1. Financial managers are supposed to make three types of important decisions: acquisition, financing, and asset management. Determining what is the optimal mix between debt and equity in the capital structure of a firm is most likely associated with which of the following functions?

(A) Acquisition

(B) Financing

(C) Asset management

2. Which of the following does NOT indicate the reason why the stock price of a firm represents shareholder value better than earnings per share (EPS)?

(A) The stock price is a forward-looking measure in a sense that it incorporates information about future profitability of the firm

(B) If the CEO’s financial compensations are tied to EPS instead of the stock price, no dividend will be paid out, in which case some shareholders will be unhappy

(C) EPS incorporates information about the riskiness of the future projects the firm is going to take

3. Which of the following items is least likely to incentivize a CEO to work in the best interests of the firm’s shareholders?

(A) Verbal compliment from shareholders

(B) Bonus

(C) Stock options

(D) Higher salary

4. \_\_\_\_\_\_\_\_\_ is elected by shareholders of a firm and work as a group of advisors and watchdogs to the CEO by means of reviewing investment opportunities and monitoring the CEO’s behavior.

(A) Chief Financial Officer

(B) Board of directors

(C) Financial manager

5. Company ABC has just purchased a small vehicle. Its price is $200,000 and the vehicle is expected to last for the next 7 years. For each year over the next 8 years, compute (a) depreciation expense for the third year (b) the net book value at the end of the third year if it decides to adopt the Modified Accelerated Cost Recovery System (MACRS).

|  |  |  |  |
| --- | --- | --- | --- |
| MACRS Schedule | | | |
| Year | 3-Year Class | 5-Year Class | 7-Year Class |
| 1 | 33.33% | 20.00% | 14.29% |
| 2 | 44.45% | 32.00% | 24.49% |
| 3 | 14.81% | 19.20% | 17.49% |
| 4 | 7.41% | 11.52% | 12.49% |
| 5 |  | 11.52% | 8.93% |
| 6 |  | 5.76% | 8.92% |
| 7 |  |  | 8.93% |
| 8 |  |  | 4.46% |

(a) 34980 (b) 87460

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Rate | Depreciation  Expense | Net Book Value |
| 1 | 0.1429 | 28580 | 171420 |
| 2 | 0.2449 | 48980 | 122440 |
| 3 | 0.1749 | 34980 | 87460 |
| 4 | 0.1249 | 24980 | 62480 |
| 5 | 0.0893 | 17860 | 44620 |
| 6 | 0.0892 | 17840 | 26780 |
| 7 | 0.0893 | 17860 | 8920 |
| 8 | 0.0446 | 8920 | 0 |

6. Suppose President Biden will change the U.S. corporate tax rates, and the schedule is as follows:

|  |  |  |
| --- | --- | --- |
| Level | Annual Taxable Income ($) | Tax Rate |
| 1 | Between 0 and 100,000 | 5% |
| 2 | Between 100,000 and 200,000 | 10% |
| 3 | Between 200,000 and 500,000 | 15% |
| 4 | Between 500,000 and 800,000 | 20% |
| 5 | Between 800,000 and 1,000,000 | 25% |
| 6 | Above 1,000,000 | 30% |

If the pre-tax income of a corporation is $1,500,000,

(a) What is the amount of income tax the corporation needs to pay?

5%\*(100,000-0) + 10%\*(200,000-100,000) + 15%\*(500,000-200,000)+20%\*(800,000-500,000) + 25%\*(1,000,000-800,000)+30%\*(1,500,000-1,000,000) = $320,000

(b) What is the average tax rate? 320,000/1,500,000 = 21. 3%

(c) What is the marginal tax rate? 30%