WGU Financial-Management C214 Practice Questions

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Question 1

Question Type: MultipleChoice

What is a primary goal of managing accounts receivable through credit policies?

Options:

A- To eliminate accounts receivable entirely
B- To transition all sales to cash-only transactions
C- To maximize sales regardless of cash flow impact
D- To balance customer convenience with the firm's cash flow needs

Answer:

D

Explanation:

The primary objective of accounts receivable management is to strike an optimal balance between increasing sales and maintaining healthy cash flows. Extending credit can stimulate demand and improve competitiveness, but excessive or poorly managed credit policies can lead to delayed cash inflows, higher bad debt losses, and increased financing costs. Financial management theory emphasizes evaluating credit standards, credit terms, and collection policies to ensure that the marginal benefit from additional sales exceeds the marginal cost of carrying receivables. These costs include opportunity costs of tied-up capital, administrative expenses, and default risk. Effective receivables management supports liquidity while preserving customer relationships. Option D accurately reflects this balanced objective, whereas the other options ignore either revenue growth or cash flow discipline.

Question 2

Question Type: MultipleChoice

Kretsmart anticipates its sales will grow by 10% each year for the next two years. Information from the company's current income statement is given below, and Cost of Goods Sold (COGS) is assumed to be a spontaneous account.

Kretsmart Income Statement Current Year	
Sales	$100
Cost of Goods Sold	$45
Gross Margin	$55

What would the company's projected gross margin for Year 2?

Options:

A- $59.45
B- $66.55
C- $71.25
D- $76.00

Answer:

B

Explanation:

When sales grow and cost of goods sold (COGS) is assumed to be a spontaneous account, COGS increases proportionally with sales. In the current year, Kretsmart's gross margin ratio is calculated as Gross Margin Sales = $55 $100 = 55%, while COGS represents 45% of sales.

Sales are projected to grow by 10% per year for two years. Therefore, projected sales for Year 2 are:

$100 1.10 1.10 = $121.00.

Since COGS remains 45% of sales, projected COGS for Year 2 equals:

$121.00 0.45 = $54.45.

Gross margin is then calculated as:

$121.00 $54.45 = $66.55.

Financial management forecasting techniques commonly use percentage-of-sales assumptions for spontaneous accounts such as COGS, inventory, and receivables. This method allows managers to project future income statements consistently with expected growth. Option B

($66.55) correctly reflects the projected gross margin for Year 2 under these assumptions.

Question 3

Question Type: MultipleChoice

What is the purpose of the Sarbanes--Oxley Act requirement for the board of directors to effectively represent shareholders?

Options:

A- To ensure the board's financial gain
B- To increase stock prices
C- To manage daily operations
D- To represent shareholders' interests in good faith

Answer:

D

Explanation:

The Sarbanes--Oxley Act reinforces the board of directors' fiduciary duty to act in the best interests of shareholders. This includes providing independent oversight of management, ensuring financial reporting integrity, and protecting shareholder rights. SOX emphasizes board independence, particularly through audit committees composed of independent directors. Financial management theory recognizes the board as a key mechanism for reducing agency conflicts between management and shareholders. Option D correctly reflects this governance-focused objective.

Question 4

Question Type: MultipleChoice

What is a potential drawback of lowering the annual dividend payment?

Options:

A- It can lead to an immediate increase in the company's stock price.
B- It could possibly increase the company's net margin.
C- It might lead to higher sales growth for the company.
D- It may cause the company's stockholders to react negatively.

Answer:

D

Explanation:

Dividend policy carries important signaling effects in financial markets. Investors often view dividends as a signal of management's confidence in the firm's future cash flows. When a company lowers its dividend, shareholders may interpret the action as a sign of financial distress, declining profitability, or uncertainty about future earnings. This negative perception can result in a decline in the firm's stock price and reduced investor confidence. While dividend reductions may free up cash for reinvestment and improve long-term financial flexibility, the short-term market reaction is often unfavorable. Financial management literature stresses that dividend changes should be made cautiously and clearly communicated to avoid misinterpretation. Option D correctly identifies this key drawback.

Question 5

Question Type: MultipleChoice

In the capital asset pricing model (CAPM), what does a beta () greater than 1 signify for a portfolio?

Options:

A- The portfolio will always outperform the market.
B- The portfolio has more risk than the market.
C- The portfolio has less risk than the market.
D- The portfolio is expected to move in the opposite direction of the market.

Answer:

B

Explanation:

Within the CAPM framework, beta quantifies the degree of systematic risk relative to the market portfolio, which by definition has a beta of 1. A portfolio with a beta greater than 1 carries more systematic risk than the market, meaning its returns are expected to be more sensitive to market movements. This higher sensitivity increases both upside potential and downside exposure. According to CAPM, investors require a higher expected return for bearing this additional risk. Importantly, a higher beta does not guarantee superior performance; it simply reflects greater volatility relative to the market. Option B accurately captures this risk-based interpretation.

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Question 6

Question Type: MultipleChoice

A stock has a dividend per share of $5 and is expected to grow at a constant rate of 3% indefinitely. The required rate of return is 9%.

What is the value of the stock?

Options:

A- $57.22
B- $85.83
C- $100.50
D- $171.67

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Answer:

B

Explanation:

This question applies the Gordon growth (constant growth dividend discount) model, which values a stock as the present value of an infinite stream of dividends growing at a constant rate. The model assumes that dividends grow steadily and that the required rate of return exceeds the growth rate, ensuring a finite value. The formula is:

Stock Value = D (r g),

where D is the dividend expected next year, r is the required rate of return, and g is the growth rate. If the current dividend is $5, the next dividend equals $5 (1 + 0.03) = $5.15. Substituting

into the formula gives:

$5.15 (0.09 0.03) = $5.15 0.06 = $85.83.

This valuation approach is commonly used for mature firms with stable dividend policies and predictable growth. Financial managers and analysts rely on this model to estimate intrinsic stock value and assess whether a stock is overvalued or undervalued relative to its market price.

Question 7

Question Type: MultipleChoice

Which type of company would likely have a high credit rating for its bonds?

Options:

A- A company with a history of defaulting on its debt obligations
B- A company with high debt ratios and low liquidity ratios
C- A financially solid company with low debt and high earnings
D- A new company with unproven market penetration and high operational costs

Answer:

C

Explanation:

Bond credit ratings assess the likelihood that a borrower will meet its interest and principal obligations. Rating agencies evaluate factors such as earnings stability, cash flow coverage, leverage, liquidity, and overall business risk. Companies with strong, consistent earnings and low leverage are viewed as less risky because they have greater capacity to service debt even during economic downturns. High liquidity further reduces default risk by ensuring near-term obligations can be met. Option C best matches these criteria. Firms with a history of default, excessive leverage, weak liquidity, or uncertain business models face higher perceived risk and therefore receive lower credit ratings. High credit ratings allow firms to borrow at lower interest rates, reducing financing costs and improving financial flexibility---key goals in long-term financial management.

Question 8

Question Type: MultipleChoice

A company has a return on assets (ROA) of 10% and total assets of $500 million.

What is its net income?

Options:

A- $5 million
B- $10 million
C- $50 million
D- $100 million

Answer:

C

Explanation:

Return on assets (ROA) measures how effectively a firm uses its assets to generate profits and is calculated as Net Income Total Assets. To find net income, the formula is rearranged:

Net Income = ROA Total Assets.

With an ROA of 10% (0.10) and total assets of $500 million, net income equals $50 million. ROA is a critical profitability metric in financial statement analysis because it links income to the asset base, allowing comparisons across firms and industries regardless of size. A higher ROA indicates more efficient asset utilization. Option C correctly applies the ROA formula and reflects standard financial analysis practice.

Question 9

Question Type: MultipleChoice

To answer this question, refer to the cash flow worksheet and the internal rate of return (IRR) calculations. The hospital is only interested in accepting projects with an IRR that exceeds 11%. Assuming the hospital has sufficient capital for both projects and is willing to invest for up to 10 years, which project(s) would the hospital accept?

Options:

A- Project A
B- Both Project A and Project B
C- Neither Project A nor Project B
D- Project B

Answer:

B

Explanation:

The internal rate of return (IRR) represents the discount rate at which a project's net present value (NPV) equals zero. Financial management theory states that a project should be accepted if its IRR exceeds the firm's required rate of return (or hurdle rate), assuming conventional cash flows and no capital rationing.

In this scenario, the hospital has a minimum required return of 11% and sufficient capital to undertake all acceptable projects. Based on the provided IRR calculations, both Project A and Project B have IRRs exceeding 11%, making them financially acceptable under the IRR decision rule. Because there is no capital constraint and the investment horizon is sufficient, the hospital should accept both projects.

Financial management texts caution that IRR can sometimes produce misleading rankings when projects differ significantly in scale or timing. However, when evaluating independent projects with acceptable IRRs, the correct decision is to accept all projects that meet or exceed the required return. Option B correctly reflects this principle.

Question 10

Question Type: MultipleChoice

What is a function of the Financial Industry Regulatory Authority (FINRA)?

Options:

A- Issuing currency
B- Insuring bank deposits
C- Managing federal monetary policy
D- Regulating brokerage firms

Answer:

D

Explanation:

FINRA's core function is regulating brokerage firms and registered representatives to ensure fair and honest markets. It establishes and enforces rules governing trading practices, licensing, disclosure, and ethical conduct. FINRA also conducts examinations, investigates misconduct, and administers arbitration and mediation between investors and brokers. Unlike the Federal Reserve or FDIC, FINRA does not manage monetary policy or insure deposits. Financial management and regulatory texts consistently describe FINRA as a critical component of U.S. securities market oversight. Option D correctly identifies its primary role.

Question 11

Question Type: MultipleChoice

What distinguishes free cash flow to equity (FCFE) from free cash flow to the firm (FCFF)?

Options:

A- FCFE is distributable only to debt holders, whereas FCFF is distributable only to equity holders.
B- FCFE includes depreciation, amortization, and other non-cash expenses, while FCFF does not.
C- FCFE measures cash distributable to equity holders after all obligations are met, including debt payments.
D- FCFE represents the total cash flow from operations that is available at the end of the period.

Answer:

C

Explanation:

Free cash flow concepts are central to valuation. Free cash flow to the firm (FCFF) represents cash available to all capital providers---both debt and equity---before interest and principal repayments. In contrast, free cash flow to equity (FCFE) measures the cash available exclusively to common shareholders after all operating expenses, capital expenditures, working capital needs, and debt obligations (interest and principal) have been satisfied. This distinction

determines which discount rate analysts use: FCFF is discounted at the weighted average cost of capital (WACC), while FCFE is discounted at the cost of equity. FCFE is especially useful when valuing equity directly or when a firm's leverage is stable and predictable. Option C correctly captures this defining difference, while the other options misstate cash flow allocation or confuse accounting adjustments with distributable cash.

Question 12

Question Type: MultipleChoice

What costs are considered part of an asset's initial investment?

Options:

A- Discounted salvage value
B- Delivery and installation
C- Depreciation
D- Market research

Answer:

B

Explanation:

The initial investment for a capital project includes all costs required to acquire and prepare an asset for use. These costs typically include purchase price, delivery, installation, testing, and any necessary setup expenses. Financial management texts clearly distinguish these capitalized costs from expenses such as depreciation, which is an accounting allocation over time, and salvage value, which is considered at the end of a project's life. Market research is usually treated as a separate operating or planning expense unless directly attributable to asset acquisition. Option B correctly identifies delivery and installation as part of the initial investment.

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