Spring 2012 Finance 3130 Sample Exam 1A Questions for Review

1. The form of organization for a business is an important issue, as this decision has very significant effect on the income and wealth of the firm's owners.

   a. True
   b. False

2. There are three primary disadvantages of a regular partnership: (1) unlimited liability, (2) limited life of the organization, and (3) difficulty of transferring ownership. These combine to make it difficult for partnerships to attract large amounts of capital and thus to grow to a very large size.

a. True
b. False

3. If an individual investor buys or sells a currently owned stock through a broker, this is a primary market transaction.

   a. True
   b. False

4. One of the functions of NYSE specialists is to facilitate trading by keeping an inventory of shares of the stocks in which they specialize, buying when investors want to sell and selling when they want to buy. They change the bid and ask prices of the securities so as to keep supply and demand in balance.

   a. True
   b. False

5. Which of the following statements is CORRECT?

   a. It is generally more expensive to form a proprietorship than a corporation because, with a proprietorship, extensive legal documents are required.
   b. Corporations face fewer regulations than sole proprietorships.
   c. One disadvantage of operating a business as a sole proprietorship is that the firm is subject to double taxation, at both the firm level and the owner level.
   d. One advantage of forming a corporation is that equity investors are usually exposed to less liability than in a regular partnership.
   e. If a regular partnership goes bankrupt, each partner is exposed to liabilities only up to the amount of his or her investment in the business.

6. Jane Doe, who has substantial personal wealth and income, is considering the possibility of starting a new business in the chemical waste management field. She will be the sole owner, and she has enough funds to finance the operation. The business will have a relatively high degree of risk, and it is expected that the firm will incur losses for the first few years. However, the prospects for growth and positive future income look good, and Jane plans to have the firm pay out all of its income as dividends to her once it is well established. Which of the legal forms of business organization would probably best suit her needs?

   a. Proprietorship, because of ease of entry.
   b. S corporation, to gain some tax advantages and also to obtain limited liability.
   c. Partnership, but only if she needs additional capital.
   d. Regular corporation, because of the limited liability.
   e. In this situation, the various forms of organization seem equally desirable.

7. Suppose the U.S. Treasury announces plans to issue $50 billion of new bonds. Assuming the announcement was not expected, what effect, other things held constant, would that have on short term bond prices and interest rates?

a. Prices and interest rates would both rise.
b. Prices would rise and interest rates would decline.
c. Prices and interest rates would both decline.
d. There would be no changes in either prices or interest rates.
e. Prices would decline and interest rates would rise.

8. Which of the following statements is CORRECT?

a. If General Electric were to issue new stock this year it would be considered a secondary market transaction since the company already has stock outstanding.
b. Capital market transactions only include preferred stock and common stock transactions.
c. The distinguishing feature between spot markets versus futures markets transactions is the maturity of the investments. That is, spot market transactions involve securities that have maturities of less than one year, whereas futures markets transactions involve securities with maturities greater than one year.
d. If the Federal Reserve completes an "open market" operation in which they buy government bonds from the public, the money supply will go up, short term interest rates will decline, and the price of bonds will increase
e. An electronic communications network (ECN) is a physical location exchange.

9. What would the future value of $125 be after 8 years at 8.5% compound interest?

a. $205.83
b. $216.67
c. $228.07

d. $240.08
e. $252.08

10. Last year Toto Corporation's sales were $225 million. If sales are Projected to be $375 million 5 years from now. What would be Toto's Compound annual growth rate in sales over the next 5 years?

a. 5.02%
b. 6.12%
c. 8.10%
d. 10.76%
e. 12.59%

11. Suppose the U.S. Treasury offers to sell you a zero coupon bond for $747.25. No payments will be made until the bond matures 5 years from now, at which time it will be redeemed for $1,000. What interest rate would you earn if you bought this bond at the offer price?

a. 4.37%
b. 4.86%
c. 5.40%
d. 6.00%
e. 6.60%

12. Last year Mason Corp's earnings per share were $2.50, and its growth rate during the prior 5 years was 9.0% per year. If that growth rate were maintained, how many years would it take for Mason's EPS to double?

a. 5.86
b. 6.52
c. 7.24
d. 8.04
e. 8.85

13. You want to go to Europe 5 years from now, and you can save $3,100 per year, beginning one year from today. You plan to deposit the funds in a mutual fund which you expect to return 8.5% per year. Under these conditions, how much will you have just after you make the 5th deposit, 5 years from now?

a. $18,368.66

b. $19,287.09

c. $20,251.44

d. $21,264.02

e. $22,327.22

14. You want to go to Europe 5 years from now, and you can save $3,100 per year, beginning immediately. You plan to deposit the funds in a mutual fund which you expect to return 8.5% per year. Under these conditions, how much will you have at the end of 5 years when you hope to start your trip?

a. $17,986.82
b. $18,933.49
c. $19,929.99
d. $20,926.49
e. $21,972.82

15. You have a chance to buy an annuity that pays $1,200 at the end of each year for 3 years. You could earn 5.5% on your money in other investments with equal risk. What is the most you should pay for the annuity?

a. $2,636.98
b. $2,775.77
c. $2,921.86
d. $3,075.64
e. $3,237.52

16. At a rate of 6.25%, what is the present value of the following cash flow stream?

Year	Cash flow
0	$0
1	$75
2	$225
3	$ 0
4	$300

a. $411.57
b. $433.23
c. $456.03
d. $480.03
e. $505.30

17. Suppose you are buying your first house for $210,000, and are making a $20,000 down payment. You have arranged to finance the remaining amount with a 30-year, monthly payment, amortized mortgage at a 6.5% nominal interest rate. What will your equal monthly payments be?

a. $1,083.84
b. $1,140.88
c. $1,200.93
d. $1,260.98
e. $1,324.02

18. You plan to borrow $75,000 at a 7% annual interest rate. The terms require you to amortize the loan with 10 equal end-of-year payments. How much interest would you be paying in Year 2?

a. $4,395.19
b. $4,626.52
c. $4,870.02
d. $5,113.52
e. $5,369.19

---

1. Answer A true
2 Answer A true
3 Answer B false
4 Answer A True
5. Answer D The corporate form of ownership will reduce the level of liability risk for equity holders more than what those same owners would have in a regular partnership.
6. Answer B Chapter S incorporation will provide lower taxes and limited liability for this chemical waste business.
7. Answer E, if the government sells bonds, then the existing bondholders would be paying money back to the government thereby lowering the money supply, in addition, the government would be increasing the supply of bonds to the open market, which would cause the price of the bonds to move downward and interest on the bonds to increase [due to the inverse relationship between the price of the bond and its market yield or interest rate return.
8. Answer D, if the government buys bonds, investors will be receiving more money, in addition, there will be an increase in the demand for the bonds thereby increasing bond prices, driving down short term interest rates.

9. Answer D, PV = -125; I/YR = 8.5; N= 8; FV = $240.08
10. Answer D, PV= -225; FV = 375; N= 5; I/YR = 10.76%
11. Answer D, PV= -747.25; FV = 1000; N = 5; I/YR = 6.00%
12. Answer D; PV = -2.5; FV = 5; I/YR = 9; N= 8.04 years
13. Answer A; PMT= -3100; I/YR = 8.5; N= 5; FV = 18,368.66
14. Answer C; Begin Mode – Gold ➔BEG/END key; PMT = -3100; I/YR= 8.5; N = 5; FV = 19,929.99
15. Answer E; PMT = 1200; I/YR 5.5; N = 3; PV = -3,237.52
16. Answer E; Uneven cash flow problem, CF(0) = 0; CF(1) = 75; CF(2) = 225; CF(3) = 0; CF(4) = 300; I/YR = 6.5; Gold➔ NPV key = 505.295 or 505.30
17. Answer C: You are financing $210,000 - $20,000 or $190,000 so, PV = -190000; you need to convert the 6.5% annual interest into a monthly rate; I/YR = 6.5/12 or .541; N= number of payment periods which is 30 years x 12 = 360; PMT = 1200.929 or $1,200.93 for the monthly payment on this mortgage.
18. Answer C; You first need to calculate the annual payment; PV = -75000; I/YR = 7; N = 10; PMT = 10678.31
Next you have to find the Loan Balance at the end of the first year [i.e. the beginning of the second year], which prospectively is N = 9; PMT = 10678.31; I/YR = 7; PV = 69571.69
Finally the amount interest paid in the second year will be: the amount of the loan balance at
The beginning of the 2nd year $69,571.69 X .07 [the interest rate on the loan balance each year] = $4,870.018 or $4,870.02