

YOU HAVE 75 MINUTES TO COMPLETE BOTH PARTS OF THIS EXAM

Instructions:

- 1) The part of the exam is closed book and closed notes. No scrap paper is allowed, use the back of the exam if necessary.
- 2) Partial points are based on readily observable evidence that you know at least part of the solution concept. The more evidence presented (and the clearer the evidence), the better the chance for partial points. In other words, SHOW ALL WORK!
- 3) If you have additional time remaining, give your work one last check.
- 4) True/False questions are worth 2 points. Multiple-choice questions are worth 3 points. Short answer/Fill in the Blanks questions usually take less than three sentences and are worth 4 points. The Essay question is worth 15 points.

1. The primary goal of a publicly owned firm interested in serving its stockholders should be to
d. Maximize the stock price per share.
2. What is a zero-sum game? You are competing in a zero-sum game, in which you are better than your competitor is. Is this game a positive NPV, negative NPV, or 0-NPV games for you? Explain why you choose this NPV.

Sum of the NPV's for all players is equal to 0. Postive, Negative, or 0 NPV depends on player skill. If there is only one other player, and you are the better player, then this should be a positive NPV game.

- 3) Before the semester, you were considering taking FINC 4531 but realized the time of the course would conflict with another class that you needed. Which term best describes the situation associated with being able to take only one of the two courses?
D) opportunity cost
4. What is the second best answer to this question? Explain your choice.

I looked for a correct definition of the term and some application of the term. Best answer hubris as only an optimistic person would take this class when they had an excuse not to take it.

- 5) Which of the following statements is most correct?
c. The tax rate the IRS applies to the pre-tax profits of corporations often exceeds 10%.
- 6) Which of the following statements best describe the difference between finance and accounting?
B) Accounting generally has an historical outlook, while finance considers the future.
- 7) What is the Balance Sheet Identity?
 $Assets = Liabilities + Equity$
8. What primarily distinguishes current liabilities from other classes of liabilities on the balance sheet?
Current liabilities mature in one year (or alternately one business cycle), all other liabilities mature in more than one year.
- 9) Name four basic stockholder rights.
 1. Voting/Control
 2. Regular Cash/Stock Dividends, based on ownership level
 3. Liquidating dividends, based on percent of ownership level
 4. preemptive right (sometimes)
- 10) The structure of a firm's balance sheet is most consistent with which model of the firm?
b) Accounting Model.

11) Since large, publicly owned firms are controlled by their management teams, and typically, ownership is widely dispersed, managers have great freedom in managing the firm. Managers may operate in stockholders' best interests, but they may also operate in their own personal best interests. As long as managers stay within the law, there simply are not any effective controls over managerial decisions in such situations.

b. False

11) Which of the following statements describe money market securities?

A) Money market securities are short-term claims with an original maturity that is generally one year or less.

12) Which of the following statements is false?

A) The maturity date for Bonds, Preferred Stock, and Common Stock are all longer than one year.

D) Bonds are long-term debt securities with a legal obligation to pay fixed, periodic interest payments and the principal on the date of maturity.

Both A and D were accepted. A is the better answer, as some debt has floating interest rates.

13) Non-cash assets are expected to produce cash over time but the amount of cash they eventually produce could be higher or lower than the values at which the assets are carried on the books.

a. True b. False

14. An agency relationship exists when one or more persons hire another person to perform some service and then delegates decision-making authority from that person.

a. True.

15. The costs associated with agency costs are most often paid by the principal.

b. False.

16) List the four required financial statements?

Balance sheet, income statement, statement of cash flows, statement of retained earnings.

17. ESSAY QUESTION (15 POINTS)

In our textbook's Chapter 2, some Principles of Finance are listed. The textbook then uses these principles, in the remaining chapters of the book, to show that most finance topics can be explained using these principles. In the design of this course, I have attempted to reward the correct application of the principles and to make the course more difficult for those that ignore the principles.

Using at least 5 different Principles of Finance and 5 different examples from this semester's 4531 class, you are to give examples of situations/activities that are consistent (at least 3 examples) and inconsistent (at least 1 example) with the principles. For each example, describe the example, list the principle, then explain apply the principle to the situation. The examples can be from written material, my actions, or actions of other students. The inconsistent must be something for which I (Dr. Hodges) am responsible. Be verbose. At a minimum, I expect you to fill completely the remainder of this page. Note, that simply listing the principles is worth no points, it is the correct application of the Principles that I am grading. Use the back of pages, if you need more room.

Lots of stuff accepted, below are paraphrased answers to protect the innocent.

Self-interested behavior –

Consistent:

a. Opportunity cost to determine how much to study for this class compared to my other classes.

b. I will write something on this question figuring the professor will give me some points because he does not want to argue about grades.

- c. I should have taken this class with Dr. Yoder, he is easier and higher grades are associated with higher salaries.
- d. One of my classmates got the exam answers when they were posted, but did not tell me they were available, thus hurting my exam score and making their class ranking higher.
- e. I helped someone in the computer lab with their project, figuring they would owe me and help me in return later.
- f. I told this guy/girl I needed help on the exam to get her/him to study with me, even though I am the better student. Mainly I just wanted an excuse to be around him/her.
- g. Professor Hodges only gave a good explanation about part of the project. He said it was to encourage us to think, I think it was because he did not want to keep writing the instructions.
- h. Professor Hodges reuses lots of test questions, probably because he is too lazy to write more.
- i. Asking people to stand up on the first day to help you learn names, helps you but did not benefit students.

Inconsistent:

- a. the number of exams, quizzes, and projects create a lot of grading and student complaints, if he were consistent he would give us less work.
- b. some students did not open the quizzes the maximum number of times.
- c. Based on how well I am doing on this test, maybe I should be working instead of going to school.

2-sided transactions

- a. I loaned someone my pencil and then I did not have anything to write with, 0-sum.
- b. The attendance policy, each point taken from people missing class is given to people who do not miss class. I have an incentive to encourage other people to miss class.
- c. Grading on the project is forced separation of grades, 1/3 to good, average, and poor. If few people do nothing, I can do anything and still get at least average.

Actions convey Information

- a. sending in my answers to the old exams signals I am a good student.
- b. Many people are turning in the 1st part of the exam, signaling tells me I need to turn in my part now also or else I am falling behind.
- c. In studying for the test, we noticed several questions/topics were on every test. I assume this signaled they were important.
- d. The professor told us the scrambled financial statements would be on the closed book part, but might be on open book if test was hard. Since the problem is not on the closed book, he is signaling this is a hard test.

When all else fails, look to what other are doing

- a. when the roll to name companies went by, the first person did not list a company, most of the rest of the class then also did not list a company.
- b. very few people will give an answer to questions asked by the instructor.
- c. many of us are wearing the same style of clothes.
- d.

Inconsistent:

- a. Professor Hodges wearing shirts of failed companies, who wants to be grouped with failures.

Diversification:

- a. I am trying to do well on the quizzes so I can slack off on the project.
- b. By taking all the quizzes many times, I am likely to get some easy questions.

Investors are risk averse:

Extraordinary returns are achievable with new ideas

- a. the first people to choose their company got the best and easiest companies.
- b. the first people to take the online quizzes had more time to correct their answers.
- c. the first people to send in solutions to the online exams, got the corrected answer 24 hours before the rest of the class.

Expertise can build value:

Consistent:

- a. If I had studied more for this exam, I would have made a better grade.
- b. The people who have completed several finance classes have the advantage over those completing only 3511.
- c.

Inconsistent:

- a. For someone who supposedly knows finance, Dr. Hodges sure makes a lot of mistakes in his lectures.
- b. I know this material really well, _____ does not, and I think she will make a better grade on this test.

Options are valuable:

- a. we had the option to take the quizzes multiple times. If I scored badly, I had the option to try again.
- b. we have the option to miss class at a cost of 1 point beyond the 1st missed class.
- c. If I flunk out of finance, I can always get a degree in management.
- d. McDonalds is always hiring.
- e. Daddy will give me a job.

Decisions are based on Incremental Benefits:

Consistent:

- a. I am not doing well on this exam, but there is nothing I can do about it, it is a sunk cost.
- b. Incremental benefit to determine how much to study for this class compared to my other classes.
- c. The attendance policy makes me look at how much I would enjoy a free day versus a cost of 1 point for each miss.

Inconsistent:

- a. I took the Chapter 2 quiz 4 times, the last three times I made 88, thus I got no incremental benefit for my time investment.

Risk-Return tradeoff:

- a. I must decide how long to spend on this part of the exam, or run the risk not to have time to complete the next part of the exam.
- b. How much to study for this class compared to my other classes.
- c. I waited till the last minute to study for this exam, taking a chance on a lower grade, in order to do other stuff I needed to do.
- d. I skipped class one day. The risk was I might miss stuff important for the exam, the return was the day off.

Capital Market Efficiency, reflect information quickly:

Time Value of Money:

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1. (3 points) Your grandmother, instead of going out to dinner on the night you were born, deposited the expected cost of the meal \$37.02 in a small cap mutual fund. Over your lifetime, the fund returns the historical average of 17.9%. Assuming you take no withdrawals during your life, at your social security retirement age of 67 (end of year 67), how much money would you expect to have in the mutual fund? Calculate your answer to the nearest \$.01.

2290136.43

2. (3 points) Assume that you currently have \$2,000. A rich uncle offers to give you nothing for the next 5 years, \$3,000 a year in Years 6 through 11, and \$12,000 in Year 12, with all cash flows to be received at the end of the year. If you expect a 9.3 percent rate of return, including your \$2000, what is the present value of these cash flows?

14678.61

3. (3 points) Using the numbers from the above problem, and maintaining the 9.3% interest rate, how much would you expect to have in 15 years?

55716.96

4. (3 points) What is the future value of an 8-year annuity due with annual payments of \$2,178, assuming a 4.4% nominal interest rate?

21252.58

5. (3 points) You are offered an investment that pays your \$2000 per year for the next 20 years. In return, you must repay \$60,000 at the end of 21 years. If your required return in 7%, what is the net present value of this investment to you? Show your answer to the nearest \$.01 and be sure to use the negative sign if the NPV is negative.

+6697.24

6. (20 points) Fill in the missing numbers. Note, all of the below accounts will be used in creating the income statement or balance sheet. Use the back of the page, if needed.

Income/(loss) from operations 13646 Interest expense, net 17966

Other Non-Current Assets 17060 Accrued Billings in excess of costs 31288

Total Long-term Liabilities 206770 Accounts receivable 294883

Additional paid-in capital 414449

Total liabilities and stockholders' equity 580933

Revenues 902284

Net income/(loss) 4843