agency conflict

65. Which type of financial market, dealer or auction, is best suited to expanding internationally and why?

A dealer market is best suited to international expansion because it is all electronic. An auction market is less adaptable to international expansion because it requires a physical trading floor.

Feedback: A dealer market is best suited to international expansion because it is all electronic. An auction market is less adaptable to international expansion because it requires a physical trading floor.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-03 Compare the financial implications of the different forms of business organizations.

Section: 1.6

Topic: Financial markets

66. Assume a firm has both a controller and a treasurer. Identify the types of responsibilities each should have and explain why their duties should be separated as you suggest.

The key point that students need to include in their answer is that the responsibility for the firm's cash must be separated from the accounting functions which record the cash transactions. The treasurer should be responsible for the cash management, credit management, capital expenditures, and financial planning. The controller should oversee the financial and cost accounting, data processing, and tax management.

Feedback: The key point that students need to include in their answer is that the responsibility for the firm's cash must be separated from the accounting functions which record the cash transactions. The treasurer should be responsible for the cash management, credit management, capital expenditures, and financial planning. The controller should oversee the financial and cost accounting, data processing, and tax management.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 01-01 Discuss the basic types of financial management decisions and the role of the financial manager.

Section: 1.2

Topic: Corporate structure