

1. From a finance perspective, what is the primary goal of the corporation?

- a. Maximize the pay and compensation of employees and managers of the firm.
- b. Maximize the value of the stockholder's position because they are the owners of the corporation.**
- c. Maximize the wealth of all stakeholders if the firm wants to continue to exist.
- d. Maximize the societal value to minimize governmental interference.
- e. Maximize profits.

2. Which of the following is not considered one of the basic questions of corporate finance?

- a. What long-lived assets should the firm invest?
- b. How much inventory should the firm hold?**
- c. How can the firm raise cash for required capital expenditures?
- d. How should the short-term operating cash flows be managed?
- e. All of the above.

3. Financial markets are composed of

- a. capital markets and equity markets.
- b. capital markets and debt markets.
- c. capital markets and money markets.**
- d. equity markets and money markets.

4. A financial manager's most important job is to create value. List four ways that describe how financial managers create value.

**Multiple answers accepted. Some examples. 1. Insuring that only positive NPV projects are accepted. 2. considering both the risk and return of projects is considered. 3. optimizing the firm's financing choices. 4. minimizing/reducing the firms operating expenses.**

5. Some facts about sole proprietorships include:

- a. they are easily and cheaply setup.
- b. the proprietorship life is limited to the business owner's life.
- c. all business taxes are paid as individual tax.
- d. All of the above.**
- e. None of the above.

6. The decision to incorporate must consider the fact that earnings will be taxed at both the corporate and personal levels. Since this is disadvantageous, provide three reasons why one may want to incorporate.

**Most popular choices were 1. life of firm not limited to life of owners. 2. ease of raising capital. 3. limited liability of firm's shareholders**

7) Name four basic stockholder rights.

- 1. voting/control**
- 2. regular cash/stock dividends**
- 3. Liquidating dividends**
- 4. pre-emptive right when firm sells new shares.**

8. The primary market is defined as the:

- a. market for insured securities.
- b. market for new issues.**
- c. market for securities of the largest firms.
- d. over-the-counter market.
- e. None of the above.

9. Finance assumes that investors are risk averse, while accounting makes no assumption about investor risk tolerance.

- a. True**
- b. False

10. Briefly explain why your answer to the above question is correct.

**Most common answers, 1) finance focuses on value (defined as present value of future cash flows discounted at risk-adjusted discount rate) while accounting focuses on profit (which does not consider risk). 2) finance forward looking therefore must explicitly consider risk, while accounting is historical in nature and there is no risk in history.**

11. One would generally expect the yield on Treasury bills to be driven primarily by the principle of capital market efficiency, while the yield on local Certificates of Deposit would be driven primarily by the behavioral principle.

a. True

b. False

12. Briefly explain why your answer to the above question is correct.

**Multiple answers accepted. Most common. Treasury bills sold at auction in a very liquid market, while local CD is sold to local customers. Smaller local banks would be more likely to look to their competition in setting these local rates.**

13. Moral hazard refers to situations wherein the agent can take unseen actions for personal benefit even though such actions are costly to the principal.

a. True

b. False

14. Which of the following is not a source of net working capital?

a. Acquiring a fixed asset.

b. Paying a cash dividend.

c. Paying off a bank loan.

d. All of the above are sources of net working capital.

**e. None of the above is a source of net working capital.**

15) List two business activities that would (temporarily) have a greater positive impact on net income than cash flow. Then list the balance sheet account(s) that would be affected by this activity.

**Many answers accepted, some include: 1. Selling a profitable item to a customer on credit. 2. Swapping services with another firm, where you count the benefit as income and capitalize the expense. 3. Lowering the tax rate used to calculate net income, as lowering the rate does not change the taxes either owed or paid. 4. Selling new stock to repurchase debt and therefore reduce interest expense.**

16) List the four required financial statements?

**Balance Sheet, Income statement, statement of cash flows, statement of retained earnings.**

### 18. ESSAY QUESTION (15 POINTS)

**Many answers accepted.**

**The key is that one must apply the lesson, not just cite the lesson.**

**People act in own self interest is Redstone firing Tom Cruise even though he is "terrific actor" as his behavior reduced the box office of Mission Impossible 3.**

1. (3 points) Your grandmother, instead of going out to dinner on the night you were born, deposited the expected cost of the meal \$79.07 in an S&P 500 index mutual fund. Over your lifetime, the fund returns the historical average of 12.2%. 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. **FV=176820.7191**

2. (3 points) Assume that you currently have \$6,000. A rich uncle offers to give you nothing for the next 4 years, \$3,500 a year in Years 5 through 11, and \$12,000 in Years 12 to 14, with all cash flows to be received at the end of the year. If you expect a 7.5 percent rate of return, including your \$6000, what is the present value of these cash flows? **NPV=+33966.09753**

3. (3 points) Using the numbers from the above problem, and maintaining the 7.5% interest rate, how much would you expect to have in 15 years? **FV=100501.5168**

4. (3 points) 1. An S&L provides a loan with 15 yearly repayments of \$8,000 with the first payment beginning immediately. Which of the following amounts comes closest to the present value of the loan if the interest rate is 7%?

a. \$ 72,863    **b. \$ 77,964**    c. \$115,648    d. \$120,000

e. Not enough information is given to determine the answer.

5. (3 points) You are offered an investment that pays you \$6000 today, and then \$2000 per year at the end of the next 25 years. In return, you must repay \$65,000 at the end of 25 years. What is the return on this investment? **Note, this was corrected to 25 years. Also the actual net cash flows are +6000 in**

**year 0, +2000 in years 1-24, and -63000 in year 25 (-65000+2000), thus the IRR = +1.091%.  
 If you solve using 30,  
 IRR=-.096%**

6. (3 points) New Hampshire Services reported \$2.6 million of retained earnings on its December 31, 2004 balance sheet. In 2005, the company lost money its net income was -\$800,000 (negative \$500,000). Despite the loss, the company still paid a \$1.00 per share dividend. The company's earnings per share for 2005 were -\$4.00 (negative \$4.00). What was the level of retained earnings on the company's December 31, 2005 balance sheet. **2.6 - .8 -.2=1.6, hint use the eps to find the number of shares the use the dps and number of shares to find the amount of the dividend.**

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.

<b>Depreciation and Amortization</b>	<u>  334.4  </u>
<b>Accumulated Depreciation</b>	<u>  865.9  </u>
Cash & Equivalents	<u>  1261.3  </u>
<b>Operating Profit</b>	<u> -2133.6  </u>
<b>Capital Surplus</b>	<u>   143.5  </u>
<b>Other Long Term Assets</b>	<u> not graded  </u>
<b>Sales</b>	<u> 2204.3  </u>
<b>Taxes Payable</b>	<u>      0  </u>
<b>TOTAL ASSETS</b>	<u>  7479.8  </u>
<b>Total Income Taxes</b>	<u> -647.3  </u>

Net Plant, Property & Equipment	4065.1	Selling, General, & Admin Expense	1081.4
Accounts Payable	445.3	Accrued Expenses	55.0
Net Income	-1540.2	Intangibles	53.8
Notes Payable	100.0	Net Receivables	1499.9
Inventories	7.3	Total Current Liabilities	708.5
Long Term Debt	123.2	Other Expenses	590.3
Deferred Charges (long term asset)	273.1	Long Term Debt Due In One Year	101.2
Interest Expense	68.3	Pretax Income	-2167.5
Prepaid Expenses	20.0	Other Current Assets	100.0
Total Current Assets	2888.5	Gross Plant, Property & Equipment	4981.0
Common Stock	5621.2	Retained Earnings	894.4
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>7479.8</b>	Cost of Goods Sold	2221.8
Gross Profit	-117.5		

Cash & Equivalents	1261.3
Net Receivables	1499.9
Inventories	7.3
Prepaid Expenses	20
Other Current Assets	100
Total Current Assets	2888.5
Gross Plant, Property & Equipment	4981
Accumulated Depreciation	915.9
Net Plant, Property & Equipment	4065.1
Intangibles	53.8
Deferred Charges (long term asset)	273.1
Other Long Term Assets	199.3
<b>TOTAL ASSETS</b>	<b>7479.8</b>
Long Term Debt Due In One Year	101.2
Notes Payable	100
Accounts Payable	445.3
Taxes Payable	7
Accrued Expenses	55
Total Current Liabilities	708.5

Long Term Debt	123.2	
Common Stock	5621.2	
Capital Surplus	132.5	
Retained Earnings	894.4	
TOTAL LIABILITIES & EQUITY		7479.8
Sales	2104.3	
Cost of Goods Sold	2221.8	
Gross Profit	-117.5	
Selling, General, & Admin Expense		1081.4
Depreciation and Amortization		310
Other Expenses	590.3	
Operating Profit	-2099.2	
Interest Expense	68.3	
Pretax Income	-2167.5	
Total Income Taxes	-627.3	
Net Income	-1540.2	