Fundamentals of Corporate Finance 2026 Release 1st edition Brealey Test Bank

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Answers are located at the end of each chapter.

1) Financial analysts are involved in monitoring the risk associated with investment projects and financing decisions.
   - ⊙ true
   - ⊙ false

2) Established firms can create value by developing long-term relationships and maintaining a good reputation.
   - ⊙ true
   - ⊙ false

3) Which one of the following gives a corporation its permanence?
   A) Founder Equity
   B) Limited liability
   C) Corporation taxation
   D) Separation of ownership and control

4) A manager's compensation plan that offers financial incentives for increases in quarterly profitability may create agency problems in that:
   A) the managers are not motivated by personal gain.
   B) the board of directors may claim the credit.
   C) short-term, not long-term profits become the focus.
   D) investors desire stable profits.

5) Which of the following is a *capital budgeting* decision?
   A) Should the firm borrow money from a bank or sell bonds?
   B) Should the firm shut down an unprofitable factory?
   C) Should the firm buy or lease a new machine that it is committed to acquiring?
   D) Should the firm issue preferred stock or common stock?

6) The separation of ownership and management is one distinctive feature of both corporations and sole proprietors.

⊚ true
⊚ false

7) Which one of these is *not* considered to be a security?

A) Shares of GE stock
B) A bond traded in the financial market
C) A mortgage loan issued and held by a bank
D) A convertible bond issued to the public

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

⊚ true
⊚ false

9) Which one of these statements is correct?

A) Financial managers have a fiduciary duty to stockholders.
B) Financial managers are concerned only with funds that flow to investors.
C) The chief financial officer generally reports directly to the corporate treasurer.
D) The corporate controller is primarily responsible for overseeing a firm's cash functions.

10) Investment banks like Morgan Stanley or Goldman Sachs:

A) collect deposits and relend the cash to corporations and individuals.
B) help companies sell their securities to investors.
C) design and sell insurance policies for businesses.
D) lend to corporations and investors in commercial real estate.

11) In the case of a limited liability partnership, ______________ has/have limited liability.

A) only some of partners
B) only the managing partner
C) all of the partners
D) none of the partners

12) Which one of the following statements more accurately describes the controller than the treasurer?

A) Reports directly to the chief executive officer
B) Monitors capital expenditures to make sure that they are not misappropriated
C) Responsible for investing the firm's spare cash
D) Responsible for arranging any issue of common stock

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

⊚ true
⊚ false

14) A well-designed compensation package can help a firm achieve its goal of maximizing market value.

⊚ true
⊚ false

15) Which one of these determines the minimum acceptable rate of return on a capital investment?

A) The alternative investment opportunities available to investors
B) The profit margin of the existing firm
C) The rate of return on the firm's outstanding shares
D) The rate of return on risk-free debt securities

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

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

17) Which one of these is a disadvantage of the corporate form of business?

A) Access to capital

B) Unlimited personal liability for owners

C) Limited firm life

D) Legal requirements

18) Financial assets have value because they are claims on the firm's real assets and the cash that those assets will produce.

⦾ true

⦾ false

19) Ethical decision making in business:

A) reduces the firm's profits.

B) requires adherence to implied rules as well as written rules.

C) is not in the best interests of shareholders.

D) is less important than good capital budgeting decisions.

20) Corporate investors are responsible for deciding whether to reinvest in the firm’s operations or take the profits as a distribution.

⦾ true

⦾ false

21) Financial managers should only accept investment projects that:

A) increase the current profits of the firm.

B) can increase the firm's market share.

C) earn a higher rate of return than the firm currently earns on its existing projects.

D) earn a higher rate of return than shareholders can get by investing on their own.

22) Which of the following is a disadvantage to incorporating a business?

A) Easier access to financial markets

B) Limited liability

C) Becoming a permanent legal entity

D) Profits taxed at the corporate level and the shareholder level

23) When a corporation fails, the maximum that can be lost by an individual shareholder is:

A) the amount of their initial investment.
B) the amount of their share of the profits.
C) their proportionate share required to pay the corporation's debts.
D) the amount of their personal wealth.

24) Real assets can be intangible assets.

⊙ true
⊙ false

25) A corporate board of directors should provide support for the top management team:

A) under all circumstances.
B) in all decisions related to cash dividends.
C) only when the board approves of management's actions.
D) under no circumstances; it is an adversarial system.

26) An IOU ("I owe you") from your brother-in-law is a financial asset.

⊙ true
⊙ false

27) Shareholders welcome higher short-term profits even when they damage long-term profits.

⊙ true
⊙ false

28) Corporations that issue financial securities such as stock or debt obligations to the public do so primarily to:

A) increase sales.
B) become profitable.
C) increase their access to funds.
D) avoid double taxation of their profits.

29) Sole proprietorships resolve the issue of agency problems primarily by:

A) avoiding excessive expense accounts.

B) discharging those who violate the rules.

C) allowing owners to share the cost of their actions with others.

D) forcing owners to bear the full cost of their actions.

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

A) the partnership itself.

B) the partners individually.

C) both the partnership and the partners.

D) neither the partnership nor the partners.

31) Which of the following is NOT a claim on the assets of a company?

A) Bond

B) Patent

C) Promissory note

D) Loan

32) A corporate director:

A) is selected by and can be removed by management.

B) can be voted out of power by the shareholders.

C) has a lifetime appointment to the board.

D) is selected by a vote of all corporate stakeholders.

33) Which one of the following can best be characterized as an agency problem?

A) Differing opinions among directors as to the merits of paying a higher dividend

B) Differing incentives between managers and owners

C) Persistently late delivery times by a major supplier

D) Geological problems in the company's new gold mine

34) Sole proprietorships face the same agency problems as those associated with corporations.

⦾ true

⦾ false

35) Unlimited liability is faced by the owners of:

A) corporations.

B) partnerships and corporations.

C) sole proprietorships and general partnerships.

D) all forms of business organization.

36) Which one of the following forms of compensation is most apt to align the interests of managers and shareholders?

A) A fixed salary

B) A salary that is linked to current company profits

C) A salary that is paid partly in the form of the company's shares

D) A salary that is linked to the company's market share

37) Which of the following organizations is least likely to use a professional corporation (PC) structure?

A) Accountants

B) Doctors

C) Lawyers

D) Manufacturers

38) Which of the following is *least* likely to be discussed in the articles of incorporation?

A) How the firm is to be financed

B) The purpose of the business

C) The price range of the shares of stock

D) How the board of directors is to be structured

39) Which of the following is NOT a requirement of the Sarbanes-Oxley Act of 2002?

A) The compensation committee must be appointed by an outside director

B) The CEO and CFO must sign off personally on corporate accounting results

C) The board of directors must meet in executive session

D) More board of directors members are independent

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

- ⊚ true
- ⊚ false

41) The Dodd-Frank financial reform law in 2010 granted shareholders a binding vote on executive compensation.

- ⊚ true
- ⊚ false

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

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

43) Agency problems can *least* be controlled by:

A) establishing good internal controls and procedures.
B) designing compensation packages that align manager's goals with those of the shareholders.
C) good systems of corporate governance.
D) electing senior managers to the board of directors.

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

- ⊚ true
- ⊚ false

45) Which one of these best defines the objective of a well-functioning financial market?

A) Establishing accurate security prices
B) Creating higher security prices
C) It is not in the best interests of shareholders.
D) Increasing shareholder value by any means possible

46) A chief financial officer would typically:

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

47) Which of the following appears to be the most appropriate goal for corporate management?

A) Maximizing market value of the company's shares
B) Maximizing the company's market share
C) Maximizing the current profits of the company
D) Minimizing the company's liabilities

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

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

49) A firm with spare cash:

A) should always reinvest it in new equipment.
B) should pay it out to shareholders unless the firm can earn a higher rate of return on the cash than the shareholders can earn by investing in the capital market.
C) should invest it in the safest projects available.
D) should always invest it in U.S. equities since these securities have a higher rate of return than Treasury bills.

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

A) Treasurer
B) Controller
C) Chief operating officer
D) Board of directors

51) Which one of these is a capital budgeting decision?

A) Deciding between issuing stock or debt securities

B) Deciding whether or not the firm should go public

C) Deciding if the firm should repurchase some of its outstanding shares

D) Deciding whether to buy a new machine or repair the old machine

52) A financial analyst in a corporation may be involved with all of the following *EXCEPT:*

A) analyzing a new investment project.

B) monitoring risk.

C) managing investment of the company's cash.

D) purchasing the firm's plant and equipment.

53) Deltas's issuance of a $1.0 billion bond is a financing decision.

⊚ true

⊚ false

54) While control of large public companies in the United States is exercised through the board of directors and pressure from the stock market; in many other countries the stock market is less important and control shifts to major stockholders, typically banks and other companies.

⊚ true

⊚ false

55) Facebook's decision to spend $700 million to acquire Instagram is an investment decision.

⊚ true

⊚ false

56) Which one of the following is a real asset?

A) A patent

B) A personal IOU

C) zero-coupon bond

D) A share of stock

57) A block holder is commonly defined as an investor who:

A) owns 5% or more of a firm's outstanding shares.
B) invests in more than one firm within the same industry.
C) is another corporation.
D) is also one of the firm's managers or directors.

58) One continuing problem with managerial incentive compensation plans is that:

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

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

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

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

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

61) Ethical decision making by management has a payoff for shareholders in terms of:

A) improved capital structure.
B) enhanced firm reputation value.
C) increased managerial benefits.
D) higher current dividend payments.

62) The separation of ownership and management is one distinctive feature of corporations.

- ⊙ true
- ⊙ false

63) The legal "life" of a corporation is:

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

64) If a project's value is less than its required investment, then the project is financially attractive.

- ⊙ true
- ⊙ false

65) Boards of directors are generally appointed by the firm's senior officers.

- ⊙ true
- ⊙ false

66) A corporation is considered to be closely held when:

A) only a few shareholders exist.
B) the market value of the shares is stable.
C) it operates in a small geographic area.
D) management also serves as the board of directors.

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

- ⊙ true
- ⊙ false

68) Firms can alter their capital structure by:

A) not accepting any new capital budgeting projects.

B) investing in intangible assets.

C) issuing stock to repay debt.

D) becoming a limited liability company.

69) "Double taxation" refers to:

A) all partners paying equal taxes on profits.

B) corporations paying taxes on both dividends and retained earnings.

C) paying taxes on profits at the corporate level and dividends at the personal level.

D) the fact that marginal tax rates are doubled for corporations.

70) Which one of the following is a financial asset?

A) A corporate bond

B) A machine

C) A patent

D) A factory

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

A) financing decision.

B) investment decision.

C) capital budgeting decision.

D) capital expenditure decision.

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

A) Lavish spending on expense accounts

B) Plush remodelling of the executive suite

C) Excessive avoidance of taxes

D) Executive incentive compensation plans

73) The best criterion for success in a capital budgeting decision would be to:
- A) minimize the cost of the investment.
- B) maximize the number of capital budgeting projects.
- C) maximize the value added to the firm.
- D) finance all capital budgeting projects with debt.

74) Which form of organization provides limited liability for the firm but yet allows the professionals working within that firm to be sued personally?
- A) Limited liability partnership
- B) Limited liability company
- C) Sole proprietorship
- D) Professional corporation

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

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

77) Which one of the following would be considered a capital budgeting decision?
- A) Planning to issue common stock rather than issuing preferred stock
- B) Deciding to expand into a new line of products, at a cost of $5 million
- C) Repurchasing shares of common stock
- D) Issuing debt in the form of long-term bonds

78) A common problem for closely held corporations is:

A) the lack of access to substantial amounts of capital.
B) the restriction that shareholders receive only one vote each.
C) the separation of ownership and management.
D) an abundance of agency problems.

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

A) Government
B) Customers
C) Competitors
D) Employees

80) The overall goal of capital budgeting projects should be to:

A) decrease the firm's reliance on debt.
B) increase the firm's sales.
C) increase the firm's outstanding shares of stock.
D) increase the wealth of the firm's shareholders.

81) When the management of a business is conducted by individuals other than the sole owners, the business is most likely to be a:

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

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

A) Internal auditing
B) Credit management
C) Banking relationships
D) Insurance

83) A major disadvantage of partnerships is that they have double taxation of profits.

- ⦾ true
- ⦾ false

84) In which type of organizational structure is the agency problem least likely to exist?

A) Limited liability corporation
B) Partnership
C) Professional corporation
D) Sole proprietorship

85) GlaxoSmithKline's spending of $3.6 billion on research and development of new drugs is a capital budgeting decision but not a financing decision.

- ⦾ true
- ⦾ false

86) Short selling involves selling a security:

A) you do not own.
B) that you have owned for less than one year.
C) at a price below current market value.
D) for less than you originally paid to purchase it.

87) An example of a firm's financing decision would be:

A) acquiring a competitive firm.
B) determining how much to pay for a specific asset.
C) issuing 10-year versus 20-year bonds.
D) deciding whether or not to increase the price of its products.

88) Which of the following is a real asset?

A) A patent
B) A share of stock issued by Bank of New York
C) An IOU ("I owe you") from your brother-in-law
D) A mortgage loan taken out to help pay for a new home

89) Which of these duties are responsibilities of the corporate treasurer?

A) Financial statements and taxes
B) Cash management and tax reporting
C) Cash management and banking relationships
D) Raising capital and financial statements

90) The term "capital structure" refers to:

A) the mix of long-term debt and equity financing.
B) the length of time needed to repay debt.
C) whether or not the firm invests in capital budgeting projects.
D) the types of assets a firm acquires.

91) Which one of these statements correctly applies to a limited partnership?

A) All partners share the daily management duties.
B) All partners enjoy limited personal liability.
C) General partners have unlimited personal liability.
D) Taxes are imposed at both the firm and the personal level on profits earned.

92) Corporations are referred to as public companies when their:

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

93) Which one of these statements is correct?

A) A dollar received next year has the same value as a dollar received today.
B) Risky cash flows are more valuable than certain cash flows.
C) Smart investment decisions create more value than smart financing decisions.
D) Corporate governance is irrelevant.

94) In a large corporation, preparation of the firm's financial statements would most likely be conducted by the:

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

95) A firm's reputation:

A) has no value.
B) is an important firm asset.
C) is irrelevant to shareholders.
D) can be easily restored once damaged.

96) The primary goal of any company should be to maximize current period profits.

⦾ true
⦾ false

97) Making good investment and financing decisions is the chief task of the financial manager.

⦾ true
⦾ false

Answer Key

Test name: Chapter 01

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

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

78) A
79) C
80) D
81) A
82) A
83) FALSE
84) D
85) TRUE
86) A
87) C
88) A
89) C
90) A
91) C
92) C
93) C
94) B
95) B
96) FALSE
97) TRUE