

## Question: 1

Lisa is a limited partner in a limited partnership. Jen, one of the other limited partners, is seeking to sell her interest in the partnership to Karen and allow Karen to become a new limited partner. Which of the following statements is true?

- A. Lisa may engage in the management of the limited partnership without losing her limited liability.
- B. Jen may transfer her interest and make Karen a new limited partner without the approval of the other partners.
- C. Jen may withdraw from the limited partnership without giving notice to the partnership.
- D. Lisa has a right to vote on the transferring of interest to and admission of Karen as a limited partner.

**Answer: D**

Explanation:

Choice "d" is correct. Limited partners have the right to vote on the transfer of interest and admission of a new partner. Admission of a new partner requires unanimous consent. Choice "a" is incorrect. A limited partner who acts as a general partner loses her limited liability status to those she acted as a general partner towards. Choice "b" is incorrect. Partners can freely transfer their interests in profits and losses to third parties, but the third party cannot become a limited partner without the unanimous consent of the other partners.

Choice "c" is incorrect. Limited partners must give 6 months notice of withdrawal in absence of an agreement to the contrary.

## Question: 2

The use of an accelerated method instead of the straight-line method of depreciation in computing the net present value of a project has the effect of:

- A. Raising the hurdle rate necessary to justify the project.
- B. Lowering the net present value of the project.
- C. Increasing the present value of the depreciation tax shield.
- D. Increasing the cash outflows at the initial point of the project.

**Answer: C**

Explanation:

Rule: The greater the depreciation expense, the greater the depreciation tax shield.

Deprecation Tax Shield =

Deprecation Expense \* Marginal Tax Rate

Choice "c" is correct. Use of an accelerated method instead of the straight-line method of depreciation in

computing the NPV of a project has the effect of increasing the PV of the depreciation tax shield.

Choice "a" is incorrect. Depreciation method does not affect the hurdle rate. The hurdle rate is independently selected by management.

Choice "b" is incorrect. Using an accelerated method instead of the straight-line method of depreciation

will increase the present value of the depreciation tax shield and therefore increase the net present value of the project.

Choice "d" is incorrect. Depreciation method does not affect cash outflows at the initial point of the project.

### Question: 3

The theory underlying the cost of capital is primarily concerned with the cost of:

- A. Long-term funds and old funds.
- B. Short-term funds and new funds.
- C. Long-term funds and new funds.
- D. Any combination of old or new, short-term or long-term funds.

**Answer: D**

Explanation:

Choice "d" is correct. The cost of capital considers the cost of all funds - whether they are short-term, long-term, new or old.

Choices "a", "b", and "c" are incorrect, per above.

### Question: 4

In 1992, Anchor, Chain, and Hook created ACH Associates, a general partnership. The partners orally agreed that they would work full time for the partnership and would distribute profits based on their capital contributions. Anchor contributed \$5,000; Chain \$10,000; and Hook \$15,000.

For the year ended December 31, 1993, ACH Associates had profits of \$60,000 that were distributed to the partners. During 1994, ACH Associates was operating at a loss. In September 1994, the Partnership dissolved.

In October 1994, Hook contracted in writing with Ace Automobile Co. to purchase a car for the partnership.

Hook had previously purchased cars from Ace Automobile Co. for use by ACH Associates partners. ACH

Associates did not honor the contract with Ace Automobile Co. and Ace Automobile Co. sued the partnership and the individual partners.

Determine whether (A) or (B) is correct. Select the answer that corresponds to the correct statement.

- A. ACH Associates and Hook would be the only parties liable to pay any judgment recovered by Ace Automobile Co.
- B. Anchor, Chain, and Hook would be jointly and severally liable to pay any judgment recovered by

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Ace Automobile Co.

**Answer: B**

Explanation:

Choice "b" is correct. Since Ace brought suit against both the partnership and the individual partners, If judgment is rendered against the partnership, all partners could be held jointly and severally liable.

### Question: 5

Which one of the following is not a characteristic of a negotiable certificate of deposit?  
Negotiable certificates of deposit:

- A. Have a secondary market for investors.
- B. Are regulated by the Federal Reserve System.
- C. Are usually sold in denominations of a minimum of \$100,000.
- D. Have yields considerably greater than bankers' acceptances and commercial paper.

**Answer: D**

Explanation:

Choice "d" is correct. Negotiable CDs generally carry interest rates slightly lower than bankers' acceptances (which are drafts drawn on deposits at a bank) or commercial paper (which is unsecured debt issued by credit worthy customers).

Choice "a" is incorrect. Negotiable CDs have a formal secondary market.

Choice "b" is incorrect. Negotiable CDs are a product of the banking industry, which is regulated by The Federal Reserve Board.

Choice "c" is incorrect. Negotiable CDs are usually sold in denominations of a minimum of \$100,000.

### Question: 6

The president of a company has signed a \$10 million contract with a construction company to build a new corporate office. Which of the following corporate documents sets forth the scope of authority under which this transaction is governed?

- A. Certificate of Incorporation.
- B. Charter.
- C. Bylaws.
- D. Proxy statement.

**Answer: C**

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Explanation:

Choice "c" is correct. The bylaws usually contain the rules for running the corporation. Choices "a" and "b" are incorrect. These are possible choices, but not as good an answer as "c". A corporation's articles of incorporation (called a charter in a few states) must set out certain information relevant to formation

of the corporation, but it may include any other information that it is not illegal. However, usually details about intracorporate power are set out in bylaws rather than in the articles or charter.

Choice "d" is incorrect. A proxy statement is a request to shareholders to allow their shares to be voted by a specified person in a specified way. It has nothing to do with a corporate president's authority.

### Question: 7

Which of the following is incorrect with regard to value chain analysis?

- A. Value chain analysis must be used in conjunction with the strategic plan of the organization.
- B. Value chain analysis is critical to assessing the competitive advantage of a firm.
- C. Value chain analysis is a strategic tool that assists the firm in determining how important the perceived value of the buyers is with respect to the market the firm operates in.
- D. The value chain starts with the firm and goes all the way through to the end users of the product.

**Answer: D**

Explanation:

Choice "d" is an incorrect statement and the correct choice. The best description of a value chain is That value starts with the suppliers who provide the raw materials for a production process, continues with the

firm and its strategic plan, continues with the value created by the customers, and then ends with the disposal and recycling of the materials.

Choices "a", "b", and "c" are incorrect, as all are correct statements with regard to value chain analysis.

### Question: 8

An increase in government spending will tend to cause:

- A. Real GDP to fall and unemployment to rise.
- B. Real GDP to rise and unemployment to fall.
- C. Real GDP to rise and unemployment to rise.
- D. Real GDP to fall and unemployment to fall.

**Answer: B**

Explanation:

Choice "b" is correct. An increase in government spending causes an increase in aggregate demand (i.e.,

causes the aggregate demand curve to shift right). As a result, an increase in government spending causes real GDP to rise and unemployment to fall.

Choice "a" is incorrect. Real GDP will rise, not fall.

Choice "c" is incorrect. Unemployment will fall, not rise.

Choice "d" is incorrect. Real GDP will rise, not fall.

## Question: 9

Corbin Inc. can issue three-month commercial paper with a face value of \$1,000,000 for \$980,000.

Transaction costs would be \$1,200. The effective annualized percentage cost of the financing, based on a 3 60-day year, would be:

- A. 2.16%
- B. 8.48%
- C. 8.65%
- D. 8.00%

**Answer: C**

Explanation:

Choice "c" is correct. The cost to issue the commercial paper is the \$20,000 original issue discount (\$1 million - \$980,000), plus transaction costs of \$1,200 for a total of \$21,200. Therefore, it costs \$21,200 to borrow \$980,000 for 3 months. The 3-month interest cost is 2.16% ( $\$21,200 / \$980,000$ ).

The annual interest cost is 8.65%

Choices "a", "b", and "d" are incorrect, per the above calculation.

## Question: 10

A project's net present value, ignoring income tax considerations, is normally affected by the:

- A. Proceeds from the sale of the asset to be replaced.
- B. Carrying amount of the asset to be replaced by the project.
- C. Amount of annual depreciation on the asset to be replaced.
- D. Amount of annual depreciation on fixed assets used directly on the project.

**Answer: A**

Explanation:

Choice "a" is correct. A project's net present value is a function of current and future cash flows, including proceeds from the sale of the old asset.

Choice "b" is incorrect. A project's net present value is a function of current and future cash flows. The carrying amount of the asset does not affect cash flows.

Choice "c" is incorrect. A project's net present value is a function of current and future cash flows. Depreciation is a noncash item and does not affect cash flows.

Choice "d" is incorrect. A project's net present value is a function of current and future cash flows. Depreciation is a noncash item and does not affect cash flows.

## Question: 11

Youngsten Electric is contemplating new projects for the next year that will require \$30,000,000 of new financing. In keeping with its capital structure, Youngsten plans to use debt & equity financing as follows:

\* Issue \$10,000,000 of 20-year bonds at a price of 101.5, with a coupon of 10%, and flotation costs of 2.5% of par value.

\* Use internal funds generated from earnings of \$20,000,000.

The equity market is expected to earn 15%. U.S. treasury bonds currently are yielding 9%. The beta coefficient for Youngsten's common stock is estimated to be .8. Youngsten is subject to a 40% corporate

income tax rate. Youngsten has a price/earnings ratio of 10, a constant dividend payout ratio of 40%, and

an expected growth rate of 12%.

An analysis of Youngsten's planned equity financing using Capital Asset Pricing Model (or Security Market Line) would incorporate only the:

- A. Expected market earnings, the current U.S. Treasury bond yield, and the beta coefficient.
- B. Expected market earnings and the price' earnings ratio.
- C. Current U.S. Treasury bond yield, the price/earnings ratio, and the beta coefficient.
- D. Current U.S. Treasury bond yield and the dividend payout ratio.

**Answer: A**

Explanation:

Choice "a" is correct. The capital asset pricing model formula is:

$$R = RF + B (RM - RF)$$

Where:

R = Required return rate on equity

RF = Risk free rate earned on U.S. treasury bonds.

B = Beta coefficient

RM = Expected market return (earnings).

Choices "b", "c", and "d" are incorrect, per the above Explanation:.

## Question: 12

If a firm increases its cash balance by issuing additional shares of common stock, working capital:

- A. Remains unchanged and the current ratio remains unchanged.
- B. Increases and the current ratio remains unchanged.
- C. Increases and the current ratio decreases.
- D. Increases and the current ratio increases.

**Answer: D**

Explanation:

Choice "d" is correct. If a firm increases its cash balance by issuing additional shares of common stock, working capital increases and the current ratio increases.

Illustration	Before	+	Stock Sale	=	After
Current Assets	300		100		400
Current Liabilities	<u>100</u>		<u>    </u>		<u>100</u>
Working Capital	<u>200</u>	+	<u>100</u>	=	<u>300</u>
Current Ratio	3 To 1				4 To 1
Equity	<u>100</u>	+	<u>100</u>	=	<u>200</u>

**Question: 13**

A working capital technique that increases the payable float and, therefore, delays the outflow of cash is:

- A. Concentration banking.
- B. A draft.
- C. A lock-box system.
- D. The use of a local post office box.

**Answer: B**

Explanation:

Choice "b" is correct. A draft is a working capital technique that increases the payable float and, therefore, delays the outflow of cash.

Each of the three following choices accelerate the flow of cash and/or data:

Choice "a" is incorrect. Concentration banking automatically channels funds from every source of the business into a single usable account, thus quickly identifying available funds each day, and moving them to accounts that have funding requirements that day, and investing the remainder in short-term, interestbearing instruments until needed.

Choice "c" is incorrect. A lock-box system is simply a central collection location that receives payment

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checks (generally, the bank where a central checking account is maintained by the firm).  
Choice "d" is incorrect. The use of a local post office box allows more rapid access to mail than actual delivery to a street address.

### Question: 14

Which of the following statements regarding the existence of substitute products is true?

- A. The impact of substitutes will have more of an effect on the competitive environment of a firm if The substitutes are readily available for customers to obtain.
- B. When the cost of buyers switching to new products is high, the effect of substitutes on the Competitive environment of a firm is high.
- C. If many close substitutes exist, buyers have little choice of products and may be willing to pay a Higher price for the products that are available.
- D. If substitutes have equal performance and are priced at or below the firm's product, the Competitive force of substitutes with respect to the firm is weak.

**Answer: A**

Explanation:

Choice "a" is correct. The impact of substitutes will have more of an effect on the competitive environment

of a firm if the substitutes are readily available to consumers.

Choice "b" is incorrect. When the cost of buyers switching to new products is low (not high), the effect of substitutes on the competitive environment of a firm is high.

Choice "c" is incorrect. If few (not many close) substitutes exist, buyers have little choice of products And may be willing to pay a higher price for the products that are available.

Choice "d" is incorrect. If substitutes have equal performance and are priced at or below the firm's product, the competitive force of substitutes with respect to the firm is strong (not weak).

### Question: 15

Demand for a product tends to be price inelastic if:

- A. The product is considered a luxury item.
- B. Few good complements for the product are available.
- C. People spend a large share of their income on the product.
- D. Few good substitutes are available for the product.

**Answer: D**

Explanation:

Choice "d" is correct. Demand for a product tends to be price inelastic if few good substitutes are available

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for the product. Even if price increases, consumers are then unable to switch to substitute goods, because there aren't any.

Choice "a" is incorrect. Luxury items may have good substitutes available.

Choice "b" is incorrect. Complementary goods are those whose demand fluctuates in unison; substitute

goods are more relevant here.

Choice "c" is incorrect. If consumers spend a large share of their income on the product, they will be Very sensitive to any price changes and hence product demand would be more "elastic."

## Question: 16

A limited liability partnership must:

- A. File registration documents with the state in which it is formed.
- B. Hold all partners personally liable for all debts and liabilities of the partnership and partners.
- C. Carry no less than one hundred thousand dollars of property insurance.
- D. Not have partners with professional licenses.

**Answer: A**

Explanation:

Choice "a" is correct. Rule: To have limited liability, an LLP must file with the state a registration statement

usually referred to as Articles of LLP. It is generally designed for professionals who desire to be partners with other like professionals and yet not have liability for the malpractice of their partners.

Some states

require that personal liability insurance (not property insurance) be carried to protect those harmed by the professionals' malpractice. Choices "b", "c", and "d" are incorrect, per the above rule.