1. All of the following statements are correct except:
   a. The matching of asset and liability maturities is considered desirable because this strategy minimizes interest rate risk.
   b. Default risk refers to the inability of the firm to pay off its maturing obligations.
   c. The matching of assets and liability maturities lowers default risk.
   d. An increase in the payables deferral period will lead to a reduction in the need to non-spontaneous funding.

2. Which of the following would increase risk?
   a. Increase the level of working capital.
   b. Change the composition of working capital to include more liquid assets.
   c. Increase the amount of short-term borrowing.
   d. Increase the amount of equity financing.

3. A firm's financial risk is a function of how it manages and maintains its debt. Which one of the following sets of ratios characterizes the firm with the greatest amount of financial risk?
   A. High debt-to-equity ratio, high interest coverage ratio, stable return on equity.
   B. Low debt-to-equity ratio, low interest coverage ratio, volatile return on equity.
   C. High debt-to-equity ratio, low interest coverage ratio, volatile return on equity.
   D. Low debt-to-equity ratio, high interest coverage ratio, stable return on equity.

4. Which of the following classes of securities are listed in order from lowest risk/opportunity for return to highest risk/opportunity for return? (E)
   A. U.S. Treasury bonds; corporate first mortgage bonds; corporate income bonds; preferred stock.
   B. Corporate income bonds; corporate mortgage bonds; convertible preferred stock; subordinated debentures.
   C. Common stock; corporate first mortgage bonds; corporate second mortgage bonds; corporate income bonds.
   D. Preferred stock; common stock; corporate mortgage bonds; corporate debentures.

5. If the return on the market portfolio is 10% and the risk-free rate is 5%, what is the effect on a company's required rate of return on its stock of an increase in the beta coefficient from 1.2 to 1.5?
   A. 3% increase B. 1.5% increase C. No change D. 1.5% decrease.

6. Cost of capital is
   a. The amount the company must pay for its plant assets.
   b. The dividends a company must pay on its equity securities.
   c. The cost the company must incur to obtain its capital resources.
   d. The cost the company is charged by investment bankers who handle the issuance of equity or long-term debt securities.

7. All of the following are examples of imputed costs except
   a. The stated interest paid on a bank loan.
   b. Assets that are considered obsolete that maintain a net book value.

c. Decelerated depreciation.
d. Lending funds to a supplier at a lower-than-market rate in exchange for receiving the supplier's products at a discount.

8. 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.

9. Management knowledge of the cost of capital is useful for each of the following except
   a. Making capital investment decisions.
   b. Managing working capital.
   c. Setting the maximum rate of return on new investments.
   d. Evaluating performance.

10. The pre-tax cost of capital is higher than the after-tax cost of capital because
    a. interest expense is deductible for tax purposes.
    b. principal payments on debt are deductible for tax purposes.
    c. the cost of capital is a deductible expense for tax purposes.
    d. dividend payments to stockholders are deductible for tax purposes.

11. The overall cost of capital is the
    A. Rate of return on assets that covers the costs associated with the funds employed.
    B. Average rate of return a firm earns on its assets.
    C. Minimum rate a firm must earn on high-risk projects.
    D. Cost of the firm's equity capital at which the market value of the firm will remain unchanged.

12. The explicit cost of debt financing is the interest expense. The implicit cost(s) of debt financing is (are) the
    a. Increase in the cost of debt as the debt-to-equity ratio increases.
    b. Increases in the cost of debt and equity as the debt-to-equity ratio increases.
    c. Increase in the cost of equity as the debt-to-equity ratio decreases.
    d. Decrease in the weighted-average cost of capital as the debt-to-equity ratio increases.

13. In computing the cost of capital, the cost of debt capital is determined by
    a. Annual interest payment divided by the proceeds from debt issuance.
    b. Interest rate times (1 – the firm's tax rate)
    c. Annual interest payment divided by the book value of the debt.
    d. The capital asset pricing model.

14. The interest rate on the bonds is greater for the second alternative consisting of pure debt than it is for the first alternative consisting of both debt and equity because
    A. The diversity of the combination alternative creates greater risk for the investor.
    B. The pure debt alternative would flood the market and be more difficult to sell.
    C. The pure debt alternative carries the risk of increasing the probability of default.
    D. The combination alternative carries the risk of increasing dividend payments.

15. If a $1,000 bond sells for $1,125, which of the following statements are correct?

I. The market rate of interest is greater than the coupon rate on the bond.
II. The coupon rate on the bond is greater than the market rate of interest.
III. The coupon rate and the market rate are equal.
IV. The bond sells at a premium.
V. The bond sells at a discount.

a. I and IV. b. I and V. c. II and IV. d. II and V.