

Question #1 of 78

Question ID: 434352

Liquidating short-term assets and renegotiating debt agreements are *best* described as a firm's:

- ☐ A) pulls and drags on liquidity.
- ☐ B) primary sources of liquidity.
- ☒ C) secondary sources of liquidity.

Explanation

Secondary sources of liquidity include liquidating short-term or long-lived assets, negotiating debt agreements (i.e., renegotiating), or filing for bankruptcy and reorganizing the company. Primary sources of liquidity are the sources of cash a company uses in its normal operations. Pulls and drags on liquidity refer to factors that weaken a company's liquidity position.

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Question ID: 414895

Assume that a 30-day commercial paper security has a holding period yield of 0.80%. The bond equivalent yield of this security is:

- ☐ A) 9.60%.
- ☒ B) 9.73%.
- ☐ C) 10.12%.

Explanation

$$\text{BEY} = \text{HPY} \times (365/\text{days})$$

$$\text{BEY} = 0.80\% \times (365/30) = 9.73\%$$

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Question ID: 414886

An analyst who is evaluating a firm's working capital management would be *least likely* to be concerned if the firm's:

- ☐ A) total asset turnover is lower than its industry average.
- ☐ B) number of days of inventory is higher than that of its peers.
- ☒ C) operating cycle is shorter than that of its peers.

Explanation

A shorter operating cycle will lead to a shorter cash conversion cycle, other things equal, which is an indication of better working capital management. Higher days inventory on hand, compared to peer company averages, will lengthen the cash conversion cycle, an indication of poorer working capital management. Good working capital management would tend to increase a firm's total asset turnover since a given amount of sales can be supported with less working capital (less current assets).

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Question ID: 414908

Corporate governance defines the appropriate rights, role, and responsibilities of:

- ☐ A) management only.
- ☐ B) management and the board of directors.
- ☒ C) management, the board of directors, and shareholders.

Explanation

Corporate governance defines the appropriate rights, roles, and responsibilities of a corporation's management, the board of directors, and shareholders.

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Question ID: 414899

Which of the following strategies is *most likely* to be considered good payables management?

- ☐ A) Taking trade discounts only if the firm's annual return on short-term investments is less than the discount percentage.
- ☐ B) Paying trade invoices on the day they arrive.
- ☒ C) Paying invoices on the last possible day to still get the supplier's discount for early payment.

Explanation

Paying invoices on the last day to get a discount (for early payment) is often the most advantageous strategy for a firm. If the annualized percentage cost of not taking advantage of the discount is less than the firm's short-term cost of funds, it would be advantageous to pay on the due date. However, the discount percentage is not an annualized rate, so it cannot be compared directly to the firm's *annual* return on short-term investments. Paying prior to the discount cut-off date or prior to the due date sacrifices interest income for no advantage.

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Question ID: 414922

Investors have a duty to determine whether the board has properly established committees of independent board members to help carry out various board functions. Which of the following statements about the "audit committee" is *least* accurate?

- ☐ A) The audit committee should ensure that the independent auditors have authority over the audit of the entire corporate group, which includes foreign subs and affiliates.
- ☒ B) Firm management is responsible for hiring and supervising the independent external auditors, but the audit committee has strict oversight responsibilities.
- ☐ C) The audit committee should ensure that the audit is conducted consistent with generally accepted auditing standards (GAAS).

Explanation

The *audit committee* is responsible for hiring and supervising the independent external auditors, in order to ensure that the auditors' priorities are consistent with the best interests of shareholders. Both remaining statements are correct.

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Question ID: 414887

The *least* appropriate security for investing short-term excess cash balances would be:

- ✓ **A) preferred stock.**
- X **B) bank certificates of deposit.**
- X **C) time deposits.**

Explanation

While adjustable-rate preferred is an appropriate security for short-term investment of excess cash balances, other preferred shares are not. Bank certificates of deposit and time deposits can be for appropriately short periods.

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Question ID: 414896

A banker's acceptance that is priced at \$99,145 and matures in 72 days at \$100,000 has a(n):

- X **A) bond equivalent yield greater than its effective annual yield.**
- X **B) discount yield greater than its bond equivalent yield.**
- ✓ **C) money market yield greater than its discount yield.**

Explanation

The money market yield is the holding period yield times $360/72$ and is always greater than the discount yield which is the actual discount from face value times $360/72$, since the holding period yield is always greater than the percentage discount from face value. A security's discount yield and its money market yield are always less than its bond equivalent yield, and its effective annual yield is always greater than its bond equivalent yield.

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Question ID: 460675

Regarding shareholder voting, interests of shareowners are *least likely* served by a firm that:

- X **A) has a third party tabulate votes and requires an audit of the tabulation.**
- ✓ **B) requires attendance at annual meetings in order to vote shares.**
- X **C) provides for cumulative voting.**

Explanation

Requiring that investors attend an annual meeting in order to vote shares limits their ability to vote. Confidential voting is supported by having third parties tabulate votes and by having the tabulation subject to audit. Cumulative voting typically may be viewed as supportive of shareholders' interests.

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Question ID: 414875

An example of a primary source of liquidity is:

- X **A) filing for bankruptcy.**
- ✓ **B) using trade credit from vendors.**
- X **C) renegotiating debt agreements.**

Explanation

Primary sources of liquidity include cash resulting from selling goods and services, collecting receivables, generating cash from other sources and sources of short-term funding such as trade credit from vendors and lines of credit from banks. Filing for bankruptcy and renegotiating debt agreements are secondary sources of liquidity.

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Question ID: 414897

A firm is choosing among three short-term investment securities:

Security 1: A 30-day U.S. Treasury bill with a discount yield of 3.6%.

Security 2: A 30-day banker's acceptance selling at 99.65% of face value.

Security 3: A 30-day time deposit with a bond equivalent yield of 3.65%.

Based only on these securities' yields, the firm would:

- ✓ **A) prefer the banker's acceptance.**
- X **B) prefer the U.S. Treasury bill.**
- X **C) prefer the time deposit.**

Explanation

We can compare the yields of these securities on any single basis. The preferred basis is the bond equivalent yield.

Security 1 = discount is $3.6\%(30 / 360) = 0.3\%$

BEY = $(0.3 / 99.7) (365 / 30) = 3.661\%$

BEY of Security 2 = $(0.35 / 99.65) \times (365 / 30) = 4.273\%$

BEY of Security 3 = 3.65%

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Question ID: 414924

Which of the following practices should be included in a firm's code of ethics?

- ✓ **A) Providing the board with relevant corporate information in a timely manner and prohibiting board members or other insiders from purchasing stock before shareholders can make purchases.**
- X **B) Prohibiting board members or other insiders from purchasing stock before shareholders can make purchases.**
- X **C) Providing the board with relevant corporate information in a timely manner and allowing board members or other insiders to purchase stock before shareholders can make purchases.**

Explanation

The firm's code of ethics establishes the basic principles of integrity, trust, and honesty. Two of the practices listed in the reading discuss providing the board with relevant corporate information in a timely manner and prohibiting board members or other insiders from purchasing stock before shareholders can make purchases.

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Question ID: 414927

Shareholder-sponsored resolutions are something investors can consider in order to be "heard". These resolutions do have implications for investors. Which of the following statements regarding shareholder-sponsored resolutions is *least* accurate?

- ☐ A) The right to propose initiatives for consideration at the firm's annual meeting is one way for shareholders to send a message that they are dissatisfied with the way the board is handling one or more firm matters.
- ☒ B) The ability shareholders have to propose needed changes in a firm can serve to erode shareholder value.
- ☐ C) The right to propose initiatives for consideration at the firm's annual meeting is one way for shareholders to send a message that they are dissatisfied with the way management is handling one or more firm matters.

Explanation

The ability to bring issues in front of the board and/or management can serve to *prevent* erosion of shareholder value.

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Question ID: 414933

Which of the following rights concerning shareholder-sponsored board nominations and shareholder-sponsored resolutions would be advantageous to an investor?

- ☒ A) The right to nominate or remove board members in certain circumstances, and the right to propose initiatives for consideration at the annual meeting.
- ☐ B) The right to nominate or remove board members in certain circumstances, but not the right to propose initiatives for consideration at the annual meeting.
- ☐ C) The right to propose initiatives for consideration at the annual meeting, but not the right to nominate or remove board members in certain circumstances.

Explanation

Investors need the power to put forth an independent board nominee. In addition, the right to propose initiatives for consideration at the annual meeting is an important method to send a message to management.

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Question ID: 414884

Compared to the prior period, a firm has greater days of receivables. The effect on the firm's cash conversion cycle and operating cycle are *most likely* a(n):

Cash conversion cycle Operating cycle

- ☒ A) Increase Increase
- ☐ B) Decrease Increase
- ☐ C) Increase Decrease

Explanation

Greater days of receivables will increase both the cash conversion cycle and operating cycle, other things equal.

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Question ID: 414873

An example of a secondary source of liquidity is:

- ✓ **A) negotiating debt contracts.**
- X **B) trade credit and bank lines of credit.**
- X **C) cash flow management.**

Explanation

Secondary sources of liquidity include negotiating debt contracts, liquidating assets, and filing for bankruptcy protection and reorganization. Primary sources of liquidity include ready cash balances, short-term funds (e.g., trade credit and bank lines of credit), and cash flow management.

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Question ID: 485792

A company has just received a \$5 million shipment from a supplier. Its terms of trade credit are 2/15 net 30. It has access to a line of credit with an annualized cost of 9%. The *best* short-term financing strategy is to pay the invoice:

- X **A) on day 30.**
- X **B) immediately.**
- ✓ **C) on day 15.**

Explanation

The firm receives free short-term financing through day 15. It should pay with cash (or use the line of credit with an annualized cost of 9%) on day 15 to take advantage of the trade discount. Paying immediately is not the best answer because the firm incurs either a financing charge with the line of credit or lost interest on its funds if paid immediately with cash. The cost of foregoing the trade discount and paying on day 30 is $\{[1 + (0.02/0.98)]^{365/(30 - 15)} - 1\} = 63.49\%$. This cost is much greater than the alternatives.

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Question ID: 460673

The audit committee for a firm is *most likely* to represent shareowners' interests if:

- X **A) the external auditor submits its auditing reports to the firm's chief financial officer.**
- X **B) the majority of the audit committee members also hold positions within the firm.**
- ✓ **C) shareowners vote to approve external auditors nominated by the audit committee.**

Explanation

Giving shareholders the ability to approve an external auditor allows them to evaluate the external auditor and express their opinion regarding whether the auditor serves their interests. The external auditor should report to the audit committee, not the firm's management, to avoid management influence. Audit committee members should be independent so that their interests are aligned with shareowners and not management.

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Question ID: 414934

Which of the following actions would *most likely* have a positive influence on shareholder value?

- ☐ A) Adopting a poison pill.
- ☒ B) Only one class of common equity has been issued.
- ☐ C) Executive board members regularly attend the board meetings.

Explanation

Firms with dual classes of equity can have a negative effect on shareholder value as the shareholder may have inferior voting rights. Takeover measures such as poison pills, golden parachutes, and greenmail typically have a negative effect on shareholder value. Annual elections are preferred for board members as it increases accountability. Executive board members regularly attending the meetings can potentially prevent free discussion among the independent members.

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Question ID: 414931

One of the issues shareholders should consider is the issue of confidential voting of proxies. Which of the following statements would be considered *most* accurate in regard to proxy voting and confidential votes?

- ☐ A) Confidentiality of voting does not ensure that all votes are counted equally.
- ☐ B) It is an SEC requirement that the proxy voting process be confidential.
- ☒ C) Shareholders are more likely to vote conscientiously if allowed to do so confidentially.

Explanation

Shareholders will be more likely to vote *and* vote conscientiously if they are sure that board members and/or management will not find out how they voted. There is no SEC requirement of confidentiality regarding proxy voting. Confidentiality of voting *does* insure that all votes are counted equally.

Question #21 of 78

Question ID: 460674

Managers of Smith Corporation are reviewing a section of the firm's code of ethics that relates to Board members. Vice president Susan Klepp argues, "Drawing upon the expertise of our Board members by hiring them as consultants is in the shareholders' best interests. However, personal use of company assets by Board members should be limited to those instances that align the incentives of the Board members with those of the firm."

With respect to the provisions that should be included in a strong corporate code of ethics, Klepp is:

- ☒ A) incorrect about both provisions.
- ☐ B) correct about only one of these provisions.
- ☐ C) correct about both provisions.

Explanation

Klepp is incorrect about both consulting contracts for Board members and Board members' use of company assets. Either practice is likely to compromise the independence of Board members and their incentive to act in shareholders' best interests. A strong corporate code of ethics should discourage such forms of compensation to Board members.

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Question ID: 414912

Which of the following activities would *least likely* be an example of good corporate governance?

- ✓ **A) Management is allowed to act independently of board of directors.**
- ✗ **B) The board of directors has decided to conduct a self-assessment.**
- ✗ **C) The board has decided to eliminate finders' fees for its members for any potential acquisitions that are brought to management's attention.**

Explanation

The board of directors should be allowed to act independently of management. Management should not be allowed to act independently from the board.

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Question ID: 414891

Which yield measure is the *most* appropriate for comparing a company's investments in short-term securities?

- ✗ **A) Money market yield.**
- ✗ **B) Discount basis yield.**
- ✓ **C) Bond equivalent yield.**

Explanation

When evaluating the performance of its short-term securities investments, a company should compare them on a bond equivalent yield basis.

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Question ID: 414892

A 30-day bank certificate of deposit has a holding period yield of 1%. What is the annual yield of this CD on a bond-equivalent basis?

- ✗ **A) 11.83%.**
- ✗ **B) 12.00%.**
- ✓ **C) 12.17%.**

Explanation

The bond-equivalent yield is calculated as the holding period yield times (365 / number of days in the holding period). $BEY = 1\% \times (365/30) = 12.17\%$.

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Question ID: 414920

The audit committee of a company's Board of Directors is *most likely* to act in the interests of shareholders when:

- ✓ **A) the committee has authority to prevent the company from engaging in non-audit business relationships with its external auditors.**
- ✗ **B) a reliable communication "firewall" is in place between the committee and the company's internal auditors.**

X **C)** a company officer other than the CEO controls the audit budget.

Explanation

The audit committee is responsible for evaluating the financial information that the company provides to shareholders. This committee should be able to approve or reject the company's proposed non-audit engagements with its external auditing firm. The audit committee, not management, should control the audit budget, and there should be no restrictions on communication between the committee and the company's internal auditors.

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Question ID: 434358

Pfluger Company's accounts payable department receives an invoice from a vendor with terms of 2/10 net 30. If Pfluger pays the invoice on its due date, the cost of trade credit is *closest* to:

X **A)** 27.9%.

✓ **B)** 44.6%.

X **C)** 43.5%.

Explanation

"2/10 net 30" is a discount of 2% of the invoice amount for payment within 10 days, with full payment due in 30 days. Cost of trade credit on day 30 =

$$\left(1 + \frac{0.02}{1 - 0.02}\right)^{365/30-10} - 1 = 44.6\%.$$

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Question ID: 414923

Which of the following statements concerning Board committees is *least* accurate?

X **A)** Members of the audit committee should be independent experts in accounting and finance.

✓ **B)** The audit committee has authority over the procedures used to audit the entire corporate group including subsidiaries and affiliates.

X **C)** The nominations committee is responsible for recruiting qualified board members and preparing an executive management succession plan.

Explanation

The independent auditor has authority over the audit procedures. The audit committee is responsible for hiring and supervising the independent auditor.

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Question ID: 414889

Which of the following factors is *most likely* to cause a firm to need short-term financing?

X **A)** Return of principal from maturing investments.

✓ **B)** Operating cash inflows that fluctuate seasonally.

X **C)** Shorter cash conversion cycle than the industry average.

Explanation

Firms with operating cash inflows that fluctuate seasonally are likely to experience short-term imbalances between cash inflows and cash outflows and must forecast these imbalances to manage their net daily cash positions, for example by arranging short-term borrowing over seasons when operating cash inflows are expected to be relatively low and operating cash outflows are relatively high.

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Question ID: 414930

Which of the following would NOT be a good source for information about a company's proxy voting rules?

- ☐ A) **Company's articles of organization and by-laws.**
- ☒ B) Firm's annual report.
- ☐ C) Firm's corporate governance statement.

Explanation

The annual report would typically not contain this detailed information.

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Question ID: 414881

Which of the following is *least likely* an indicator of a firm's liquidity?

- ☐ A) **Inventory turnover.**
- ☒ B) Amount of credit sales.
- ☐ C) Cash as a percentage of sales.

Explanation

No inferences about liquidity are warranted based on this measure. A firm may have higher credit sales than another simply because it has more sales overall. Cash as a proportion of sales and inventory turnover are indicators of liquidity.

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Question ID: 414925

A strong corporate code of ethics is vitally important. Which of the following statements concerning a firm's code of ethics is *least likely* accurate?

- ☒ A) **A firm's code of ethics should require clear disclosure of any advantages given to the firm's insiders that are not also offered to shareholders.**
- ☐ B) As part of investor review of the firm's ethical climate, investors should determine whether the firm gives the board access to relevant corporate information in a timely manner.
- ☐ C) A firm's code of ethics sets standards for ethical conduct based on basic principles of integrity, trust and honesty.

Explanation

The firm's code of ethics should *prohibit* practices that give advantages to company insiders that are not also offered to shareholders.

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Question ID: 414929

The *most likely* outcome of adopting a golden parachute, poison pill, or greenmail is a:

- ✓ **A) reduced possibility for a successful takeover bid and a negative impact on the stock price.**
- X B) negative impact on the stock price and a greater possibility for a successful takeover bid.
- X C) reduced possibility for a successful takeover bid and a positive impact on the stock price.

Explanation

Adopting a golden parachute, poison pill, or greenmail are all take-over defenses used to frustrate an acquisition attempt. The barriers created by such defenses are likely to decrease the value of the stock.

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Question ID: 414915

There are a lot of issues to consider in determining board independence. What would be the *best* definition of true "independence"? Independence, as it relates to board members, refers to:

- ✓ **A) the degree to which these persons are not biased or otherwise controlled by firm management or other groups which may have some degree of control over management.**
- X B) avoidance of material conflicts of interest.
- X C) the degree to which these persons are not biased or otherwise controlled by firm management or the outside audit group.

Explanation

Avoiding material conflicts of interest is important, but this is not a true definition of independence. Independent board members should be independent from the outside audit group, but this is not part of the actual definition. Benefiting management interests should not be a board priority.

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Question ID: 414910

Corporate governance is the set of internal controls, processes and procedures defining how a firm is managed. Which of the following statements concerning corporate governance is *least* accurate?

- X **A) Corporate governance defines the appropriate rights, roles and responsibilities of management, the board, and stakeholders within a firm.**
- ✓ B) Good corporate governance means that the board can work effectively with management.
- X C) Good corporate governance dictates that the firm's financial, operating and governance activities are reported to stakeholders in a fair, accurate and timely manner.

Explanation

The board of directors must be able to act independently from management. Both remaining statements concerning corporate governance are accurate.

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Question ID: 414905

Which of the following sources of short-term liquidity is considered reliable enough that it can be listed in the footnotes to a firm's financial statements as a source of liquidity?

- ✓ **A) Revolving line of credit.**
- X **B) Factoring agreement.**
- X **C) Uncommitted line of credit.**

Explanation

With an uncommitted line of credit, the lender is not committed to make loans in any amount. A revolving line of credit is typically for a longer period and involves an agreement to lend funds in the future up to some maximum amount. Factoring does not typically involve an agreement for future receivables purchases.

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Question ID: 460671

Randex Industries has the following investment policy statement: "In order to achieve the safety and liquidity necessary in the investment of excess cash balances, the CFO or his designee may invest excess cash balances in 30-day U.S. Treasury bills, or in banker's acceptances with maturities of less than 31 days or 30-day certificates of deposit, where the credit rating of the issuing bank is A+ or higher." This policy statement is:

- ✓ **A) inappropriate because it is too restrictive.**
- X **B) appropriate because these are all safe, liquid securities.**
- X **C) inappropriate because both banker's acceptances and certificates of deposit are illiquid.**

Explanation

The policy statement is inappropriate because it is too restrictive. A policy statement should focus on meeting the specific safety and liquidity needs of the firm but should also allow the flexibility to increase yield within these constraints. There are many other securities potentially suitable for cash management that would provide equivalent or better liquidity and safety of principal at least equivalent to that of the securities issued by A+ rated banks.

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Question ID: 414878

Alton Industries will have better liquidity than its peer group of companies if its:

- X **A) average trade payables are lower.**
- X **B) quick ratio is lower.**
- ✓ **C) receivables turnover is higher.**

Explanation

Higher receivables turnover is an indicator of better receivables liquidity since receivables are converted to cash more rapidly. A lower quick ratio is an indication of less liquidity. Lower trade payables could be related to better liquidity, but could also be consistent with very poor liquidity and a requirement from its suppliers of cash payment.

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Question ID: 414903

A large, creditworthy manufacturing firm would *most likely* get short-term financing by:

- ☐ A) factoring its receivables.
- ☐ B) entering into an agreement for a committed line of credit.
- ☒ C) issuing commercial paper.

Explanation

Large, creditworthy firms can get the lowest cost of financing by issuing commercial paper. Selling receivables to a factor is a higher cost source of funds used by firms with poor credit quality. A committed line of credit requires payment of a fee and represents bank borrowing, which would be attractive to a firm that did not have the size or creditworthiness to issue commercial paper.

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Question ID: 414913

Rochelle Dixon is delivering a presentation on best practices for corporate governance. Two of her recommendations are as follows:

Statement 1: To avoid the potential for harming shareholders' interests by wasting company resources, the Board of Directors should get management's approval before it hires outside consultants.

Statement 2: The more members a Board of Directors has, the more likely it is to represent shareholders' interests fairly.

Are Dixon's statements CORRECT?

<u>Statement 1</u>	<u>Statement 2</u>
<input type="radio"/> A) Correct	Correct
<input type="radio"/> B) Incorrect	Correct
<input checked="" type="radio"/> C) Incorrect	Incorrect

Explanation

Both statements are incorrect. An independent board should have the ability to seek specialized advice by hiring outside consultants without management approval. The size of the board should be appropriate for the facts and circumstances of the firm; having more members does not imply that the board will be more independent if the additional members are aligned closely with management or are less well qualified.

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Question ID: 414916

Which of the following statements related to corporate governance is *least* accurate?

- ☒ A) **It is desirable for the chairman of the board to be the firm's current CEO or former CEO.**
- ☐ B) Board members should not have any material relationships with the firm's advisers, auditors, and their families.
- ☐ C) It is desirable for board members to have board experience with other boards.

Explanation

The willingness of independent board members to express opinions that are not aligned with managements' may be impaired

when the chairman is the firm's current CEO or a former CEO.

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Question ID: 414900

With respect to inventory management,:

- ✓ **A) an increase in days of inventory on hand can be the result of either good or poor inventory management.**
- X **B) a firm with inventory turnover higher than the industry average can be expected to have better profitability as a result.**
- X **C) a decrease in a firm's days of inventory on hand indicates better inventory management and can lead to increased profits.**

Explanation

An increase in inventory could indicate poor sales and an accumulation of obsolete items or could be the result of a conscious effort to have adequate supplies to avoid losses from not having items to satisfy customer orders (stock outs). Higher-than-average inventory turnover could indicate better inventory management or could indicate that a less than optimal inventory is being maintained by the company.

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Question ID: 414877

Which of the following is NOT a limitation to financial ratio analysis?

- X **A) Differences in international accounting practices.**
- ✓ **B) A firm that operates in only one industry.**
- X **C) The need to use judgment.**

Explanation

If a firm operates in multiple industries, this would limit the value of financial ratio analysis by making it difficult to find comparable industry ratios.

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Question ID: 414921

A special-purpose board committee with which of the following responsibilities would be *least likely* to act in the best interests of the shareholders?

- X **A) Mergers and acquisitions.**
- X **B) Corporate governance.**
- ✓ **C) Takeover defense.**

Explanation

A committee responsible for takeover defense would most likely be acting in the interests of the company's current management rather than in the interests of shareholders.

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Question ID: 414904

Which of the following sources of credit would an analyst *most likely* associate with a borrower of the lowest credit quality?

- ☐ A) **Revolving line of credit.**
- ☐ B) Committed line of credit.
- ☒ C) Uncommitted line of credit.

Explanation

Committed lines and revolving lines of credit all contain a commitment by a lender to lend up to a maximum amount, at the borrower's option for some period of time. A firm with lower credit quality may have an uncommitted line of credit which offers no guarantee from the lender to provide any specific amount of funds in the future.

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Question ID: 414937

Which of the following firms is *most likely* to have a board of directors that considers the best interest of all shareholders?

- ☐ A) **Neither firms with different classes of common equity with supermajority rights given to one class, nor firms that assign a single vote to each share.**
- ☐ B) Firms that assign a single vote to each share, and firms with different classes of common equity with supermajority rights given to one class.
- ☒ C) Firms that assign a single vote to each share, but not firms with different classes of common equity with supermajority rights given to one class.

Explanation

Firms that assign one vote to each share are more likely to have a board that considers the best interest of all shareholders. Firms with dual classes of common equity where supermajority rights are given to one class are likely to have boards that focus on the interests of the supermajority shareholders.

Question #46 of 78

Question ID: 414894

An investment policy statement for a firm's short-term cash management function would *least* appropriately include:

- ☐ A) **procedures to follow if the investment guidelines are violated.**
- ☒ B) a list of permissible securities.
- ☐ C) information on who is allowed to invest corporate cash.

Explanation

An investment policy statement typically begins with a statement of the purpose and objective of the investment portfolio, some general guidelines about the strategy to be employed to achieve those objectives, and the types of securities that will be used. A list of permitted securities for investment would be limited and likely too restrictive. A list of permitted security types is appropriate and can provide the necessary flexibility to increase yield within the safety and liquidity constraints appropriate for the firm.

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Question ID: 434355

The average number of days that it takes to turn raw materials into cash proceeds is a firm's:

- ✓ **A) operating cycle.**
- X **B) receivables cycle.**
- X **C) inventory turnover cycle.**

Explanation

Operating cycle = days of inventory + days of receivables, and is the number of days that it takes to turn raw materials into cash from sales.

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Question ID: 414888

An appropriate cash management strategy for a company that has a seasonally high need for cash prior to the holiday shopping season would *least likely* include:

- X **A) allowing short-term securities to mature without reinvestment.**
- X **B) borrowing funds through a bank line of credit.**
- ✓ **C) investing in U.S. Treasury notes at other times of the year because they are highly liquid.**

Explanation

Treasury notes have maturities between 2 and 10 years and, thus, have maturities longer than those of securities suitable for cash management. Allowing short-term securities to mature without reinvesting the cash generated would be one way to meet seasonal cash needs. Short-term bank borrowing or issuing commercial paper that can be paid off when holiday sales generate cash would be appropriate strategies for dealing with a predictable short-term need for cash.

Question #49 of 78

Question ID: 414901

A result that is *most likely* to give a financial manager concern that his firm's credit policy may have become too lenient is:

- X **A) receivables turnover has increased significantly.**
- X **B) inventory turnover has decreased considerably.**
- ✓ **C) weighted average collection period has increased.**

Explanation

The weighted average collection period is the average number of days it takes to collect a dollar of receivables. A decreased percentage of sales made on credit or an increase in the receivables turnover ratio might result from more strict credit terms. Inventory turnover is not directly affected by credit terms, only through the effect of credit terms on overall sales.

Question #50 of 78

Question ID: 414911

All of the following practices constitute good corporate governance, EXCEPT:

- X **A) there are proper procedures and controls covering management's day-to-day operations and the firm acts lawfully in dealings with shareholders.**

- ✓ **B)** the firm's financial, operating, and governance activities are reported to shareholders in a fair, accurate, and timely manner, and management acts independent of the board of directors.
- X **C)** the board of directors protects shareholder interests, and the shareholders have a voice in governance.

Explanation

The board of directors must be able to act independent of management, not vice versa. Both of the remaining practices are examples of good corporate governance.

Question #51 of 78

Question ID: 414906

Which of the following sources of liquidity is the *most* reliable?

- ✓ **A) Revolving line of credit.**
- X **B)** Committed line of credit.
- X **C)** Uncommitted line of credit.

Explanation

A revolving line of credit is typically for a longer term than an uncommitted or committed line of credit and thus is considered a more reliable source of liquidity. With an uncommitted line of credit, the issuing bank may refuse to lend if conditions of the firm change. An overdraft line of credit is similar to a committed line of credit agreement between banks and firms outside of the U.S. Both committed and revolving lines of credit can be verified and can be listed in the footnotes to a firm's financial statements as sources of liquidity.

Question #52 of 78

Question ID: 434353

Compared to the prior year, Chart Industries has reported that its operating cycle has remained relatively stable while its cash conversion cycle has decreased. The *most likely* explanation for this is that the firm:

- X **A) has improved its inventory turnover.**
- ✓ **B)** is relying more on its suppliers for short-term liquidity.
- X **C)** is paying its bills for raw materials more rapidly.

Explanation

The cash conversion cycle is its operating cycle minus its average days payables outstanding. Therefore, the firm's average days payables must have increased, a clear indication that the firm is relying more heavily on credit from its suppliers. Improved inventory turnover would tend to decrease both the operating and cash conversion cycles. Relaxed credit policies would tend to increase the firm's operating cycle as receivables turnover would tend to decrease.

Question #53 of 78

Question ID: 414914

A board of directors is *most likely* to protect the shareholders' interests when:

- X **A) the board includes representatives from the firm's key customers and suppliers.**
- X **B)** the board requires that management attend all meetings.

✓ **C)** one individual can be identified as the leading board member from outside the firm.

Explanation

Especially in cases where the chairman of the board is closely aligned with the firm, independent board members are more able to protect shareholders' interests when they have a leading or primary independent member. The board should meet regularly outside the presence of management. Board members who represent the firm's customers and suppliers may have interests that conflict with those of shareholders.

Question #54 of 78

Question ID: 414893

A 91-day Treasury bill has a holding period yield of 1.5%. What is the annual yield of this T-bill on a bond-equivalent basis?

- ✓ **A) 6.02%.**
X **B)** 6.24%.
X **C)** 6.65%.

Explanation

$BEY = 1.5\% \times (365/91) = 6.02\%$.

Question #55 of 78

Question ID: 414909

Which of the following statements regarding corporate governance practices is *least* accurate?

- ✓ **A) Corporate governance is not as important for firms with largely dispersed minority shareholders.**
X **B)** Good corporate governance practices ensure that the firm's financial and operating activities are reported to shareholders in a verifiable manner.
X **C)** Corporate governance is the system of internal controls/procedures by which firms are managed.

Explanation

Good corporate governance practices are extremely important in the case of firms with largely dispersed minority shareholders. Both remaining statements are accurate.

Question #56 of 78

Question ID: 414876

An analyst computes the following ratios for Iridescent Carpeting Inc. and compares the results to the industry averages:

<i>Financial Ratio</i>	<i>Iridescent Carpeting</i>	<i>Industry Average</i>
Current Ratio	2.3x	1.8x
Net Profit Margin	22%	24%
Return on Equity	17%	20%
Total Debt / Total Capital	35%	56%
Times Interest Earned	4.7x	4.1x

Based on the above data, which of the following can the analyst conclude? Iridescent Carpeting:

- ☐ A) has stronger profitability than its competitors.
- ☐ B) is most likely a younger company than its competitors.
- ☒ C) has better short-term liquidity than its competitors.

Explanation

Based on the data provided, the analyst can conclude that Iridescent Carpeting has weaker profitability than its competitors based on the net profit margin and return on equity. The analyst can also conclude that the company has less financial leverage (risk) than the industry average based on the total debt / total capital and the times interest earned ratios. The analyst can conclude that the company has better short-term liquidity than the industry average (i.e., its competitors) based on the current ratio.

Question #57 of 78

Question ID: 414917

A properly qualified board member is of vital importance to proper corporate governance within a firm. Board members who lack the requisite skills, knowledge and expertise to conduct a thorough review of the firm's activities are:

- ☒ A) more likely to defer to management when making decisions.
- ☐ B) less likely to participate fully in decision-making matters during board meetings.
- ☐ C) more likely to consult with outside interests to assist in decision-making.

Explanation

Board members must be properly qualified, having the knowledge and experience which is required to advise management in light of the firm's specific situations encountered. Both remaining answers are incorrect.

Question #58 of 78

Question ID: 414936

When examining a firm's ownership structure, it is imperative to examine any super-voting rights by certain classes of shareholders. Which of the following statements concerning these voting rights is *most* accurate?

- ☒ A) Super-voting rights by certain classes of shareholders impair the firm's ability to raise capital for the future.
- ☐ B) If a company has a significant minority shareowner group, such as a founding family, cumulative voting to elect board members can be a positive factor for shareholders.
- ☐ C) Firms with a single class of common equity could encourage prospective acquirers to only deal directly with shareholders with the supermajority rights.

Explanation

Firms with *dual* classes of common equity could encourage prospective acquirers to only deal directly with shareholders with the supermajority rights. If the firm has a significant minority ownership group, such as a founding family, use of cumulative voting to elect board members can favor specific interests at the expense of the interests of other shareholders.

Question #59 of 78

Question ID: 414919

A critical corporate governance issue is ensuring that the board and its members have the requisite experience needed to properly govern the firm for the shareholders' benefit. When considering board member qualifications, investors and shareholders should consider whether board members can act with care and competence as a result of their experience with all of the following EXCEPT:

- ☐ **A) legal issues.**
- ☒ **B) the competitive landscape the firm faces.**
- ☐ **C) technologies, products, services which the firm offers.**

Explanation

Knowledge of the firm's competitive landscape is likely beyond what a board member should have intimate knowledge about. The other items are all issues a board member should be knowledgeable about. Other issues board members *should* have experience with include financial operations, accounting and auditing topics, and business risks the firm faces.

Question #60 of 78

Question ID: 414926

Which of the following policies regarding shareowner rights for equity investors is *most likely* detrimental to the shareowners' interests?

- ☐ **A) The company uses a third-party entity to tabulate shareowner votes.**
- ☐ **B) Shareowners are permitted to vote either by paper ballot or a proxy voting service.**
- ☒ **C) Shareowners can approve changes to the corporate structure only with a supermajority vote.**

Explanation

Provisions that require a supermajority can even make changes strongly supported by shareowners more difficult to enact.

Question #61 of 78

Question ID: 434356

A high cash conversion cycle suggests that a company's investment in working capital is:

- ☐ **A) too low.**
- ☒ **B) too high.**
- ☐ **C) appropriate.**

Explanation

The cash conversion cycle is equal to average days of receivables plus average days of inventory minus average days of payables. High cash conversion cycles relative to those of comparable firms are considered undesirable. A cash conversion cycle that is too high implies that the company has excessive investment in working capital.

Question #62 of 78

Question ID: 414928

Which of the following is *least likely* to be considered a "best practice" regarding corporate governance?

- ☒ **A) Board members are limited to a six-year term.**
- ☐ **B) Use of a third party to tabulate votes and retain voting records.**

- ☐ C) A code of ethics that is audited and improved periodically.

Explanation

Anything beyond 2- or 3-year term limits on board membership has the potential to restrict the ability for shareholders to change the composition of the board if its members are not acting in the shareholders' best interest.

Question #63 of 78

Question ID: 414874

The condition that occurs when a company disburses cash too quickly, stretching the company's cash reserves, is *best* described as a:

- ☐ A) drag on liquidity.
- ☐ B) liquidity premium.
- ☒ C) pull on liquidity.

Explanation

When cash payments are made too quickly, the condition is known as a pull on liquidity. A drag on liquidity occurs when cash inflows lag.

Question #64 of 78

Question ID: 434354

Which of the following *most* accurately represents the cash conversion cycle?

- ☒ A) average days of receivables + average days of inventory - average days of payables.
- ☐ B) average days of receivables + average days of inventory + average days of payables.
- ☐ C) average days of payables + average days of inventory - average days of receivables.

Explanation

The cash conversion cycle, also called the net operating cycle is:

$$\text{cash conversion cycle} = \left(\text{average days of receivables} \right) + \left(\text{average days of inventory} \right) - \left(\text{average days of payables} \right)$$

The cash conversion cycle measures the length of time required to convert a firm's cash investment in inventory back into cash resulting from the sale of the inventory. A short cash conversion cycle is good because it indicates a relatively low investment in working capital.

Question #65 of 78

Question ID: 460672

An analyst is reviewing the working capital portfolio investment policy of a publicly traded firm. Which of the following components of the policy is the analyst *least likely* to find acceptable?

- ☒ A) Investments in U.S. T-bills, commercial paper, and bank CDs are acceptable unless issued by Stratford Bank.
- ☐ B) Investments must have an A-1 rating from S&P or an equivalent rating from another agency.

- ☐ **C)** Authority for selecting and managing short-term investments rests with the firm's treasurer and any designees selected by the treasurer.

Explanation

An investment policy for short-term portfolios should have the following elements: purpose, authorities, limitations/restrictions, quality, and other items. The purpose section should state the general reason the portfolio exists and the general strategy that will be followed. The limitations section generally states the types of investments that are or are not acceptable and should note only categories of securities rather than specific issuers of securities. The authorities section should state the executives who will oversee the portfolio. The quality section should state guidelines for the credit quality of the investments in the portfolio. The "other" section may be used for portfolio requirements not covered in the first four sections, such as auditing or reporting requirements.

Question #66 of 78

Question ID: 414880

The quick ratio is considered a more conservative measure of liquidity than the current ratio because the quick ratio excludes:

- ☐ **A) accounts receivable, which may not be collectible in the short term.**
- ☐ **B)** short-term marketable securities, which may need to be sold at a significant loss.
- ☒ **C)** inventories, which are not necessarily liquid.

Explanation

The quick ratio is usually defined as (current assets - inventory) / current liabilities. It is a more restrictive measure of liquidity than the current ratio, which equals current assets / current liabilities. The numerator of the quick ratio includes cash, receivables, and short-term marketable securities.

Question #67 of 78

Question ID: 414890

A firm records the following cash flows on the same day: \$250 million from debt proceeds; \$100 million funds transferred to a subsidiary; \$125 million in interest payments; and \$30 million in tax payments. The net daily cash position:

- ☐ **A) remained the same.**
- ☒ **B)** worsened.
- ☐ **C)** improved.

Explanation

Improving a firm's net daily requires more inflows than outflows. Debt proceeds are cash inflows while funds transferred to a subsidiary, interest and dividend payments, and tax payments are outflows. The net cash change for the day is $\$250 - \$100 - \$125 - \$30 = -\$5$ million.

Question #68 of 78

Question ID: 414882

In a recent staff meeting, David Hurley, stated that analysts should understand that financial ratios mean little by themselves. He advised his colleagues to evaluate financial ratios carefully. During the discussion he made the following statements:

Statement 1: A company can be compared with others in its industry by relating its financial ratios to industry norms. However,

care must be taken because many ratios are industry-specific, but not all ratios are important to all industries.

Statement 2: Comparing a company to the overall economy is useless because overall business conditions are constantly changing. Specifically, it is not the case that financial ratios tend to improve when the economy is strong and weaken during recessionary times.

Are statements 1 and 2 as made by Hurley regarding financial ratio analysis CORRECT?

<u>Statement 1</u>	<u>Statement 2</u>
✓ A) Correct	Incorrect
X B) Correct	Correct
X C) Incorrect	Correct

Explanation

Financial ratios are meaningless by themselves. To have meaning an analyst must use them with other information. An analyst should evaluate financial ratios based on industry norms and economic conditions. Statement 1 is correct. However, statement 2 is not because financial ratios tend to improve when the economy is strong and weaken when the economy is in a recession. So, financial ratios should be reviewed in light of the current stage of the business cycle.

Question #69 of 78

Question ID: 414879

A firm has average days of receivables outstanding of 22 compared to an industry average of 29 days. An analyst would *most likely* conclude that the firm:

- X **A) has a lower cash conversion cycle than its peer companies.**
- ✓ **B) may have credit policies that are too strict.**
- X **C) has better credit controls than its peer companies.**

Explanation

The firm's average days of receivables should be close to the industry average. A significantly lower average days receivables outstanding, compared to its peers, is an indication that the firm's credit policy may be too strict and that sales are being lost to peers because of this. We can not assume that stricter credit controls than the average for the industry are "better." We cannot conclude that credit sales are less, they may be more, but just made on stricter terms. The average days of receivables are only one component of the cash conversion cycle.

Question #70 of 78

Question ID: 460670

Robel Company, which pays no dividends, carries out a 3-for-5 reverse split of its common shares. How will this transaction affect Robel's forecasts of its net cash position?

- X **A) No effect on the short-term forecast but less net cash in the longterm forecast.**
- X **B) More net cash in both the short-term forecast and the long-term forecast.**
- ✓ **C) No effect because this transaction does not affect future cash flows.**

Explanation

Stock splits and reverse stock splits do not affect a firm's future cash flows unless dividend yields are increased as a result.

These transactions change the number of shares outstanding but they do not raise capital for the firm.

Question #71 of 78

Question ID: 414935

Which of the following statements regarding company takeover defenses is CORRECT?

- ☒ **A) Newly created anti-takeover provisions may or may not require stakeholder authorization/approval.**
- ☐ **B) The firm's annual report contains pertinent details concerning takeover defenses.**
- ☐ **C) A firm's proxy is the most likely place to find information about present takeover defenses.**

Explanation

These provisions may or may not require such approval. In either case, the firm may have to, at a minimum, provide information to its shareholders about any amendments to existing takeover defenses. A firm's articles of organization are the most likely places to locate information about present takeover defenses.

Question #72 of 78

Question ID: 460669

In reviewing the effectiveness of a company's working capital management, an analyst has calculated operating cycle and cash conversion cycle measures for the past three years.

	<u>20X6</u>	<u>20X7</u>	<u>20X8</u>
Operating cycle (number of days)	55	60	62
Cash conversion cycle (number of days)	27	30	32

The trends in the operating cycle and cash conversion cycle *most likely* indicate:

- ☐ **A) improving liquidity.**
- ☐ **B) stretching of payables.**
- ☒ **C) slower collections of receivables.**

Explanation

Longer operating and cash conversion cycles are frequently signs of liquidity problems. Slower collections or inventory turnover lengthen the operating cycle. The cash conversion cycle is also growing longer, which suggests the company is not stretching payables to offset the lengthening operating cycle.

Question #73 of 78

Question ID: 434359

Which of the following forms of short-term financing is typically used to facilitate international trade?

- ☐ **A) Commercial paper.**
- ☒ **B) Banker's acceptances.**
- ☐ **C) Overdraft line of credit.**

Explanation

Banker's acceptances are used by firms that export goods. A banker's acceptance is a guarantee from the bank of the firm that has ordered the goods stating that a payment will be made upon receipt of the goods. The exporting company can then sell this acceptance at a discount in order to generate immediate funds.

Question #74 of 78

Question ID: 414932

All of the following negatively affect shareholders' proxy voting rights, EXCEPT:

- ☐ A) preventing investors who wish to vote their shares from trading during a period prior to the annual meeting.
- ☒ B) allowing proxy voting by means other than a paper ballot.
- ☐ C) requiring attendance at the annual meeting.

Explanation

Allowing proxy voting by means other than a paper ballot has a positive impact on shareholders' proxy voting rights. Both of the remaining choices negatively affect shareholders' proxy voting rights.

Question #75 of 78

Question ID: 414918

Which of the following might be an undesirable trait of a member of the board of directors?

- ☐ A) Experience with the technologies, products, and services the firm offers.
- ☒ B) Service on the board for more than 10 years.
- ☐ C) Lack of legal or regulatory problems as a result of working with other firms.

Explanation

Service on the board for more than 10 years may indicate knowledge and experience, but may result in a member becoming too close to management.

Question #76 of 78

Question ID: 434357

Yields on firms' investments in short-term securities for comparison purposes are *best* stated as:

- ☐ A) $\frac{\text{discount}}{\text{face}} \left(\frac{360}{\text{days to maturity}} \right)$.
- ☐ B) holding period return $\left(\frac{360}{\text{days to maturity}} \right)$.
- ☒ C) holding period return $\left(\frac{365}{\text{days to maturity}} \right)$.

Explanation

The yields on investments in short-term securities should be stated as bond equivalent yields (BEYs), and returns on portfolios of these securities should be stated as a weighted average of BEYs. The BEY, which is holding period yield $\times \left(\frac{365}{\text{days to maturity}} \right)$, allows fixed-income securities whose payments are not annual to be compared with securities with annual yields.

Question #77 of 78

Question ID: 460668

Pierce Motor Company has an operating cycle of 150 days and a cash conversion cycle of 120 days, while Dunhill Motor, Inc. has an operating cycle of 140 days and a cash conversion cycle of 125 days. Based on these figures it is *most likely* that:

- ✓ **A) average days of payables for Dunhill is less than for Pierce.**
- X B) average days of receivables for Dunhill is less than for Pierce.
- X C) average days of inventory for Dunhill is less than for Pierce.

Explanation

The operating cycle is days of inventory plus days of receivables. The cash conversion cycle is the operating cycle minus days of payables. Therefore, average days of payables are the operating cycle minus the cash conversion cycle. Dunhill's average days of payables ($140 - 125 = 15$) are less than Pierce's average days of payables ($150 - 120 = 30$). Which company has higher average days of inventory or receivables cannot be determined from the information provided.

Question #78 of 78

Question ID: 414907

During a recent luncheon, Angus Rahamut and Dan Riding became engaged in a discussion of issues related to corporate governance. Neither of these individuals is an expert in the field of corporate governance and either of them may have made an inaccurate statement. Which of the following is *most likely* to be an *inaccurate* statement?

- X **A) "Board members must have the experience and qualifications necessary for them to be able to make decisions independently from the firm's management."**
- ✓ B) "In order to avoid conflicts of interest, board members should seek management approval prior to hiring external advisors."
- X C) "To be independent, a board member must not have any material relationship with the firm's executive management or their families."

Explanation

Ideally, independent board members can hire external consultants without management's approval. This enables the board to obtain advice on specialized issues that is not biased by the interests of management.