Principles of Managerial Finance 16th edition Zutter Test Bank

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Principles of Managerial Finance, 16e **(Zutter/Smart)**
Chapter 1 The Role of Managerial Finance

1.1 Finance and the firm

1) A firm is a business organization that sells goods and services.
Answer: TRUE
Diff: 2
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

2) In finance we say that the goal of the firm ought to be to maximize profits.
Answer: FALSE
Diff: 1
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

3) Other things being equal, it is better to receive money sooner rather than later.
Answer: TRUE
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

4) Financial managers evaluating decision alternatives or potential actions must consider _____.
A) only risk
B) only return
C) either risk or return
D) risk, return, and the impact on share price
Answer: D
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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5) If a firm earns a profit, it will necessarily also generate a positive cash flow.
Answer: FALSE
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

6) If a firm's stockholders are risk averse, the firm will make its stockholders better off by earning the highest possible returns on its investments.
Answer: FALSE
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

7) Which of the following is an example of a firm's stakeholder?
A) suppliers
B) Federal Reserve
C) media
D) competitors
Answer: A
Diff: 1
Topic: What About Stakeholders?
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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8) A financial manager must choose between four alternative Assets: 1, 2, 3, and 4. Each asset costs $35,000 and is expected to provide earnings over a three-year period as described below.

Asset	Year 1	Year 2	Year 3
Asset 1	$21,000	$15,000	$6,000
Asset 2	6,000	15,000	21,000
Asset 3	20,000	14,000	8,000
Asset 4	14,000	14,000	14,000

Based on the wealth maximization goal, the financial manager would choose _____.
A) Asset 1
B) Asset 2
C) Asset 3
D) Asset 4
Answer: A
Diff: 2
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

9) In the most recent year, two different companies generated the same earnings per share. The stocks of these two companies should trade at the same price.
Answer: FALSE
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

10) One reason that firms exist is that most investors are risk averse, so they are not willing to make the kinds of risky investments that firms typically undertake.
Answer: FALSE
Diff: 1
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

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11) Which of the following is true of stakeholders?
A) They are the owners of a firm.
B) They are groups to whom a firm has financial obligations.
C) They are groups having a direct economic link to a firm.
D) They include only the bondholders, common stockholders, and preferred stockholders.
Answer: C
Diff: 1
Topic: What About Stakeholders?
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

12) Which of the following is true regarding cash flow?
A) Profits do not necessarily result in cash flows available to the stockholders.
B) It is guaranteed that the board of directors will increase dividends when net cash flows increase.
C) A firm's income statement will never show a positive profit when its cash outflows exceed its cash inflows.
D) An increase in revenue will always result in an increase in cash flow.
Answer: A
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

13) Investors who are risk averse will make risky investments as long as they expect sufficient compensation for doing so.
Answer: TRUE
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

14) Which of the following is true of cash flows and risk?
A) Lower cash flow and lower risk result in an increase in share price.
B) Higher cash flow and lower risk result in an increase in share price.
C) Higher cash flow and higher risk result in an increase in share price.
D) Lower cash flow and higher risk result in an increase in share price.
Answer: B
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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15) The goal of business ethics is to motivate business and market participants to adhere to both the letter and the spirit of laws and regulations in all aspects of business and professional practice.
Answer: TRUE
Diff: 1
Topic: The Role of Business Ethics
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Ethical Understanding and Reasoning

16) The primary goal of a financial manager is _____.
A) minimizing risk
B) maximizing profit
C) maximizing wealth
D) minimizing return
Answer: C
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

17) Corporate owners earn a return _____.
A) by realizing gains through increases in share price and interest earnings
B) by realizing gains through increases in share price and cash dividends
C) through capital appreciation and retained earnings
D) through interest earnings and earnings per share
Answer: B
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

18) The wealth of the owners of a corporation is represented by _____.
A) profits
B) earnings per share
C) share value
D) cash flow
Answer: C
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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19) Wealth maximization as the goal of a firm implies enhancing the wealth of _____.
A) the auditors
B) the creditors
C) the federal reserve
D) the firm's stockholders
Answer: D
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

20) The amount earned during the accounting period on each outstanding share of common stock is called _____.
A) dividend per share
B) earnings per share
C) net profits after taxes
D) book value per share
Answer: B
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

21) Firm A generates more cash flow while taking less risk than Firm B. The stock price of Firm A should be higher than the stock price of Firm B.
Answer: TRUE
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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22) Which of the following is NOT a reason that a firm that maximizes profits may fail to maximize shareholder wealth.
A) The timing of profits matters. Shareholders might prefer lower profits that arrive sooner.
B) Risk matters. Shareholders are risk averse, so they prefer less risky investments that generate lower profits.
C) Shareholder wealth depends on cash flow which is not the same as profit.
D) If a firm maximizes profits by engaging in unethical business practices, it's stock price may be adversely affected.
Answer: B
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

23) _____ pool investment capital, make risky investment decisions, and manage risky investments on behalf of investors who would otherwise not be able to do so own their own.
A) Firms
B) Stockholders
C) Stakeholders
D) Regulators
Answer: A
Diff: 1
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

24) Finance is _____.
A) the system of verifying, analyzing, and recording business transactions
B) the science of the production, distribution, and consumption of goods and services
C) the science and art of how individuals and businesses raise, allocate, and invest money
D) the art of merchandising products and services
Answer: C
Diff: 1
Topic: What is Finance?
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

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25) In a recent quarter, Amazon and Clorox reported nearly identical earnings per share, but the stock price of Amazon was more than six times higher than the Clorox stock price. The most likely explanation for that difference is that _____.
A) Clorox is bad for the environment
B) Amazon is a riskier company
C) investors see better long-term prospects for Amazon
D) Amazon has more shares of stock outstanding
Answer: C
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

26) The wealth of corporate owners is measured by the share price of the stock.
Answer: TRUE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

27) Risk, along with the magnitude and timing of cash flows are the key determinants of share price, which represent the wealth of the owners in the firm.
Answer: TRUE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

28) A higher earnings per share (EPS) does not necessarily translate into a higher stock price.
Answer: TRUE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

29) The profit maximization goal ignores the timing of returns, does not directly consider cash flows, and ignores risk.
Answer: TRUE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

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30) When considering a firm's financial decision alternatives, financial managers should accept only those actions that are expected to maximize shareholder value.
Answer: TRUE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Ethical Understanding and Reasoning

31) An increase in a firm's risk will always result in a higher share price since the stockholder must be compensated for the greater risk.
Answer: FALSE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

32) An objection to managing a firm on behalf of stakeholders rather than shareholders is that _____.
A) stakeholders have no economic interest in the firm
B) stakeholders have an interest only in short-term outcomes
C) there is no clear way to satisfy all stakeholders whose economic interests may be at odds with each other
D) the goal of managing on behalf of stakeholders is too narrow
Answer: C
Diff: 1
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

33) An effective ethics program _____.
A) can weaken corporate value
B) has no effect on a corporation's value
C) can enhance a corporation's value
D) will result in high employee attrition rate
Answer: C
Diff: 1
Topic: Ethics and Share Price
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Ethical Understanding and Reasoning

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34) When considering a firm's financial decision alternatives, financial managers should accept only those actions that are expected to increase the firm's profitability.
Answer: FALSE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Ethical Understanding and Reasoning

35) _____ are the standards of conduct or moral judgment that apply to persons engaged in commerce.
A) Government regulations
B) The Uniform Commercial Codes
C) The rules of fair play
D) Business ethics
Answer: D
Diff: 1
Topic: Finance and the Firm
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

36) Cash flows and risk are the key determinants in share price. Increased risk, other things remaining the same, results in _____.
A) a lower share price
B) a higher share price
C) an unchanged share price
D) an undetermined share price
Answer: A
Diff: 2
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

37) Cash flows and risk are the key determinants in share price. Increased cash flow results in _____, other things remaining the same.
A) a lower share price
B) a higher share price
C) an unchanged share price
D) an undetermined share price
Answer: B
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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1.2 Managing the firm

1) A treasurer is responsible for the firm's accounting activities, such as corporate accounting, tax management, financial accounting, and cost accounting.
Answer: FALSE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 2
Learning Outcome: F-01
AACSB: Analytical Thinking

2) _____ decisions focus on how a company will spend its financial resources on long-term projects that ultimately determine whether the firm successfully creates value for its owners.
A) Investment
B) Financing
C) Working capital
D) Risk management
Answer: A
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

3) The principle of the time value of money basically says that _____.
A) because firms pay managers a great deal, managers need to use their time very effectively
B) money received today is more valuable than money received in the future because money in the future is more risky
C) money received today is more valuable than money received in the future because firms and individuals can invest money they have today and earn a return on that money
D) because of the principal-agent problem, investors cannot trust that money firms promise to pay in the future will ever arrive
Answer: C
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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4) The primary principle that finance borrows from economics is _____.
A) generally accepted accounting principles
B) cash is king
C) marginal cost-benefit analysis
D) shareholder value maximization
Answer: C
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

5) Financing decisions deal with the left-hand side of the firm's balance sheet.
Answer: FALSE
Diff: 1
Topic: Primary Activities of the Financial Manager
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

6) Which of the following activities of a finance manager determines the types of assets the firm holds?
A) budget allocation
B) investment decisions
C) financing decisions
D) analyzing and planning cash flows
Answer: B
Diff: 1
Topic: Primary Activities of the Financial Manager
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

7) You own a building supply store. Today you sold construction materials to a contractor for $10,000 that you acquired a week ago for $8,000. You paid for the materials in cash, but you sold them to the contractor on credit, and you expect him to pay his bill in a few months. Based on this information during the week you earned a positive profit but experienced a negative cash flow.
Answer: TRUE
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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8) There is a tendency for CEOs of larger companies to earn more money than CEOs of smaller companies. Suppose a CEO decides to acquire another company, thus increasing the size of the CEO's firm. Suppose also that the price of the stock of the acquiring firm falls when investors learns of the upcoming acquisition. This appears to be an example of _____.
A) a CEO pursuing profit maximization rather than wealth maximization
B) the principal-agent problem
C) a CEO behaving unethically
D) the general principal that acquisitions are generally not good investments
Answer: B
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

9) A corporation's stockholders elect its CEO.
Answer: FALSE
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

10) The money that firms raise to finance their activities is called _____.
A) the capital budget
B) working capital
C) capital
D) accruals
Answer: C
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

11) Marginal cost-benefit analysis states that financial decisions should be made and actions should be taken only when the added benefits exceed the added costs.
Answer: TRUE
Diff: 1
Topic: Relationship to Economics
Learning Objective: LG 4
Learning Outcome: F-03
AACSB: Analytical Thinking

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12) The treasurer typically manages a firm's cash, investing surplus funds when available and securing outside financing when needed.
Answer: TRUE
Diff: 1
Topic: Relationship to Accounting
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

13) A corporate treasurer's focus tends to be more external, while the controller's focus is more internal.
Answer: TRUE
Diff: 1
Topic: Organization of the Finance Function
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

14) The accrual method recognizes revenue at the point of sale and recognizes expenses when incurred.
Answer: TRUE
Diff: 1
Topic: Relationship to Accounting
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

15) A treasurer is commonly responsible for handling _____.
A) tax management
B) corporate accounting
C) investing surplus funds
D) cost accounting
Answer: C
Diff: 1
Topic: Organization of the Finance Function
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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16) Which of the following is true of accrual basis accounting?
A) Expenses are recognized either when they are incurred or cash is paid.
B) Revenue is recognized when a customer pays cash.
C) Expenses are recognized when they are incurred.
D) Revenue is recognized when a customer pays cash or shows interest to purchase the product or service.
Answer: C
Diff: 1
Topic: Relationship to Accounting
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

17) Johnson, Inc. has just ended the calendar year making a sale in the amount of $10,000 of merchandise purchased during the year at a total cost of $7,000. Although the firm paid in full for the merchandise during the year, it is yet to collect at year end from the customer. The net profit and cash flow from this sale for the year are _____.
A) $3,000 and $10,000, respectively
B) $3,000 and -$7,000, respectively
C) $7,000 and -$3,000, respectively
D) $3,000 and $7,000, respectively
Answer: B
Diff: 2
Topic: Relationship to Accounting
Learning Objective: LG 4
Learning Outcome: F-02
AACSB: Analytical Thinking

18) A firm has just ended its calendar year making a sale in the amount of $150,000 of merchandise purchased during the year at a total cost of $112,500. Although the firm paid in full for the merchandise during the year, it is yet to collect at year end from the customer. The net profit and cash flow from this sale for the year are _____.
A) $0 and $150,000, respectively
B) $37,500 and -$150,000, respectively
C) $37,500 and -$112,500, respectively
D) $150,000 and $112,500, respectively
Answer: C
Diff: 2
Topic: Relationship to Accounting
Learning Objective: LG 4
Learning Outcome: F-02
AACSB: Analytical Thinking

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19) Stockholders expect to earn higher rates of return on investments with lower risk and lower rates of return on investments with higher risk.
Answer: FALSE
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

20) As the risk of a stock investment increases, investors' _____.
A) return will increase
B) return will decrease
C) required rate of return will decrease
D) required rate of return will increase
Answer: D
Diff: 1
Topic: Maximize Shareholder Wealth
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

21) The principal-agent problem arises when _____.
A) the owners of the firm are not the people managing the firm
B) the owners of the firm also manage the firm
C) managers serve on a firm's board of directors
D) a firm is organized as a sole proprietorship
Answer: A
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

22) Which of the following works as a conduit of information between the firm and its investors?
A) the treasurer
B) the controller
C) the director of internal audit
D) the director of investor relations
Answer: D
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Analytical Thinking

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23) _____ decisions refer to how a firm manages its short-term resources on a day-to-day basis.
A) Financing
B) Investment
C) Working capital
D) Managerial finance
Answer: C
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

24) There is a tradeoff between risk and return (i.e., to earn higher returns you generally have to take more risk) because _____.
A) investors like risk and return and want more of both
B) investors are risk averse, so they will not accept riskier investments unless they offer higher returns
C) to earn higher returns you have to make bigger investments and bigger investments are always riskier than smaller ones
D) investors care about returns but not about risks
Answer: B
Diff: 2
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Reflective Thinking

25) The time value of money principle implies that all other things being equal, investments that produce profits faster are preferred over those that produce more distant profits.
Answer: TRUE
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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26) The _____ has a role that focuses on budgeting, accounting, and tracking the performance of a single business unit.
A) controller
B) treasurer
C) chief financial officer
D) director of risk management
Answer: A
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 3
Learning Outcome: F-01
AACSB: Reflective Thinking

27) When managers are trying to create value for shareholders, their primary focus should be on earnings rather than cash flow.
Answer: FALSE
Diff: 1
Topic: Managing the Firm
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

1.3 Organizational forms, taxation, and the principal-agent relationship

1) Which of the following legal forms of organization is most expensive to organize?
A) sole proprietorships
B) partnerships
C) corporations
D) limited partnership
Answer: C
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

2) Which of the following legal forms of organization is the easiest to dissolve?
A) sole proprietorships
B) partnerships
C) limited partnerships
D) corporations
Answer: A
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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3) Under which of the following legal forms of organization is ownership readily transferable?
A) sole proprietorships
B) partnerships
C) limited partnerships
D) corporations
Answer: D
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

4) Which of the following forms of organizations is the easiest to form?
A) sole proprietorships
B) limited liability corporation
C) limited partnership
D) S-corporations
Answer: A
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

5) A major weakness of a partnership is _____.
A) the difficulty in maintaining owners' control
B) the difficulty in liquidating or transferring ownership
C) the double taxation of income
D) its high organizational costs
Answer: B
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
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6) Which of the following is a strength of a corporation?
A) low taxes
B) limited liability
C) low organization costs
D) less government regulation
Answer: B
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

7) Which of the following legal forms of organizations is characterized by unlimited liability?
A) sole proprietorship
B) limited partnership
C) corporation
D) C-corporation
Answer: A
Diff: 2
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

8) Which of the following is true of a partnership and a corporation?
A) In a corporation, income is taxed at the corporate level; whereas, in a partnership, income is taxed twice.
B) In a partnership, income is taxed once at the individual level; whereas, in a corporation, income is taxed twice.
C) Income from both forms of organizations are double-taxed.
D) In a partnership, income is exempted from tax up to $10 million; whereas, in a corporation, income is taxed twice.
Answer: B
Diff: 1
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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9) Which of the following is true of sole proprietorships and corporations?
A) It is difficult to transfer ownership of corporations compared to that of sole proprietorships.
B) Income from both forms of organizations are taxed only at the corporate level.
C) Both sole proprietorships and corporations are equally scrutinized and regulated by government bodies.
D) In sole proprietorships, owners have unlimited liability; whereas, in corporations, owners have limited liability.
Answer: D
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

10) In partnerships, partners can readily transfer their wealth to other partners.
Answer: FALSE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

11) A sole proprietor has unlimited liability; his or her total investment in the business, but not his or her personal assets, can be taken to satisfy creditors.
Answer: FALSE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

12) In a limited partnership, all partners' liabilities are limited to their investment in the partnership.
Answer: TRUE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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13) Under a progressive tax structure in which tax rates rise with income levels _____.
A) the marginal tax rate and the average tax rate are the same
B) the average tax rate is what really matters when an individual or business is making a financial decision
C) the marginal tax rate is usually less than the average tax rate
D) the marginal tax rate is usually greater than the average tax rate
Answer: D
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

14) The term "double taxation" means that _____.
A) partnerships and sole proprietorships pay tax on the income that they earn, and then income distributed from the business to the owner is taxed again at the individual level
B) the highest federal income tax rate faced by corporations is twice the highest tax rate faced by individuals
C) corporations pay tax on the income they earn and then shareholders pay tax on income that the corporation distributes to them
D) a corporation pays tax on the interest it pays to bondholders and then bondholders pay tax again on the interest payments they receive from firms
Answer: C
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Reflective Thinking

15) Suppose a certain business pays 10.0% tax on its first $10,000 in come, 12.0% tax on income above $10,000 but below $40,000, and 22.0% tax on income above $40,000. Suppose the business earns $50,000 in income this year. It's marginal tax rate is _____.
A) 12.0%
B) 13.6%
C) 22.0%
D) greater than 22.0%
Answer: C
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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16) Corporate governance refers to _____.
A) the rules, processes, and laws by which companies are operated, controlled, and regulated
B) the fact that corporations heavily influence the actions of governments through their lobbying efforts
C) the notion that corporations act like a democracy in the sense that every shareholder has an equal vote on corporate decisions
D) the idea that a corporate CEO is really accountable to no one and must be constrained by government action
Answer: A
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

17) Agency costs are _____.
A) costs that managers bear when they do not act in the interests of shareholders
B) costs that firms must pay to comply with the regulations imposed by federal government agencies
C) costs that are exempt from taxation
D) costs that shareholders bear because managers pursue their own interests rather than acting in the interests of shareholders
Answer: D
Diff: 2
Topic: Legal Forms of Business Organization
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

18) Firms are legally required to pay dividends to stockholders just as they must make interest payments to lenders.
Answer: FALSE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Reflective Thinking

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19) Suppose a certain business pays 10% tax on its first $10,000 in come, 12% tax on income above $10,000 but below $40,000, and 22% tax on income above $40,000. Suppose the business earns $50,000 in income this year. Its average tax rate is closest to _____.
A) 22%
B) 14%
C) 10%
D) 17%
Answer: B
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

20) Dividends are periodic distributions of cash to the stockholders of a firm.
Answer: TRUE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Reflective Thinking

21) Suppose a certain business pays 10% tax on its first $10,000 in come, 12% tax on income above $10,000 but below $40,000, and 22% tax on income above $40,000. Suppose the business earns $50,000 in income this year. It tax liability is _____.
A) $6,800
B) $11,000
C) $9,800
D) $5,800
Answer: A
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

22) Under a flat tax structure, where the same tax rate applies to all income levels _____.
A) the marginal tax rate is greater than the average tax rate
B) the marginal tax rate is less than the average tax rate
C) the marginal tax rate is equal to the average tax rate
D) the marginal tax rate is irrelevant
Answer: C
Diff: 2
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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23) In partnerships, owners have unlimited liability and may have to cover debts of other less financially sound partners.
Answer: TRUE
Diff: 1
Topic: Legal Forms of Business Organization
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

24) The board of directors is responsible for managing day-to-day operations and carrying out the policies established by the chief executive officer.
Answer: FALSE
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Analytical Thinking

25) Institutional investors are professional investors who work on behalf of individuals, business, and government.
Answer: TRUE
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Analytical Thinking

26) The major purpose of the Sarbanes-Oxley Act of 2002 was to place caps on the compensation that could be paid to corporate executives.
Answer: FALSE
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Analytical Thinking

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27) The board of directors is typically responsible for _____.
A) approving strategic goals and plans
B) managing day-to-day operations
C) arranging finance for approved long-term investments
D) maintaining and controlling the firm's daily cash balances
Answer: A
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Analytical Thinking

28) The responsibility for managing day-to-day operations and carrying out corporate policies belongs to the _____.
A) board of directors
B) chief executive officer
C) stockholders
D) creditors
Answer: B
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Analytical Thinking

29) Which of the following is an example of agency cost?
A) costs incurred for setting up an agency
B) failure to make an investment that would make shareholders wealthier
C) payment of income tax
D) payment of interest
Answer: B
Diff: 1
Topic: The Agency Issue
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Ethical Understanding and Reasoning

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30) Which of the following is a routine way that boards try to align the interests of managers and stockholders?
A) fire managers who are inefficient
B) remove management's perquisites
C) tie management compensation to the performance of the company's common stock price
D) tie management compensation to the level of dividend per share
Answer: C
Diff: 1
Topic: The Agency Issue
Learning Objective: LG 6
Learning Outcome: F-26
AACSB: Ethical Understanding and Reasoning

31) The marginal tax rate paid on a firm's ordinary income can be calculated by dividing its taxes by its net income.
Answer: FALSE
Diff: 1
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

32) The average tax rate paid on the firm's ordinary income can be calculated by dividing its taxes by its taxable income.
Answer: TRUE
Diff: 1
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

33) The tax deductibility of various expenses such as general and administrative expenses _____.
A) increases their pretax cost
B) reduces their after-tax cost
C) has no effect on their after-tax cost
D) has an unpredictable effect on their after-tax cost
Answer: B
Diff: 1
Topic: Ordinary Income
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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34) Jennings, Inc. has a tax liability of $170,000 on pretax income of $500,000. What is the average tax rate for Jennings, Inc.?
A) 34 percent
B) 46 percent
C) 25 percent
D) 40 percent
Answer: A
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

35) The average tax rate of a corporation with ordinary income of $105,000 and a tax liability of $24,200 is _____.
A) 46 percent
B) 23 percent
C) 34 percent
D) 15 percent
Answer: B
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

36) If a corporation sells certain capital equipment for more than its initial purchase price, the difference between the sale price and the purchase price is called a(n) _____.
A) ordinary gain
B) revenue gain
C) capital gain
D) abnormal gain
Answer: C
Diff: 1
Topic: Capital Gains
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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37) In general, most corporate capital gains are taxed at _____ tax rate.
A) the average
B) the regular corporate
C) the historic
D) a 30 percent
Answer: B
Diff: 1
Topic: Capital Gains
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

38) Corporation X needs $1,000,000 and can raise this through debt at an annual rate of 6 percent, or preferred stock at an annual cost of 8 percent. If the corporation has a 21 percent tax rate, the after-tax cost of each is _____.
A) debt: $60,000; preferred stock: $80,000
B) debt: $47,400; preferred stock: $63,200
C) debt: $47,400; preferred stock: $80,000
D) debt: $60,000; preferred stock: $63,200
Answer: C
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

39) The marginal tax rate represents the rate at which the next dollar of income is taxed.
Answer: TRUE
Diff: 1
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

40) All dividend income received by a corporation is exempted from taxation.
Answer: FALSE
Diff: 1
Topic: Ordinary Income
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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41) The tax liability of a sole proprietorship with ordinary income of $105,000 is closest to _____.

Range of taxable income			Marginal rate
$ 0	to	$ 9,875	10%
9,875	to	40,125	12
40,125	to	85,525	22
85,525	to	163,300	24

A) $25,200
B) $22,050
C) $32,090
D) $19,280
Answer: D
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

42) The tax liability of a sole proprietorship with ordinary income of $450,000 is closest to _____.

Range of taxable income			Marginal rate
$ 0	to	$ 9,875	10%
9,875	to	40,125	12
40,125	to	85,525	22
85,525	to	163,300	24
163,300	to	207,350	32
207,350	to	518,400	35

A) $157,500
B) $132,295
C) $94,500
D) $114,700
Answer: B
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

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43) Prior to the Tax Cuts and Jobs Act, corporations faced a progressive tax rate schedule with rates ranging from 15% to 39%. Under that old tax law, a firm with taxable income of $100 million would have owed taxes of $35 million. Under the Tax Cuts and Jobs Act, the corporate tax rate is a flat 21%. For a firm that makes $100 million in taxable income, the size of the tax reduction that the firm enjoys because of the new tax law is closest to _____.
A) $18 million
B) $21 million
C) $14 million
D) $35 million
Answer: C
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

44) Corporation A owns a small percentage of the stock of corporation B. Corporation B pays corporation A $100,000 in dividends. Corporation A pays tax at a 21% rate and is allowed to exclude from taxable income 50% of dividends received from other firms. The incremental taxes that Corporation A must pay on the dividends received are _____.
A) $21,000
B) $10,500
C) $0
D) $1,050
Answer: B
Diff: 2
Topic: Ordinary Income
Learning Objective: LG 4
Learning Outcome: F-01
AACSB: Analytical Thinking

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45) Consider two firms, Go Debt corporation and No Debt corporation. Both firms are expected to have earnings before interest and taxes of $100,000 during the coming year. In addition, Go Debt is expected to incur $40,000 in interest expenses as a result of its borrowings whereas No Debt will incur no interest expense because it does not use debt financing. Both firms are in the 21 percent tax bracket. Calculate the earnings after tax for both firms. Compare the difference in after-tax earnings to the difference in interest expense. Can you reconcile that difference?
Answer:

	Go Debt	No Debt
Earnings before interest and taxes	$100,000	$100,000
Less: Interest expense	40,000	0
Earnings before taxes	$ 60,000	$100,000
Less: Taxes (21%)	12,600	21,000
Earnings after taxes	$ 47,400	$ 79,000

Go Debt has lower earnings after taxes compared to No Debt, and the difference is $31,600 ($79,000 - $47,400). The difference in interest expense is $40,000. The reason the difference in earnings is less than the difference in interest expense is that the interest expense that Go Debt pays saves the company $8,400 in taxes (a number which you can calculate by multiplying 21% times the $40,000 interest expense).
Diff: 3
Topic: Taxes
Learning Objective: LG 5
Learning Outcome: F-01
AACSB: Analytical Thinking

46) Restricted stock is stock that _____.
A) is not publicly traded due to on-going investigations by the Securities and Exchange Commission
B) allow managers to buy new shares of stock at a fixed price
C) firms pay out to managers as part of a compensation package that do not fully transfer from the company to the managers until specific conditions are met
D) firms issue for the sold purpose of raising funds to invest in environmentally friendly projects
Answer: A
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

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47) An activist investor is an investor who _____.
A) lobbies the government to force companies to manage for stakeholders rather than for shareholders only
B) specializes in influencing management
C) organizes boycotts and other kinds of protests to draw attention to firms' unethical treatment of labor
D) served in government before moving into the investment industry
Answer: A
Diff: 1
Topic: Corporate Governance
Learning Objective: LG 6
Learning Outcome: F-01
AACSB: Reflective Thinking

1.4 Developing skills for your career

1) Communication skills are very important to financial and nonfinancial managers because _____.
A) they will be communicating with the investment community regularly
B) they work together in cross-functional teams and need to understand how members of their teams think
C) they will write reports that are disclosed in the firm's financial reports
D) they are all responsible for selling the firms goods and services to customers
Answer: B
Diff: 1
Topic: Developing Skills for Your Career
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Reflective Thinking

2) Developing financial computing skills, such as expertise with software like Excel, is important because _____.
A) everyone in the firm must be an Excel expert to have success
B) everyone in the firm needs to understand financial reports and models at some level, and those are usually constructed and presented in Excel
C) there are no good alternatives to Excel
D) mistakes are more likely to occur when people do financial work by hand rather than using a product like Excel
Answer: B
Diff: 1
Topic: Developing Skills for Your Career
Learning Objective: LG 1
Learning Outcome: F-01
AACSB: Analytical Thinking

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