

**Exam 1**  
**Sample Questions**

*INSTRUCTIONS:* Read each question carefully. After you choose an answer, you can check to see if it is correct by clicking “CHECK ANSWER” below the question.

1. Which of the following statements about the corporate form of business organization is *incorrect*?
  - a. The corporation is the easiest form of business organization to establish.
  - b. In the United States, corporations generate a significantly greater percentage of total annual sales than either partnerships or proprietorships.
  - c. Corporations generally are larger than either partnerships or proprietorships.
  - d. One of the most important features of the corporate form of business organization is that stockholders have limited liability.
  - e. None of the above.

[CHECK ANSWER](#)

2. Why is the present value of an amount to be received in the future less than the future amount?
  - a. Deflation causes investors to lose purchasing power when their dollars are invested for greater than one year.
  - b. Investors have the opportunity to earn positive rates of return, so any amount invested today should grow to a larger amount in the future.
  - c. Investments generally are not as good as those who sell them suggest, so investors usually are not willing to pay full face value for such investments, thus the price is discounted.
  - d. Because investors are taxed on the income received from investments they never will buy an investment for the amount expected to be received in the future.
  - e. None of the above is a correct answer.

[CHECK ANSWER](#)

3. According to the text, which of the following is a financial intermediary?
  - a. New York Stock Exchange
  - b. the over-the-counter (OTC) market
  - c. investment banker
  - d. mutual fund (investment) company
  - e. More than one of the above.

[CHECK ANSWER](#)

4. All else equal, if you expect to need a certain amount in the future, say, \$500 in 10 years, the *present value* of that future amount—that is, the amount you need to invest today—will be *highest* if the interest earned on such investments if compounded
  - a. daily
  - b. weekly
  - c. monthly
  - d. quarterly

- e. annually

[CHECK ANSWER](#)

5. Michael just received a prize certificate for a contest he won. The prize is \$120,000 cash. Michael does not need the cash, so he has decided to invest the prize money. If all investors have the opportunity to invest at a rate equal to 6 percent *compounded quarterly*, how much will Michael's investment be worth in five years?
- a. \$89,096.45
  - b. \$160,587.07
  - c. \$384,856.26
  - d. \$161,622.60
  - e. None of the above is correct.

[CHECK ANSWER](#)

6. Which of the following statements concerning "agency problems" is *most* correct?
- a. Regardless of economic conditions, if a firm's stock price falls during the year, this indicates that the firm's managers *must not* be acting in the best interests of the shareholders.
  - b. One method of controlling agency problems is to engage in the taking of "poison pills."
  - c. One of the best means to control agency problems is to require the managers and other important decision makers of the firm to also be owners of the firm.
  - d. Agency problems probably would not exist if the important decisions of a firm were made by persons who *have no vested interests*, such as ownership, in the firm.
  - e. None of the above is a correct statement.

[CHECK ANSWER](#)

7. Which of the following statements concerning a firm's quest to maximize wealth is correct?
- a. In extremely competitive industries, we would expect firms would voluntarily engage in many socially beneficial projects to try to maximize their stocks' values.
  - b. Actions that maximize a firm's stock price are inconsistent with maximizing social welfare.
  - c. The concepts of social responsibility and ethical responsibility on the part of corporations are completely different and neither is relevant in maximizing stock price.
  - d. In a competitive market, if a group of firms does not spend resources making social welfare improvements, but another group does, in general, this will not affect the second group's ability to attract funds.
  - e. If the government did not mandate socially responsible corporate actions, such as those relating to product safety and fair hiring practices, most firms in competitive markets probably would not pursue such policies voluntarily.

[CHECK ANSWER](#)

8. Following is information about a company that Sue Brittany is analyzing for her boss:

$$\text{Total assets turnover} = \frac{\text{Sales}}{\text{Total assets}} = 3.0 \times$$

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}} = 0.40 = 40.0\%$$

Total liabilities = \$500,000

What were the company's sales?

- a. \$1,250,000
- b. \$1,500,000
- c. \$ 200,000
- d. \$3,750,000
- e. None of the above.

[CHECK ANSWER](#)

9. If the interest rate in the financial markets for all investments is zero, the present value of an annuity equal to \$1,000 per year to be received at the beginning of the next five years would be
- a. greater than \$5,000.
  - b. equal to \$5,000.
  - c. less than \$5,000.
  - d. There is not enough information to answer this question.
  - e. None of the above is the correct answer.

[CHECK ANSWER](#)

10. When constructing a Statement of Cash Flows, which of the following actions would be considered a *use* of cash?
- a. decrease in dividend payments
  - b. increase in accounts receivable
  - c. decrease in plant and equipment
  - d. increase in common equity
  - e. All of the above are uses of cash.

[CHECK ANSWER](#)

11. *Everything else equal*, if a firm wants to *reduce* its debt ratio, which of the following actions should be taken? THINK before answering.

$$\text{Total assets turnover} = \frac{\text{Sales}}{\text{Total assets}} = 3.0 \times$$

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}} = 0.40 = 40.0\%$$

- a. Pay off some existing debt with cash.
- b. Issue new debt and use the proceeds to pay off some of the old (existing) debt.
- c. Issue additional debt.
- d. Purchase new equipment using cash.
- e. More than one of the above actions will reduce a firm's debt ratio.

[CHECK ANSWER](#)

12. The *effective annual return* (EAR) for an investment that pays 10 percent interest compounded *quarterly* is
- 10.00%
  - 11.04%
  - 10.38%
  - This question cannot be answered without knowing the dollar amount of the investment.
  - None of the above is correct.

[CHECK ANSWER](#)

13. Assume you just won the Florida lotto and must make a choice between taking a lump-sum (single) payment equal to \$6 million today or 30 annual payments equal to \$400,000. If you take the annual payments, *the first payment will be given to you today*. Which alternative should you select if your opportunity cost is 5.5 percent compounded annually?
- The \$6 million lump-sum payment is better, because it is always better to receive money today than to wait until some future period regardless of the amounts involved.
  - The \$6 million lump-sum payment is better, because it is greater than the present value of the \$400,000 annuity, which equals \$5,813,498.
  - The \$400,000 annuity should be selected because its present value, which equals \$6,133,240, is greater than the \$6 million lump-sum amount that would be received today.
  - The \$6 million lump-sum payment should be selected because it can be invested at 5.5 percent, and thus will grow to an amount in the future that is greater than the present value of the \$400,000 annuity.
  - The two choices are identical, so you should flip a coin to make the decision.

[CHECK ANSWER](#)

14. Eight years ago Steve received a fairly large amount of money from his relatives when he graduated from college. At that time, he invested all the money in a mutual fund. Today, when he looked at the statement he just received from the mutual fund company, he noticed that his investment has a value that is four times greater than the amount he originally invested. If the only investment in the mutual fund was the graduation money Steve invested eight years ago, what is the average rate of return that he has earned on his investment?
- approximately 9%
  - approximately 19%
  - 32%
  - This question cannot be answered without knowing the dollar amount that was invested by Steve.
  - None of the above is a correct answer.

[CHECK ANSWER](#)

15. The amount reported on the balance sheet in the retained earnings account represents the amount the firm has

- a. accumulated over the years because it chose to retain some interest that was owed to creditors to reinvest these funds in the firm to achieve growth.
- b. available to invest in capital budgeting projects in the current year.
- c. accumulated over the years because it chose to retain income, which could have otherwise been paid out as dividends to common stockholders, to fund growth.
- d. in its cash account, which can be paid as dividends in the current period.
- e. None of the above is correct.

[CHECK ANSWER](#)