Exam

Name________________________________

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

1) To obtain the necessary money a company sells financial assets or securities. 1) _______

2) The liability of sole proprietors is limited to the amount of their investment in the company. 2) _______

3) General partners have limited personal liability for business debts in a limited partnership. 3) _______

4) The corporate form of business organization is often accompanied by separation of ownership and management. 4) _______

5) A major disadvantage of partnerships is that they have "double taxation" of profits. 5) _______

6) Capital budgeting decisions are used to determine how to raise the cash necessary for investments. 6) _______

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

8) The duties of a corporate controller typically include the preparation of financial statements. 8) _______

9) A successful investment is one that increases the value of the firm. 9) _______

10) The primary goal of any company should be to maximize current period profit. 10) _______

11) Maximizing profits is the same as maximizing the value of the firm. 11) _______

12) Ethical decision making in business can be viewed as a long-term investment in reputation. 12) _______

13) Agency problems act as a hindrance to the goal of maximizing firm value. 13) _______

14) Managers are spurred on by incentive schemes that provide big returns if shareholders gain but are valueless if they do not. 14) _______

15) If employee compensation plans are not designed properly, they can create incentives for errant behaviour by management. 15) _______

16) Poorly performing companies are also more likely to be taken over by another firm. After the takeover, the old management team may find itself out on the street. 16) ______

17) Managers are subject to the scrutiny of specialists. Their actions are monitored by the security analyst who advises investors to buy, hold, or sell the company's shares. 17) ______

18) The agency problem is mitigated in practice through several devices. 18) ______

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

19) In which of the following organizations would the existence of agency problems be *least* likely? 19) ______

A) a closely held corporation
B) a partnership
C) a corporation
D) a sole proprietorship

20) Which of the following represents a financing decision? 20) ______

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

21) For small firms, shareholders and management may be one and the same. But for large companies, separation of ownership and management is: 21) ______

A) a fraudulent move.
B) a liability.
C) a practical necessity.
D) not a necessity.

22) Which of the following would not be considered a real asset? 22) ______

A) a patent
B) a corporate bond
C) a machine
D) a factory

23) Which of the following would be considered an advantage of the sole proprietorship form of organization? 23) ______

A) unlimited liability
B) wide access to capital markets
C) a pool of expertise
D) profits taxed at only one level

24) Sole proprietorships resolve the issue of agency problems by: 24) ______

A) allowing owners to share the cost of their actions with others.
B) forcing owners to bear the full cost of their actions.
C) avoiding excessive expense accounts.
D) discharging those who violate the rules.

25) When managers' compensation plans are tied in a meaningful manner to the profits of the firm, agency problems: 25) ______

A) are eliminated entirely from the firm. B) can be reduced.
C) are shifted to other stakeholders. D) will be created.

26) In a firm having both a treasurer and a controller, which of the following would most likely be handled by the controller? 26) ______

A) internal auditing B) insurance
C) banking relationships D) credit management

27) Which of the following is *not* an advantage to incorporating a business? 27) ______

A) limited liability.
B) becoming a permanent legal entity.
C) profits taxed at the corporate level and the shareholder level.
D) easier access to financial markets.

28) In a partnership form of organization, income tax liability, if any, is incurred by: 28) ______

A) the partners individually.
B) the partnership itself.
C) Both the partnership and the partners.
D) Neither the partnership nor the partners.

29) In the case of a professional corporation, ________ has/have limited liability. 29) ______

A) Neither the professionals *nor* the business
B) only the business
C) only the professionals
D) Both the professionals *and* the business

30) A firm decides to pay for a small investment project through a $1 million increase in short-term bank loans. This is best described as an example of a(n): 30) ______

A) investment decision. B) capital market decision.
C) financing decision. D) capital budgeting decision.

31) Which of the firm's financial managers is most likely to be involved with obtaining financing for the firm? 31) ______

A) controller B) treasurer
C) board of directors D) chief executive officer

32) In a large corporation, budget preparation would most likely be conducted by the: 32) ______

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

33) Which of the following groups is least likely to be considered a stakeholder of the firm? 33) ______

A) bondholders B) employees C) government D) competitors

34) What are the two critical decisions that have to be made by the financial manager? 34) ______

A) short term and long term.
B) investment and financing.
C) debt and equity.
D) All of the choices are correct.

35) Profit-sharing plans may be beneficial when used to: 35) ______

A) reduce the payment of cash dividends.
B) improve managers' incentives for effective decision making.
C) divert financial resources from shareholders.
D) reduce the impact of corporate income taxes.

36) One continuing problem with managerial incentive-compensation plans is that: 36) ______

A) the plans increase agency problems.
B) effectiveness of the plans is difficult to evaluate.
C) managers prefer guaranteed salaries.
D) the plans do not reward shareholders.

37) Which of the following is *least* likely to represent an agency problem? 37) ______

A) plush remodeling of the executive suite.
B) excessive investment in "safe" projects.
C) lavish spending on expense accounts.
D) executive incentive compensation plans.

38) Which of the following statements best distinguishes the difference between real and financial assets? 38) ______

A) financial assets represent claims to income that are generated by real assets.
B) financial assets appreciate in value; real assets depreciate in value.
C) real assets are tangible; financial assets are not.
D) real assets have less value than financial assets.

39) The short-term decisions of financial managers are comprised of: 39) ______

A) investment decisions.
B) financing decisions.
C) capital structure decisions.
D) both investment and financing decisions.

40) Which of the following would correctly differentiate general partners from limited partners in a limited partnership? 40) ______

A) general partners are subject to double taxation.
B) general partners have unlimited personal liability.
C) general partners have more job experience.
D) general partners have an ownership interest.

41) A corporation's board of directors: 41) ______
- A) can be voted out of power by the shareholders.
- B) is selected by a vote of all corporate stakeholders.
- C) has a lifetime appointment to the board.
- D) is selected by and can be removed by management.

42) One common reason for partnerships to convert to a corporate form of organization is that the partnership: 42) ______
- A) agreement expires after ten years of use.
- B) faces rapidly growing financing requirements.
- C) wishes to avoid double taxation of profits.
- D) has issued all of its allotted shares.

43) Which of the following is correct regarding board membership in a corporation? 43) ______
- A) in a public corporation, shareholders are not board members.
- B) in a private corporation, shareholders are also board members.
- C) all corporations have board of directors.
- D) All of the choices are correct.

44) The overall goal of capital budgeting projects should be to: 44) ______
- A) decrease the firm's reliance upon debt.
- B) increase the firm's outstanding shares of stock.
- C) increase the wealth of the firm's shareholders.
- D) increase the firm's sales.

45) Ethical decision making by management has a payoff for shareholders in terms of: 45) ______
- A) enhanced reputation value.
- B) higher dividend payments.
- C) improved capital structure.
- D) increased managerial benefits.

46) Ethical decision making in business: 46) ______
- A) is not in the best interests of shareholders.
- B) reduces the firm's profits.
- C) is less important than good capital budgeting decisions.
- D) requires adherence to implied rules as well as written rules.

47) Firms can alter their capital structure by: 47) ______
- A) issuing stock to repay debt.
- B) not accepting any capital budgeting projects.
- C) becoming a limited liability company.
- D) investing in non-tangible assets.

48) A corporation is considered to be closely held when: 48) ______
A) the market value of the shares is stable.
B) only a few shareholders exist.
C) it operates in a small geographic area.
D) management also serves as the board of directors.

49) A managerial objective to increase market share is more likely to be successful in the long run if the firm is: 49) ______
A) selling shares in the secondary market.
B) managed by the board of directors.
C) the low-cost producer in the industry.
D) investing in capital budgeting projects.

50) The best criterion for success in a capital budgeting decision would be to: 50) ______
A) finance all capital budgeting projects with debt.
B) maximize the difference between cash inflows and cost.
C) maximize the number of capital budgeting projects.
D) minimize the cost of the investment.

51) Which of the following appears to be the most appropriate goal for corporate management? 51) ______
A) maximizing the company's market share.
B) maximizing the current profits of the company.
C) minimizing the company's liabilities.
D) maximizing market value of the company's shares.

52) The primary goal of corporate management should be to: 52) ______
A) maximize the shareholders' wealth.
B) maximize the number of shareholders.
C) minimize the firm's costs.
D) maximize the firm's profit.

53) When a corporation decides to issue long-term debt in order to pay for the acquisition of real assets, it has made a: 53) ______
A) capital budgeting decision.
B) secondary market decision.
C) financing decision.
D) money market decision.

54) A corporate board of directors should provide support for the top management team: 54) ______
A) in all decisions related to cash dividends.
B) only when the board has confidence in management's actions.
C) under all circumstances.
D) if shareholders are pleased with the firm's performance.

55) When the management of a business is conducted by individuals other than the owners, the business is more likely to be a: 55) ______

A) sole proprietorship. B) corporation.
C) general partner. D) partnership.

56) "Double taxation" refers to: 56) ______

A) paying taxes on profits at the corporate level and on dividends at the personal level.
B) the fact that marginal tax rates are doubled for corporations.
C) corporations paying taxes on both dividends and retained earnings.
D) all partners paying equal taxes on profits.

57) The legal "life" of a corporation is: 57) ______

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

58) One corporate activity that is specifically reserved for the board of directors is the: 58) ______

A) preparation of budgets. B) declaration of dividends.
C) day-to-day operation of the firm. D) custody of records.

59) By organizing itself as a corporation, a business may be able to attract: 59) ______

A) partners. B) agents. C) proprietors. D) investors.

60) How may a reduction in cash dividends be in the best interests of current shareholders? 60) ______

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

61) A chief financial officer would typically: 61) ______

A) supervise both the treasurer and controller.
B) report to both the treasurer and controller.
C) report to the controller, but supervise the treasurer.
D) report to the treasurer, but supervise the controller.

62) Which of the following would be considered a capital budgeting decision? 62) ______

A) issuing debt in the form of long-term bonds
B) a decision to expand into a new line of products, at a cost of $5 million
C) planning to issue common stock rather than issuing preferred stock
D) repurchasing shares of common stock

63) The financial manager has to determine a value to uncertain cash flows. The variables involved in this determination are: 63) ______

A) timing
B) risk
C) amount
D) All of the choices are correct.

64) Long-term financing arrangements occur in the: 64) ______

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

65) A first step in determining managerial objectives is to: 65) ______

A) serve the needs of the customer.
B) develop appropriate compensation policies.
C) select an appropriate capital structure.
D) eliminate agency problems.

66) A board of directors is elected as a representative of the corporation's: 66) ______

A) customers.
B) shareholders.
C) top management.
D) stakeholders.

67) Corporations are referred to as public companies when their: 67) ______

A) shareholders have no tax liability.
B) shares are widely traded.
C) products or services are available to the public.
D) shares are held by the federal or state government.

68) A manager's compensation plan that offers financial incentives for increases in quarterly profitability may create agency problems in that: 68) ______

A) the managers are not motivated by personal gain.
B) short-term, not long-term, profits become the focus.
C) investors desire stable profits.
D) the board of directors may claim the credit.

69) Unlimited liability is faced by the owners of: 69) ______

A) corporations.
B) sole proprietorships and partnerships.
C) partnerships and corporations.
D) all forms of business organization.

70) Agency problems can best be characterized as a: 70) ______

A) spending corporate resources.
B) dislike of firm's bondholders by its equity holders.
C) friction between the primary and secondary markets.
D) differing incentives between managers and owners.

71) A corporation is characterized by: 71) ______

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

72) When a corporation fails, the maximum that can be lost by an investor protected by limited liability is: 72) ______

A) the amount of the profit on the investment.
B) the amount of the investor's personal wealth.
C) the amount necessary to pay the corporation's debts.
D) the amount of the initial investment.

73) The shareholders in a sole proprietorship are represented by: 73) ______

A) the board of directors of the firm.
B) the owner of the firm.
C) the general partner of the firm.
D) no one; sole proprietorships have no shareholders.

74) Whom of the following is not a financial manager? 74) ______

A) the treasurer.
B) the controller.
C) the marketing manager.
D) the chief financial officer (CFO).

75) Corporate managers are expected to make corporate decisions that are in the best interest of: 75) ______

A) all corporate employees.
B) top corporate management.
C) the corporation's shareholders.
D) the corporation's board of directors.

76) The term "corporate stakeholder" typically refers to: 76) ______

A) the equity holders of the firm.
B) the management and board of directors of the firm.
C) a company's customers.
D) anyone with a financial interest in the firm.

77) Which of the following statements generally cannot be correct for an investor who faces unlimited liability on an investment? 77) ______

A) the investor is responsible for managing the firm.
B) the investor owns stock in the firm.
C) the investor is subject to double taxation.
D) the investor has no partners.

78) An example of a firm's financing decision would include: 78) ______
A) acquisition of a competitive firm.
B) the issuance of ten-year versus twenty-year bonds.
C) how much to pay for a specific asset.
D) whether or not to increase the price of its products.

79) Which of the following is *least* likely to be discussed in the articles of incorporation? 79) ______
A) the number of members of the board of directors.
B) the maximum number of shares that can be issued.
C) the price range of the shares of stock.
D) the purpose of the business.

80) A common problem for closely held corporations is: 80) ______
A) an abundance of agency problems.
B) the separation of ownership and management.
C) lack of access to substantial amounts of capital.
D) that shareholders receive only one vote each.

81) Within the realm of ethical decision making, managers should attempt to maximize: 81) ______
A) the market value of the shareholders' wealth.
B) the profits of the firm.
C) their compensation plans.
D) their firm's market share.

82) A financial manager facing a capital budgeting decision must decide whether to: 82) ______
A) use primary markets or secondary markets.
B) use the money market or capital market.
C) issue stock or debt securities.
D) buy new machinery or repair the old.

83) The term "capital structure" refers to: 83) ______
A) the length of time needed to repay debt.
B) which specific assets the firm should invest in.
C) whether the firm invests in capital budgeting projects.
D) the manner in which a firm obtains its long-term sources of funding.

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

84) What general factors may influence the decision of whether to organize as a sole proprietorship, a partnership, or a corporation? 84) ____________

85) Discuss why corporations typically exhibit separation of ownership and management, as distinguished from sole proprietorships or partnerships. 85) ____________

86) Why is limited liability such an important aspect to investors? 86) ______________

87) Provide at least three examples each of real and financial assets that might appear on the balance sheet of General Motors. 87) ______________

88) Distinguish between a firm's capital budgeting decision and financing decision. 88) ______________

89) Discuss the interrelationship between a firm's financing and capital structure decisions. 89) ______________

90) Provide examples of managerial goals other than the maximization of market value. 90) ______________

91) Explain why managers should use ethical decision making as a way to increase the profitability of a firm. 91) ______________

92) Describe agency problems in general, and offer at least three examples from corporations. 92) ______________

93) What are the two major decisions made by a financial manager? 93) ______________

94) What does "real asset" mean? What is a "financial asset"? 94) ______________

95) How do corporations ensure that managers' and shareholders' interests coincide? 95) ______________

96) Tabulate and compare the differences among corporations, proprietorships and partnerships. 96) ______________

97) Are all investment decisions made by the financial manager multi-billion dollar investment? 97) ______________

98) Briefly discuss income trusts. 98) ______________

99) What specific arrangements can be used to ensure management is working towards shareholders' goals? 99) ______________

Answer Key
Testname: UNTITLED1

1) TRUE
2) FALSE
3) FALSE
4) TRUE
5) FALSE
6) FALSE
7) TRUE
8) TRUE
9) TRUE
10) FALSE
11) FALSE
12) TRUE
13) TRUE
14) TRUE
15) TRUE
16) TRUE
17) TRUE
18) TRUE
19) D
20) A
21) C
22) B
23) D
24) B
25) B
26) A
27) C
28) A
29) B
30) C
31) B
32) C
33) D
34) B
35) B
36) B
37) D
38) A
39) D
40) B
41) A
42) B
43) D
44) C
45) A
46) D
47) A
48) B
49) C
50) B

51) D
52) A
53) C
54) B
55) B
56) A
57) C
58) B
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60) A
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64) C
65) A
66) B
67) B
68) B
69) B
70) D
71) C
72) D
73) D
74) C
75) C
76) D
77) C
78) B
79) C
80) C
81) A
82) D
83) D
84) Factors that may influence the decision concerning organizational form would include: amount of capital needed in relation to amount of capital that can be raised, estimated sales volume, the extent of managerial expertise, the willingness to share profits, the importance of limited liability, a desire for the permanence of the organization, the issue of double taxation.
85) One reason corporations typically exhibit a separation of ownership and management is that ownership often includes a diverse amount of relatively small investors. Thus, it would be nearly impossible to coordinate these owners into decision makers. Also, many small investors are pleased in being relieved of management responsibilities. Therefore, the quality of management is likely to be better if those managers have been hired specifically for that function. Finally, the separation minimizes managerial disruptions that would occur with changing or deceased investors. Most sole proprietorships and partnerships are smaller firms that do not need, may not be able to afford, and may not desire even if they could afford, the existence of a separate management.

86) Many investors would not be willing to commit their investment funds into projects if it were known they were risking more than those specific funds. Specifically in the case of separated ownership and management, shareholders may be unwilling to remain liable for decisions they did not have a hand in making. With the aversion to risk that is witnessed in general for many investors, it is questionable whether investors would direct their funds into financial assets that did not offer limited liability. Thus, the existence of limited liability may greatly affect the demand for corporate shares.

87) Examples of real assets for General Motors: cash, raw materials inventory, production facilities, tools and machines, finished inventory of automobiles. Examples of financial assets that could have been issued by General Motors: common stock (different classes), preferred stock, corporate bonds, bank loans, et cetera. Of course, GM could show financial assets on the left side of their balance sheet also, such as: short-term investments in government securities, contracts receivable from the financing of their automobiles, or possibly residential mortgages (GM, through its subsidiaries, is a large originator of residential mortgages, although most would eventually be sold in the secondary market).

88) Examples of the capital budgeting decision for a firm could include: a decision to replace all of the firm's personal computers, a decision to expand the size of the production facility, a decision to buy a corporate jet, a decision to expand production into two new product lines, et cetera. Examples of the financing decision for a firm could include: a decision to issue corporate bonds rather than expand a bank loan, a decision to float a new issue of common stock, a decision to denominate a loan in Japanese yen rather than Canadian dollars, a decision to roll over short-term financing rather than borrow for a longer term, et cetera.

89) Although the capital budgeting decision considers what to invest in and specifically how much to invest, this decision is importantly related to how the necessary funds should be raised. For example, if many other firms of similar risk have recently issued bonds, the supply of loanable funds may be low, which could affect the interest rate on such funds. Or, the current market value of common stock may be so low that management would prefer not to issue additional shares at this time. Alternatively, the existence of loan or bond covenants could restrict certain forms of borrowing. Finally, although certain forms of financing may appear attractive, they may not represent the targeted capital structure. Thus, elements of the financing decision need to be considered simultaneously with the capital budgeting decision.

90) Managers may attempt to maximize profits, or to maximize market share, or even to maximize their own benefits! Problems with maximizing profits can include the method of maximizing (i.e., is it in the long-run or short-run best interests of the firm?), the maintenance of product quality, ethical decision making, customer satisfaction, et cetera. Problems with market share can include economies of scale (i.e., low average cost of production), maintained profitability, increased liabilities, et cetera. Agency problems that relate to managerial compensation or perquisites that are not in the long-run interest of shareholders are another example of misguided goals.

91) Ethical decision making can have an important impact on employee attitudes, investor actions, and customer retention. Further, all of these factors can have a large impact on the bottom line. The list of potential benefits for a firm that has developed a reputation for ethical operations can be long-easier employee recruitment, lower employee turnover, easier issue of primary securities, repeat business, good word of mouth, et cetera. In other words, the actions of all stakeholders can be positively affected when they perceive the firm to be ethical in its decisions.

92) Whenever the firm's managers are different from the firm's owners, the potential exists for agency problems. Management may be taking advantage of the fact that corporate ownership is often quite diverse, such that none of the owners appears to be "minding the store." In those cases, it may be easy for top management to vote itself an excessive raise, or to redecorate the corporate suite, or to be lax on the justification of expense reports, or even to invest in projects that are "too safe." Why might managers choose safe projects? For example, the executive may have one year remaining on an employment contract and be more concerned with stable profits than with rising profits.

93) Financial management can be broken down into (1) the investment, or capital budgeting decision, and (2) the financing decision. The firm has to decide on how much to invest and which real assets to invest in, and secondly, how to raise the necessary cash.

94) Real assets include all assets used in the production or sale of the firm's products or services. Real assets can be tangible or intangible. Financial assets are securities such as shares, sold by the firm to raise money, and represent claims on the firm's real assets and the cash generated by those assets.

95) Conflicts of interest between managers and shareholders can lead to agency problems. These problems are kept in check by compensation plans that link the well-being of employees to that of the firm; by monitoring of management by the board of directors, security holders, and creditors; and by the threat of takeover.

96)

	Sole Proprietorship	Partnership	Corporation
Who owns the Business?	The manager	Partners	Shareholders
Are managers and owner(s) separate?	No	No	Usually
What is the owner's liability?	Unlimited	Unlimited	Limited
Are the owner and business taxed separately?	No	No	Yes

97) No. Most investment decisions are smaller and simpler, such as purchase of trucks, machine tools or computer systems. But the objective is to add value to the firm.

98) An income trust is an investment fund, legally known as a mutual fund trust. Mutual fund trusts sell units to investors to raise money to purchase shares and debt of operating businesses. Mutual fund trusts are not operating companies but flow-through entities, in which the earnings on the investments are not taxed at the fund level, but rather are taxed in the hands of the unit holders. Unlike typical investment funds, which invest in many different companies, an income trust invests in only one company, making a unit similar to a share. Clever lawyers and financial experts were able to structure income trusts to dramatically reduce the taxes paid by the underlying business enterprise. One way this was accomplished was by having the income trust own both the debt and the equity of the underlying corporation. This allowed the corporation to be financed with a lot of debt, reducing its taxes. Income trusts became very popular, with some corporations converting to the trust structures and other business going public as trusts. On October 31, 2006, the Canadian federal government, fearing significant loss of tax revenue, changed the rules for the taxation of income trusts, taking away their tax advantage, and the income trust boom came to a sudden end.

99) Compensation Plans, board of directors, takeover threats, specialist monitoring, legal and regulatory requirements.