

MULTIPLE CHOICE (3 points each)

1. Which of the following statements is correct?
 - A. Accountants are focused on what happened in the past.
 - B. Financial managers are focused on what happened in the past.
 - C. Financial managers double-check the accountant's statements.
 - D. Accountants and financial managers use total quality management systems to standardize data.

2. Maximizing owners' equity value means carefully considering all of the following except _____.
 - A. Which projects to invest in
 - B. How best to increase the firm's risk
 - C. How to best bring additional funds into the firm
 - D. How best to return the profits from those projects to the owners over time

3. The most common type of business in the United States is the _____.
 - A. Hybrid organization such as a limited liability company
 - B. Sole Proprietorship
 - C. Partnership
 - D. Corporation

4. All of the following are advantages to organizing as a corporation except _____.
 - A. Easy to transfer ownership
 - B. Easy access to capital
 - C. Double taxation
 - D. Limited liability

5. From the perspective of raising to capital, the best form of business organization is the _____.
 - A. Sole proprietorship
 - B. S Corporation
 - C. Corporation
 - D. Partnership

6. From the perspective of limiting ownership risk, the best form of business organization is the _____.
 - A. Sole proprietorship
 - B. S Corporation
 - C. Corporation
 - D. Partnership

7. The biggest disadvantage of the sole proprietorship is _____.
 - A. Limited access to capital
 - B. Unlimited liability
 - C. Double taxation
 - D. Total control

8. From the perspective of key owner control, the best form of business organization is the _____.

- A. Sole proprietorship
- B. S Corporation
- C. Corporation
- D. Partnership

9. Which of the following statements is correct?

- A. Shareholder wealth maximization is achieved by maximizing company profits.
- B. Shareholder wealth maximization is achieved by maximizing market share.
- C. Shareholder wealth maximization is achieved by maximizing sales.
- D. Shareholder wealth maximization is achieved by minimizing costs.
- E. Shareholder wealth maximization is achieved by maximizing risks.
- F. Shareholder wealth maximization is achieved by minimizing risks.
- G. None of the above.

10. An employee stock option plan is _____.

- A. A plan that only partnerships can use to defer compensation to partners
- B. A perk usually only given to the board of directors as compensation
- C. A way to align the interests of employees with those of the owners
- D. None of these answers are correct

11. The agency relationship in corporate finance refers to _____.

- A. when the board of directors oversee the CEO
- B. when the board of directors are elected to staggered terms
- C. when the shareholders hire a manager to run their company
- D. when the corporate hires an advertising agency to market their new product/service

12. While cash flow is more often used in financial analysis, which of the following is not a reason to require firms to still report accounting profit?

- A. We need to keep accountants employed
- B. accounting profit proxies economic profit
- C. accounting profit will generally have less erratic swings from year to year
- D. accounting profits reflect the prospect of the business as a 'going concern'

13. All of the following are cash flows from investing activities except a(n)_____.

- A. All of these items are cash flows from investing.
- B. Increases in marketable securities
- C. Decreases in fixed assets
- D. Increases in fixed assets

14. All of the following are cash flows from financing activities except a(n) _____.

- A. Increase in accounts payable
- B. Stock Repurchases
- C. Paying dividends
- D. Issuing stock

15. Choose the phrase that makes this statement true: Ratio analysis can provide useful information on a firm's

- A. past but not current position.
- B. current position and hint at future performance.
- C. current position but should never be used to forecast future performance.
- D. past and current position, but should never be used to forecast future performance.

16. Which of the following is not true about ratio analysis?

- A. Ratio analysis tells us how to fix our organization.
- B. Ratio analysis can show us how our organization changes over time.
- C. Though ratio analysis uses accounting data, not cash flow, it is still useful.
- D. Ratio analysis can show us how our organization compares to other organizations.

17. Which of the following statements is correct?

- A. To interpret financial ratios, users should analyze the performance of the firm over time and the performance of the firm against one or more companies in the same industry.
- B. Performing cross-sectional analysis is easy as industries are clustered with firms that are identical.
- C. Time-series analysis is useless in assessing improvement or deterioration of ratios since the data is historical.
- D. Performing cross-sectional ratio analysis refers to assessing how a firm performed over a certain section of time.

18. All of the following are reasons that one should be cautious in interpreting financial statements except _____.

- A. Firms can take steps to over, or understate earnings at various times.
- B. It is difficult to compare two firms that use different depreciation methods.
- C. Financial managers have some latitude in accounting rules to manage their reported earnings.
- D. All of the above are reasons to be cautious in interpreting financial statements.

19. A strong liquidity position means that _____.

- A. the firm pays out a large portion of its net income in the form of dividends
- B. the firm is able to meet its short-term obligations
- C. the firm uses little debt in its capital structure
- D. the firm pays its creditors on-time

20. Which of the following statements is correct?

- A. In general, a firm should strive for a high average payment period because it wants to pay for its purchases as quickly as possible.
- B. If a firm has a very high fixed asset turnover, it means that the firm may be nearing its maximum production capacity.
- C. An extremely low average collection period will maximize net income.
- D. A debt ratio of zero, so no interest is paid, is the most profitable strategy.

21. Which of the following activities will increase a firm's current ratio?

- A. Purchase inventory using cash.
- B. Accrued wages and taxes increase.
- C. Accounts receivable are paid in cash.
- D. Buy equipment with a short-term bank loan.
- E. None of these statements will increase a firm's current ratio.

22. A firm has an average collection period of 13 days. The industry average ACP is 27 days. Which of the following statements is true given this information?

- A. The firm could probably increase its sales by relaxing its strict accounts receivable policy.
- B. The firm is maximizing its net income by minimizing its losses in accounts receivable.
- C. The firm has an excellent accounts receivable policy.
- D. Both statements b and c are correct.

23. A firm may not want to strive to match industry average ratios when:

- A. Firms in the industry are shifting into different directions.
- B. Most of the other firms in the industry are foreign firms.
- C. They are the leader in the industry.
- D. All of the above.

24. Which of the following will always increase a firm's quick ratio assuming no other accounts change?

- A. An increase in inventory by long-term borrowing.
- B. A reduction in accounts payable by returning defective products.
- C. A decrease in accounts receivable by collecting money owed.
- D. All of these statements will increase a firm's quick ratio.

25. Which statement is true?

- A. Extremely high levels of liquidity guard against liquidity crises, but at the cost of lower returns on assets
- B. The less liquid assets a firm holds, the less likely it is that the firm will experience financial distress.
- C. The lower the liquidity ratios, the less liquidity risk a firm has.
- D. Liquid assets generate profits for the firm.

26. Which of the following statements is correct?

- A. The use of debt in the capital structure results in tax benefits to the firm.
- B. Debt is referred to as "financial leverage" because it magnifies returns to shareholders.
- C. Debt management ratios evaluate whether a firm is financing its assets with a reasonable amount of debt versus equity financing.
- D. All of these statements are correct.

27. The main two sources of the time value of money are:

- A. Interest Rates and Risk,
- B. Inflation and Interest Rates,
- C. Risk and timing of Consumption,
- D. Inflation and timing of Consumption.

28. Compounding is _____.

- A. the adding of interest earned every period on both the original investment and the interest previously earned and retained with the investment
- B. the adding of interest earned every period on both the original investment and additional deposits
- C. the process of using time-value equations to compute the number of years
- D. the process of finding a present value

29. Which of the following will decrease a present value?

- A. Increasing the future value.
- B. Decreasing the interest rate.
- C. Decreasing the number of periods.
- D. None of the above will decrease a present value.

30. Which of the following will increase the present value of an annuity?

- A. The interest rate decreases.
- B. The number of periods decreases.
- C. The amortization schedule decreases.
- D. The effective rate is calculated over fewer years.

31. If a bond is selling at a discount, which of the following statements is correct?

- A. The coupon rate must be greater than the yield to maturity.
- B. The current yield must be greater than the coupon rate.
- C. The bond must have a low bond rating.
- D. All of the statements are correct.

32. In theory, a perpetuity's value will be infinite

- A. when the payments are constant,
- B. when payments go on forever,
- C. if the interest rate is 100%,
- D. if the interest rate is zero,
- E. always.

33. Which of the following statements is correct?

- A. Long-term bonds have more reinvestment rate risk than short-term bonds.
- B. Long-term bonds have more interest rate risk than short-term bonds.
- C. Short-term bonds with high coupons have high interest rate risk.
- D. A zero coupon bonds do not have interest rate risk.

34. Under which conditions will an investor demand a larger return (yield) on a bond?

- A. The bond issue is upgraded from A to AA.
- B. The bond issue is downgraded from A to BBB.
- C. Interest rates decrease due to a decline in inflation.
- D. None of these conditions will cause an increase in the bond's yield.

35. Which of the following is an electronic stock market without a physical trading floor?

- A. Mercantile Exchange
- B. Nasdaq Stock Market
- C. American Stock Exchange
- D. New York Stock Exchange

36. This is the portion of total risk that is attributable to overall economic factors.

- A. modern portfolio risk
- B. firm specific risk
- C. market risk
- D. total risk

37. This is defined as the portion of total risk that is attributable to firm or industry factors and can be reduced through diversification.

- A. modern portfolio risk
- B. firm specific risk
- C. market risk
- D. total risk

38. This is the risk that a security issuer will miss an interest or principal payment or continue to miss such payments.

- A. maturity risk
- B. liquidity risk
- C. default risk
- D. price risk

39. A _____ is defined as a combination of investment assets held by an investor.

- A. bundle
- B. portfolio
- C. market basket
- D. All of these

40. Once firms issue stock publicly, these same stocks and bonds are then traded in which of these?

- A. over-the-counter stocks
- B. initial public offerings
- C. secondary markets
- D. direct transfers

41. This is the interest rate that is actually observed in financial markets.

- A. nominal interest rates
- B. real interest rates
- C. real risk free rate
- D. market premium

42. This is the interest rate that would exist on a default free security if no inflation were expected.

- A. nominal interest rate
- B. real risk free rate
- C. real interest rate
- D. market premium

43. Calculating the average of the possible returns weighted by the likelihood of those returns occurring provides the

- A. market return
- B. efficient return
- C. required return
- D. expected return

44. This theory argues that individual investors and financial institutions have specific maturity preferences, and to encourage buyers to hold securities with maturities other than their most preferred requires a higher interest rate.

- A. Unbiased Expectations Theory
- B. Liquidity Premium Hypothesis
- C. Market Segmentation Theory
- D. Supply and Demand Theory

45. This is typically considered the return on U.S. government bonds and bills and equals the real interest and the expected inflation premium.

- A. market risk premium
- B. required return
- C. risk-free rate
- D. risk premium

46. According to this theory of term structure of interest rates, at any given point in time, the yield curve reflects the market's current expectations of future short-term rates.

- A. Expectations Theory
- B. Unbiased Expectations Theory
- C. Future Short-term Rates Theory
- D. Term Structure of Interest Rates Theory

47. A measure of the sensitivity of a stock or portfolio to market risk.

- A. behavioral finance
- B. efficient market
- C. hedge
- D. beta

48. This is the reward investors require for taking risk.

- A. market risk premium
- B. required return
- C. risk premium
- D. risk-free rate

49. Which of these is the measurement of risk for a collection of stocks for an investor?

- A. beta
- B. portfolio beta
- C. efficient market
- D. expected return

50. A theory that describes the types of information that are reflected in current stock prices.

- A. asset pricing
- B. behavioral finance
- C. public information
- D. efficient market hypothesis

PROBLEMS

1. (9 points) In the Wall Bricks, Inc.'s balance sheet lists net fixed asset as \$15 million. The fixed assets could currently be sold for \$18 million. Wall Bricks' current balance sheet shows current assets of \$9 million and current liabilities of \$6 million. If all the current accounts were liquidated today, the company would receive \$4 million cash after paying the \$6 million in current liabilities. What is the book value of Wall Bricks' assets today? What is the market value of these assets?

Book Value: \$ _____; **Market Value:** \$ _____

2. (6 points) Approximately (using the Rule of 72), how many years will it take to double a \$1000 investment when interest rates are 4% per year?

Years: _____

3. (6 points) A stock investor deposited \$1000 five years ago in a non-dividend paying stock. Today the stock is valued at \$1,539. What annual rate of return has this investor earned?

Rate: _____ %

4. (12 points) A friend wants to retire in 40 years when he is 65. At age 25, he can invest \$200/**month** that earns 6% each year. But he is thinking of waiting 20 years when he is age 45, and then investing \$600/**month** to catch up, earning the same 6% per year. He feels that by investing over three times as much for half as many years (20 instead of 40 years) he will have more.

A. What is the future value of each of these options at age 65, and under which scenario would he accumulate more money?

Scenario A: \$ _____, **Scenario B:** \$ _____, **Best:** _____

B. He is now retiring at age 65, and has saved \$526,140. He wants the money to last until he turns age 100. He continues to earn 6%. How much can he spend each month to spend his final dollar at age 100?

PMT = \$ _____

5. (6 points) TV's R Yours is advertising a deal, in which you buy an 86" flat screen TV/entertainment package for \$2,409.90 (including tax) with one year before you need to pay (no interest is incurred if you pay by the end of the one year). How much would you need to deposit at the end of each month in a savings account earning 0.9% APR (NOT 9%), compounded monthly, to be able to pay the \$2,409.90 bill in one year?

Monthly Deposit: _____

6. (6 points) You purchase a house for \$200,000 by getting a mortgage for \$160,000 and paying a \$40,000 down payment (20%). You can get a 30 year mortgage with a 3.5% interest rate.

What would be your monthly payment? _____

7. (6 points) A credit card is offered with monthly payments and a 29.99% APR. What is the loan's effective annual rate (EAR)?

EAR: _____

8. (9 points) Calculate the price of a \$1,000 bond, offering a 8% coupon payment with 20 years left to maturity and a market interest rate of 10%. (Assume interest payments are semiannual.) Is this a discount or premium bond?

Price: _____ **Type:** _____

9. (8 points) On Jan 4, 2019, the Dow Jones Industrial Average opened at \$24,819.78 and closed at \$25,332.18. What was the daily return that day, and what was the effective annual rate return (in percent) of the stock market that day?

Daily Return: % **EAR:** %

10. (8 points) Financial analysts forecast GDY Inc.'s growth for the future to be 6%. GDY's recent annual dividend was \$1.70. What is the value of GDY stock when the required return is 10%?

Stock Value: \$

11. (6 points) UROK Inc. recently paid a \$2.00 annual dividend. The dividend is expected to grow at a 5% rate. At a current stock price of \$42, what is the return shareholders are expecting?

Expected Return %

12. (6 points) **Portfolio Return** Last year, Company X had earned a 12% return. During the same time period, Company Y earned + 14% and Company Z earned – 6% (negative 6%). If you have a portfolio made up of 20 percent Company X, 55 percent Company Y, and 25 percent Company Z, what is your portfolio return?

_____ %

13. (12 points) You hold the positions in the table below.

<u>COMPANY</u>	<u>PRICE</u>	<u># SHARES</u>	<u>BETA</u>
Goodmonth	\$25.00	200	+ 4.0
Icestone	\$40.00	375	– 2.0
Bridgerock	\$50.00	600	+ 1.5

A. What is the beta of your portfolio?

Beta _____

B. If you expect the market to earn 8% and the risk-free rate is 3%, what is the required return of the portfolio?

Portfolio Required Return: _____ %