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 20 points.

1. What is the goal of a firm? Be sure to mention risk and cash flows in your answer.

2. Finance is primarily concerned with determining __________.
   A) costs  B) profits  C) value
   D) all of the above  E) none of the above

3) Which of the following forms of ownership are purchased in the capital markets?
   A) stocks  B) computer equipment  C) bank debt
   D) all of the above  E) none of the above

4) The following statement best describes an asymmetric information problem.
   A) Insiders know that the market tests are favorable but investors do not.
   B) Managers and owners are privy to the same information.
   C) Executives and customers both know that flip-flops can be made cheaply.
   D) All shareholders are also debtholders.
   E) All of the above correctly describe the asymmetric information problem.

5) Which of the following statements best describe the difference between finance and accounting?
   A) Accounting focuses on making decisions, while finance tries to determine value.
   B) Accounting generally has an historical outlook, while finance considers the future.
   C) Accounting asks questions like "Where do we go from here?", while finance asks questions like, "What do we do now?"
   D) Finance wants to know what happened yesterday, while accounting wants to know what happened today.
   E) There is little difference between finance and accounting.

6) Which of the following statements is true?
   A) The set-of-contracts model views the firm as a set of contracts among its various stakeholders.
   B) The set-of-contracts model represents the firm as a set of financial statements.
   C) The investment-vehicle model views the firm from the viewpoint of debtholders.
   D) The investment-vehicle model views the firm from the viewpoint of managers.
   E) None of the above is a true statement.

7) The difference between the value of one action and the value of the best alternative is called moral hazard.
   a. True  b. False
8) Name four basic stockholder rights.
   1.
   2.
   3.
   4.

9) Hubris implies that a decision to buy or sell an asset can imply information about the condition of the asset.
   a. True       b. False

10) Arbitrage refers to the act of buying and selling an asset simultaneously, where the sale price is greater than the purchase price, so that the difference produces a riskless profit.
    a. True       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.
   B) Money market securities are long-term claims with an original maturity that is generally more than one year.
   C) Money market securities are short-term claims with an original maturity that is generally six months or less.
   D) Money market securities are short-term claims with an original maturity that is generally two years or less.
   E) All of the above are consistent with money market securities.

12) Which of the following statements is false?
    A) Preferred stock promises a dividend payment but usually does not give voting rights.
    B) Bonds are long-term securities issued by corporations or governments.
    C) Preferred stock is the residual interest in the firm and gives the owner dividend rights, voting rights, liquidation rights, and preemptive rights.
    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.

13) The income statement reports the financial position of a firm at a particular point in time.
    a. True       b. False

14) Depreciation increases an asset's book value each year.
    a. True       b. False

15) Generally accepted accounting principles (GAAP) refer to:
    A) the extent to which something can be sold for cash quickly and easily without loss of value.
    B) the length of an asset's life when it is issued.
    C) a report issued annually by a firm that includes, at a minimum, an income statement, a balance sheet, a statement of cash flows, and accompanying notes.
    D) a technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.

16) List the four required financial statements?
17) Book value (or Net book value) refers to:
A) the price for which something could be bought or sold in a reasonable length of time, where "reasonable length of time" is defined in terms of the item's liquidity.
B) the length of an asset's life when it is issued.
C) the statement of a firm's financial position at one point in time, including its assets and the claims on those assets by creditors (liabilities) and owners (stockholders' equity).
D) the net amount (net book value) for something shown in accounting statements.
E) None of the above.

18) What primarily distinguishes current liabilities from the other classes of liabilities on the balance sheet?

19. ESSAY QUESTION (20 POINTS)
Using at least 6 Principles of Finance, comment on the below story that appeared recently. Be verbose. At a minimum, I expect you to completely fill the following page. Use the back of pages, if you need more room.

Mutual fund probes spread

NEW YORK (CNN/Money) - Problems spread for the mutual fund industry Thursday, as more probes of the industry's trading practices were disclosed. Standard & Poor's said it is monitoring a similar mutual funds probe by the New York Attorney General Eliot Spitzer. Spitzer filed the complaints Wednesday charging four of the nation's largest mutual funds -- Bank One (ONE: Research, Estimates), Janus (JNS: Research, Estimates), Strong Financial and Bank of America (BAC: Research, Estimates) Nations Funds -- illegally gave a hedge fund special privileges to make illegal trades, in return for fees. S&P said it is not yet clear if the firms' credit ratings would be hurt by the probe, even if they are ultimately forced to pay a civil penalty. "Any potential settlement or litigation charges would be analyzed within the context of a firm's ongoing franchise and earnings power, and would need to be of a material size for there to be a ratings impact," said S&P's statement.

Spitzer also announced a $40 million settlement on Wednesday with Canary Capital Partners, a hedge fund based in Secaucus, N.J. Spitzer said Canary and its managing principal, Edward Stern, agreed to pay $30 million in restitution and a $10 million penalty to settle the charges against it, which included allegations that it had performed illegal trades of mutual fund shares. The firm and Stern neither admitted nor denied wrongdoing as part of the settlement.

The Boston Globe first reported in its Thursday edition that Prudential Securities is at the heart of an investigation by the Massachusetts' top securities regulator, Bill Galvin. A spokesman for Galvin subsequently confirmed to Reuters that the secretary was investigating Prudential, but did not say whether the probe also targets other companies. A spokesman for Prudential declined to comment.

Shares of insurer Prudential (PRU: down $0.94 to $36.51, Research, Estimates), parent of Prudential Securities were lower in trading Thursday, as were shares of Janus (JNS: down $1.12 to $15.76, Research, Estimates), Bank One (ONE: down $0.64 to $39.33, Research, Estimates) and Bank of America (BAC: down $1.61 to $76.39, Research, Estimates)
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1. (3 points) An investor deposits $500 into a bank account that pays interest at the rate of 6.5% per year (payable at the end of each year). She leaves the money and all accrued interest in the account for 15 years. How much will she have at the end of the 15 years?

2. (3 points) What is the present value of $700 to be received in two equal installments ($350 each), two years and five years from today, when the annual discount rate is 10%?

3. (3 points) Net income is $1,000,000 for the year, EBT is $2,500,000, retained earnings in January were $5,000,000, preferred dividends paid for the year are $100,000, common stock dividends paid for the year are $300,000, and common shares outstanding are 1,000,000. What are end-of-year retained earnings?

4. (20 points) Write out the Income Statement and Balance Sheet in the correct format and fill in the missing numbers. On the back of this page.

### Income Statement

For the Period January 1, 1999 to December 31, 1999

- **Sales**: 74.0
- **Total Liabilities and Stockholder’s Equity**: 23.6

### Balance Sheet

- **Paid In Capital**: 4.0 (an equity account)
- **Other Short Term Liabilities**: 3.0

- **Current Portion of Long Term Debt**: 1.7
- **Earnings before Taxes**: _____
- **Depreciation**: 2.5
- **Total Current Assets**: 17.1
- **Prepaid Rent**: 1.0
- **Cash and Marketable Securities**: _____
- **Cost of Goods Sold**: _____
- **Selling and Administrative Expenses**: 13
- **Total Current Liabilities**: _____

### Income Statement

- **Interest Expense**: .5
- **Income Taxes**: _____
- **EBIT**: _____
- **Net Plant and Equipment**: _____
- **Accounts Receivable**: 3.6
- **As of December 31, 1999**:
- **Inventory**: 9.5
- **Gross Profit**: 28.5
- **Labor Expense**: 6.0
- **Long Term Debt**: 3.5
- **Retained Earnings**: 7.0
- **Net Income**: 3.5
- **Accounts Payable**: _____
- **Common Stock (.01 par)**: 1.0
MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) C

2) A

3) A

4) B

5) D

6) A

7) A

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

8) The goal of a firm is to maximize shareholder wealth by focusing on the future cash flows of the firm.

9) The rights of stockholders include dividend rights, voting rights, liquidation rights, and preemptive rights.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

10) FALSE

11) FALSE

12) TRUE

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

13) B

14) C

15) A

16) C

17) B
TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.
18)   FALSE
19)   FALSE

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.
20)   D
21)   D
22)   B
23)   C
24)   C

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.
25) A call option is a right to buy. A put option is a right to sell.
26) Shares of stock in a firm represent ownership of the firm and gives voting rights. Bonds issued by a firm are long-term debt obligations of the firm that give holders first priority on the firm's cash flows.
27) A

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.
28) Current liabilities are liabilities that come due or are expected to be paid out in cash within 1 year.
29) B

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.
30) B