



# PRINCIPLES OF FINANCE

## Official Content Guide

CREDIT HOURS	LEVEL
3	Upper

# 2014–2015

**Use this guide if you are planning to test between October 1, 2014 and September 30, 2015.**

If you are planning to test on or after October 1, 2015, you should also obtain the revised version of this guide which will be available in late summer 2015. You may access the revised version online from our website.

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## SECTION ONE

# Preparing for the Exam

## Before You Choose This UExcel Exam

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### Uses for the Examination

Excelsior College, the test developer, recommends granting three (3) semester hours of upper-level undergraduate credit to students who receive a letter grade of C or higher on this examination. The examination may be used to help fulfill the course requirement for the BS in General Business or as a free elective for all Excelsior College degree programs that allow for free electives. Other colleges and universities also recognize this exam as a basis for granting credit or advanced standing. Individual institutions set their own policies for the amount of credit awarded and the minimum acceptable score.

Exam-takers **enrolled** in an Excelsior College degree program should ask their academic advisor where this exam fits within their degree program.

Exam-takers **not enrolled** in an Excelsior College degree program should check with the institution from which they wish to receive credit to determine whether credit will be granted and/or to find out the minimum grade required for credit.

### Examination Length and Scoring

The examination consists of approximately 60 four-option multiple-choice questions, some of which are unscored, pretest questions. The pretest questions are embedded throughout the exam, and they are indistinguishable from the scored questions. It is to your advantage

to do your best on all of the questions. You will have two (2) hours to complete the examination. Your score will be reported as a letter grade.

## UExcel Exam Resources

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### Excelsior College Bookstore

The Excelsior College Bookstore offers recommended textbooks and other resources to help you prepare for UExcel exams.

The bookstore is available online, at:  
**[www.excelsior.edu/bookstore](http://www.excelsior.edu/bookstore)**

Bookstore staff are available, Eastern time:  
Monday–Thursday: 7:00 AM – 9:00 PM  
Friday: 7:00 AM – 6:00 PM  
Saturday: 8:00 AM – 5:00 PM  
Sunday: noon – 4:00 PM

Phone: 800-325-3252 (International 573-441-9179)  
Fax: 800-325-4147 (International 573-446-5254)

### UExcel Practice Exams

The official UExcel practice exams are highly recommended as part of your study plan. Once you [register](#) for your UExcel exam, you are eligible to purchase the corresponding practice exam, which can be taken using any computer with a supported Web browser. Each practice exam includes two forms that you may take within a 90-day period.

## Open Educational Resources

Open Educational Resources (OER) are learning materials that are freely available to learners via the Web. These materials may include brief lessons on very specific topics, e-textbooks, and podcasts, and even university courses you can download. These resources can introduce you to new information, broaden your knowledge of particular subject matter, and enrich your understanding of exam and course topics.

## Excelsior College Library

Access millions of authoritative resources online through the Excelsior College Library. Created through our partnership with the Sheridan Libraries of The Johns Hopkins University, the library provides access to journal articles, books, websites, databases, reference services, and many other resources. Special library pages relate to the nursing degree exams and other selected exams. **The library is available to enrolled Excelsior College students only.** To access it, visit [www.excelsior.edu/library](http://www.excelsior.edu/library) (login is required).

Our library provides:

- 24/7 availability
- Millions of the world's most current authoritative resources
- Help and support from staff librarians

## Online Tutoring

**Enrolled Excelsior College students** can use this service (available through SMARTTHINKING™) to connect with tutors who have been trained in a variety of academic subjects. For details, log on to your MyExcelsior page, find the Resources tab, and click on the link under Free Tutoring – Smarthinking.

## MyExcelsior Community

MyExcelsior Community enables Excelsior College students and alumni to interact with their peers online. As members, students can participate in real-time chat groups, join online study groups, buy and sell used textbooks, and share Internet resources. **Enrolled students have automatic access from their MyExcelsior page.**

# Preparing for UExcel Exams

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## How Long Will It Take Me to Study?

A UExcel exam enables you to show that you've learned material comparable to one or more 15-week, college-level courses. As an independent learner, you should study and review as much as you would for a college course. For a three-credit course in a subject they don't know, most students would be expected to study nine hours per week for 15 weeks, for a total of 135 hours.

## Study Tips

Become an active user of the resource materials. Aim for understanding rather than memorization. The more active you are when you study, the more likely you will be to retain, understand, and apply the information.

The following techniques are generally considered to be “active learning”:

- **preview or survey** each chapter
- **highlight or underline text** you believe is important
- **write questions or comments** in the margins
- **practice re-stating content** in your own words
- **relate what you are reading** to the chapter title, section headings, and other organizing elements of the textbook
- **find ways to engage** your eyes, your ears, and your muscles, as well as your brain, in your studies
- **study with a partner or a small group** (if you are an enrolled student, search for partners on MyExcelsior Community)
- **prepare your review notes** as flashcards or create recordings that you can use while commuting or exercising

When you feel confident that you understand a content area, review what you have learned. Take a second look at the material to evaluate your understanding. If you have a study partner, the two of you can review by explaining the content to each other or writing test questions for each other to answer. Review questions from textbook chapters may be helpful for partner or individual study, as well.

## Using UExcel Practice Exams

We recommend taking the first form of the practice exam when you begin studying, to see how much you already know. After taking the first practice exam, check your performance on each question and find out why your answer was right or wrong. This feedback will help you improve your knowledge of the subject and identify areas of weakness that you should address before taking the exam. Take the second form of the practice exam after you have finished studying. Analyze your results to identify the areas that you still need to review.

Although there is no guarantee, our research suggests that students who do well on the practice exams are more likely to pass the actual exam than those who do not do well (or do not take advantage of this opportunity).

## About Test Preparation Services

Preparation for UExcel® exams and Excelsior College® Examinations, though based on independent study, is supported by Excelsior College with a comprehensive set of exam learning resources and services designed to help you succeed. These learning resources are prepared by Excelsior College so you can be assured that they are current and cover the content you are expected to master for the exams. These resources, and your desire to learn, are usually all that you will need to succeed.

There are test-preparation companies that will offer to help you study for our examinations. Some may imply a relationship with Excelsior College and/or make claims that their products and services are all that you need to prepare for our examinations.

Excelsior College is not affiliated with any test preparation firm and does not endorse the products or services of these companies. No test preparation vendor is authorized to provide admissions counseling or academic advising services, or to collect any payments, on behalf of Excelsior College. Excelsior College does not send authorized representatives to a student's home nor does it review the materials provided by test preparation companies for content or compatibility with Excelsior College examinations.

To help you become a well-informed consumer, we suggest that before you make any purchase decision regarding study materials provided

by organizations other than Excelsior College, you consider the points outlined on our website at [www.excelsior.edu/testprep](http://www.excelsior.edu/testprep).

## Preparing for This Exam

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### Prior Knowledge

Familiarity with macroeconomics, microeconomics, financial accounting, and statistics is assumed.

### Using the Content Outline

Each content area in the outline includes (1) the recommended minimum hours of study to devote to that content area and (2) the most important sections of the recommended resources for that area. These annotations are not intended to be comprehensive. You may need to refer to other chapters in the recommended textbooks. **Chapter numbers and titles may differ in other editions.**

This content outline contains examples that illustrate the types of information you should study. Although these examples are numerous, do not assume that everything on the exam will come from these examples. Conversely, do not expect that every detail you study will appear on the exam. Any exam is only a broad sample of all the questions that could be asked about the subject matter.

### Using the Sample Questions and Rationales

Each content guide provides sample questions to illustrate those typically found on the exam. These questions are intended to give you an idea of the level of knowledge expected and the way questions are typically phrased. The sample questions do not sample the entire content of the exam and are not intended to serve as an entire practice test.

After the sample questions, you will find rationales for them (with the correct answer printed in bold). The rationales explain why the answer is correct and the other choices are wrong. The number in parentheses at the beginning of each rationale refers to the appropriate section of the content outline. Especially if you chose one of the wrong answers, you should return to its section of the content outline for additional study.



# Recommended Resources for the UExcel Exam in Principles of Finance

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The study materials listed below are recommended by Excelsior College as the most appropriate resources to help you study for the examination. For information on ordering from the Excelsior College Bookstore, see page 1 of this guide. You may also find resource materials in college libraries. Public libraries may have some of the textbooks or may be able to obtain them through an interlibrary loan program.

You should allow sufficient time to obtain resources and to study before taking the exam.

## Textbooks

**The following textbook was used by the examination development committee to verify all questions on the exam. These study materials may be purchased from the Excelsior College Bookstore.**  
**[www.excelsior.edu/bookstore](http://www.excelsior.edu/bookstore)**

Ross, S.A., Westfield, R.W., & Jordan, B.D. (2013).  
*Fundamentals of corporate finance* (10th ed.). New York: McGraw-Hill.

**These study materials may be purchased from the Excelsior College Bookstore.**

## Open Educational Resources

Both of these courses are geared to the lower level, but should provide you with some excellent guidance.

The Saylor Foundation provides free, high quality courses through online, self-paced, free learning resources.

Saylor Foundation: Principles of Finance  
<http://www.saylor.org/course/bus202/>

Coursera provides free, online, open educational resources.

Coursera: Introduction to Finance  
<https://www.coursera.org/#course/introfinance>

Many colleges and universities have free versions of their courses available through iTunes U.

You might also try this upper-level course from iTunesU:

Liberty University: Corporate Finance  
<https://itunes.apple.com/us/course/corporate-finance/id537316922>

Corporate Finance, New York University  
<https://itunes.apple.com/us/course/corporate-finance-spring-2013/id595523235>

If you lack any of the prerequisites (Macroeconomics, Microeconomics, Statistics, or Financial Accounting), you can find Saylor Foundation courses on those topics listed in the corresponding exam content guides.



## SECTION TWO

# Content Outline

### **General Description of the Examination**

The UExcel exam in Principles of Finance measures knowledge and understanding of material typically taught in an upper-level undergraduate course in principles of finance. The content of the examination is drawn from that commonly included in courses with such titles as Finance, Principles of Finance, or Corporation Finance. The examination assumes a familiarity with macroeconomics, microeconomics, financial accounting, and statistics.

The exam focuses on balancing finance, marketing, and operating decisions for doing business in multi-currency environments. It also includes the basic role of finance in a corporation and how management decisions are made from the financial perspective.

### **Learning Outcomes**

After you have successfully worked your way through the recommended study materials, you should be able to demonstrate the following learning outcomes:

1. Identify and describe the fundamental financial concepts, including those basic accounting concepts necessary for the understanding of finance.
2. Apply financial theory and quantitative tools to analyze financial problems.
3. Explain how financial decisions should respond to different situations, including changes in the global financial environment.
4. Describe Sarbanes Oxley and its impact on the financial markets.
5. Describe and evaluate ethical dilemmas that companies often face in pursuing financing and profit.
6. Describe and evaluate how the contemporary financial environment affects how investors and financial professionals think about risk.
7. Describe the concepts of financial economics and the contexts within which it is practiced.
8. Describe the elements of financial statement analysis and how they are applied, and apply basic ratio tools used to interpret and evaluate financial statements.
9. Identify and describe the process and procedures for capital budgeting analysis and be able to construct and solve basic capital budgeting problems.

## Content Outline

The content outline, which is similar to a syllabus, describes the various areas of the test. To fully prepare requires self-direction and discipline. Study involves careful reading, reflection, and systematic review.

The major content areas on the Principles of Finance examination, the percent of the examination, and the hours to devote to each content area are listed below.

Content Area	Percent of the Examination	Hours of Study
I. Fundamental Finance and Accounting Concepts	25%	34
II. Economics	5%	7
III. Risk and Risk Management	25%	34
IV. Quantitative Financial Analysis	35%	47
V. Legal and Social Environment	10%	14
<b>Total</b>	<b>100%</b>	

**NOTE:** Occasionally, examples will be listed for a content topic to help clarify that topic. However, the content of the examination is not limited to the specific examples given.

### I. Fundamental Finance and Accounting Concepts

**25** PERCENT OF EXAM | **34** HOURS OF STUDY

- Ch. 1, Introduction to Corporate Finance
- Ch. 2, Financial Statements and Cash Flow
- Ch. 3, Working with Financial Statements
- Ch. 4, Long-Term Financial Planning and Growth
- Ch. 10, Making Capital Investment Decisions
- Ch. 16, Financial Leverage and Capital Structure Policy
- Ch. 18, Short-Term Finance and Planning

#### A. Nature of corporate finance

1. Role of the financial manager

2. Financial management decisions (capital budgeting, capital structure, and working capital)

#### B. Financial statements, taxes, and cash flow

1. Balance sheet concepts
  - a. Assets, liabilities, and owner's equity
  - b. Net working capital
  - c. Liquidity
  - e. Debt vs. equity
  - f. Market value vs. book value
2. Income statement concepts
  - a. GAAP
  - b. Noncash items
  - c. Fixed and variable costs
3. Tax rates and tax calculations
  - a. Corporate tax brackets
  - b. Average vs. marginal tax rates
4. Cash flow



- a. Assets (operating cash flow, capital spending, change in net working capital)
- b. Cash flow to creditors and stockholders

### C. Analyzing financial statements

1. Relationship between cash flow and financial statements
2. Standardized financial statements
  - a. Common-size statements (balance sheets, income statements, statements of cash flows)
  - b. Common-base year financial statements and analysis
3. Ratio analysis
  - a. Short-term solvency or liquidity measures (current ratio, quick or acid-test ratio, cash ratio NWC to total assets ratio, interval measure)
  - b. Long-term solvency or leverage measures (total debt ratio, times interest earned ratio, cash coverage ratio)
  - c. Asset management or turnover measures (inventory turnover and days sales in inventory, receivables turnover and days' sales in receivables, profit margin, return on assets, return on equity,
  - d. Market measures (price-earnings ratio, price-sales ratio, market-to-book ratio)
  - e. The DuPont identity
  - f. Using financial statement information
    - 1) Internal and external uses
    - 2) Benchmark analyses (time trend, peer group)
    - 3) Problems with financial statement analysis

### D. Long-term financial planning models

1. Limitations of growth as a financial management goal
2. Dimensions of financial planning

- a. Planning horizon
- b. Aggregation
- c. Worst, best, and normal case assumptions

3. Goals of financial planning (examining interactions, exploring options, avoiding surprises, ensuring feasibility and internal consistency)
4. Common elements of financial planning models
  - a. Sales forecast
  - b. Pro forma statements
  - c. Asset requirements
  - d. Financial requirements
  - e. The plug variable
  - f. Economic assumptions
5. The percentage of sales approach
  - a. Income statements and balance sheets
  - b. Working with scenarios
6. External financing (EFN), financial policy, and growth
  - a. Internal and sustainable growth rates
  - b. Determinants of growth (profit margin, dividend policy, financial policy, total asset turnover)

### E. Estimating cash flows in capital budgeting

1. Project cash flows (incremental cash flows and the stand-alone principle)
2. Projecting cash flows
  - a. Pro forma financial statements
  - b. Developing project cash flows
    - 1) Net working capital
    - 2) Depreciation
      - a) Modified ACRS depreciation (MACRS)
      - b) Book value vs. market value
  - c. Other ways to define operating cash flow
    - 1) Bottom-up

- 2) Top-down
- 3) Tax shield
- d. Applying value criteria to projected total cash flow
- e. Discounted cash flow analysis
  - 1) Cost-cutting proposals
  - 2) Competitive bidding
  - 3) Evaluating equipment options

#### F. Capital structure decisions

- 1. Optimal capital structure
  - a. Static theory of capital structure
  - b. Minimizing the cost of capital
  - c. Managerial recommendations to address taxes and financial distress as capital structure factors
  - d. The extended pie model and the pecking-order theory (claims and implications)
- 2. Common elements of observed capital structures
- 3. The bankruptcy process
  - a. Liquidation and reorganization
  - b. Role of the financial manager in the bankruptcy process
  - c. Avoiding bankruptcy

#### G. Short-term operating activities

- 1. Tracking current assets, current liabilities, and net working capital
  - a. Operating cycle and cash cycle (definitions, managerial responsibilities)
    - 1) Calculating the operating and cash cycles
    - 2) Interpreting the cash cycle
  - b. Aspects of short-term financial policy
    - 1) Level of investment in current assets
    - 2) Financing of current assets
      - a) The ideal economy

- b) Financing current assets under realistic conditions
- 3) Considerations in choosing a financing policy
  - a) Cash reserves
  - b) Maturity hedging
  - c) Relative interest rates
- c. Elements of the cash budget
  - 1) Sales and cash collections
  - 2) Cash outflows
  - 3) Net cash inflow or cash balance
- d. Short-term borrowing
  - 1) Unsecured loans and lines of credit
    - a) Compensating balances
    - b) Letters of credit
  - 2) Secured loans
    - a) Accounts receivable financing
    - b) Inventory loans

## II. Economics

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**5** PERCENT OF EXAM | **7** HOURS OF STUDY

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**Ch. 7**, Interest Rates and Bond Valuation

**Ch. 10**, Making Capital Investment Decisions

**Ch. 12**, Some Lessons from Capital Market History

**Ch. 21**, International Corporate Finance

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### A. Interest rates and bond valuation

- 1. Types of bonds
  - a. Government bonds
  - b. Zero coupon bonds
  - c. Floating-rate bonds
  - d. Other
- 2. Bond markets
  - a. How bonds are bought and sold
  - b. Bond price reporting

3. Determinants of bond yields
    - a. The term structure of interest rates
    - b. Bond yields and the yield curve
  4. Inflation and interest rates
    - a. Real vs. nominal rates
    - b. The Fisher effect
    - c. Inflation and present values
- B. Estimating cash flows in capital budgeting**
1. Incremental cash flows
    - a. Sunk costs
    - b. Opportunity costs
    - c. Side effects
    - d. Net working capital
    - e. Financing costs
    - f. Other issues
- C. Risk and return**
1. Capital market efficiency
    - a. Price behavior in an efficient market
    - b. The efficient market hypothesis
    - c. Common misperceptions about the EMH
    - d. Forms of market efficiency
- D. International finance**
1. Foreign exchange markets and exchange rates
    - a. Exchange rates
      - 1) Exchange rate quotations
      - 2) Cross-rates and triangle arbitrage
      - 3) Types of transactions
  2. Purchasing power parity
    - a. Absolute purchasing power parity
    - b. Relative purchasing power parity
      - 1) The basic idea
      - 2) The result
      - 3) Currency appreciation and depreciation
3. Interest rate parity, unbiased forward rates, and the international Fisher effect
    - a. Covered interest arbitrage
    - b. Interest rate parity
    - c. Forward rates and future spot rates
    - d. Uncovered interest parity
    - e. The international Fisher effect
  4. International capital budgeting
    - a. Method 1: The home currency approach
    - b. Method 2: The foreign currency approach
    - c. Unremitted cash flows
  5. Exchange rate risk
    - a. Short-run exposure
    - b. Long-run exposure
    - c. Translation exposure
    - d. Managing exchange rate risk
  6. Political risk

### III. Risk and Risk Management

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**25** PERCENT OF EXAM | **34** HOURS OF STUDY

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**Ch. 5**, Introduction to Valuation: The Time Value of Money

**Ch. 6**, Discounted Cash Flow Valuation

**Ch. 11**, Project Analysis and Evaluation

**Ch. 12**, Some Lessons from Capital Market History

**Ch. 13**, Return, Risk, and the Security Market Line

**Ch. 14**, Cost of Capital

**Ch. 16**, Financial Leverage and Capital Structure Policy

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#### A. Introduction to valuation

1. Future value and compounding
  - a. Investing for a single period
  - b. Investing for more than one period
  - c. Compound growth
2. Present value and discounting
  - a. The single-period case

- b. Present values for multiple periods
  - 3. Present and future values
    - a. Present vs. future values
    - b. Determining discount rate
    - c. Finding the number of periods
- B. Future and present values of multiple cash flows**
  - 1. Future value with multiple cash flows
  - 2. Present value with multiple cash flows
    - a. Annuities and perpetuities
      - 1) Present value for annuity cash flows
        - a) Annuity tables
        - b) Finding the payment
        - c) Finding the rate
      - 2) Future value for annuities
      - 3) Perpetuities
      - 4) Growth annuities and perpetuities
    - b. Comparing rates
      - 1) Effective annual rates and compounding
      - 2) Calculating and comparing effective annual rates
      - 3) EARS and APRS
      - 4) Compounding
    - c. Loan types and amortization
      - 1) Pure discount loans
      - 2) Interest-only loans
      - 3) Amortized loans
- C. Evaluating risk in capital budget**
  - 1. Evaluating NPV estimates
    - a. The basic problem
    - b. Projected vs. actual cash flows
    - c. Forecasting risk
    - d. Sources of value
- D. Risk and return**
  - 1. Average returns
    - a. Calculating average returns
- b. Risk premiums
  - 2. More about average returns
    - a. Arithmetic vs. geometric averages
    - b. Calculating geometric average returns
    - c. Arithmetic average return or geometric average return
- E. Return, risk, and the security market line**
  - 1. Expected returns and variance
    - a. Expected returns
    - b. Calculating the variance
  - 2. Risk: systematic and unsystematic
    - a. Systematic and unsystematic risk
    - b. Systematic and unsystematic components of return
  - 3. Diversification and portfolio risk
    - a. The effect of diversification
    - b. The principle of diversification
    - c. Diversification and unsystematic risk
    - d. Diversification and systematic risk
  - 4. Systematic risk and beta
    - a. The systematic risk principle
    - b. Measuring systematic risk
    - c. Portfolio betas
  - 5. The security market line
    - a. Beta and risk premium
      - 1) The reward-to-risk ratio
    - b. The security market line
      - 1) Market risk premium
      - 2) The capital asset pricing model (CAPM)
  - 6. The security market line and the costs of capital
- F. Cost of capital**
  - 1. The cost of capital
    - a. Required return vs. cost of capital
    - b. Financial policy and cost of capital
  - 2. The cost of equity

- a. The dividend growth model
    - 1) Implementing the approach
    - 2) Estimating  $g$
    - 3) Advantages and disadvantages of the approach
  - b. The SML approach
    - 1) Implementing the approach
    - 2) Advantages and disadvantages of the approach
  - 3. The costs of debt and preferred stock
    - a. The cost of debt
    - b. The cost of preferred stock
  - 4. The weighted average costs of capital
    - a. The capital structure weights
    - b. Taxes and the weighted average cost of capital
    - c. Calculating WACC
    - d. Solving the warehouse problem and similar capital budgeting problems
    - e. Performance evaluation: another use of WACC
  - 5. Divisional and project costs of capital
    - a. The SML and the WACC
    - b. Divisional cost of capital
    - c. The pure play approach
    - d. The subjective approach
  - 6. Flotation costs and the weighted average cost of capital
    - a. The basic approach
    - b. Flotation costs and NPV
    - c. Internal equity and flotation costs
- G. Capital structure and the effects of leverage**
- 1. The capital structure
    - a. Capital structure and the cost of capital
  - 2. The effect of financial leverage
    - a. The basics of financial leverage

- 1) EPS vs. EBIT
- b. Corporate borrowing and homemade leverage
- 3. Capital structure and the cost of equity capital
  - a. M&M proposition I: the pie model
  - b. The cost of equity and financial leverage: M&M proposition II
  - c. Business and financial risk
- 4. M&M proposition I and II with corporate taxes
  - a. The interest tax shield
  - b. Taxes and M&M proposition I
  - c. Taxes, the WACC, and M&M proposition II
- 5. Bankruptcy costs
  - a. Direct bankruptcy costs
  - b. Indirect bankruptcy costs

#### IV. Quantitative Analysis

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**35** PERCENT OF EXAM | **47** HOURS OF STUDY

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- Ch. 7**, Interest Rates and Bond Valuation
- Ch. 8**, Stock Valuation
- Ch. 9**, Net Present Value and Other Investment Criteria
- Ch. 11**, Project Analysis and Evaluation
- Ch. 12**, Some Lessons from Capital Market History
- Ch. 13**, Return, Risk, and the Security Market Line
- Ch. 17**, Dividends and Payout Policy
- Ch. 19**, Cash and Liquidity Management
- Ch. 20**, Credit and Inventory Management

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#### A. Interest rates and bond valuation

- 1. Bonds and bond valuation
  - a. Bond features and prices
  - b. Bond values and yields
  - c. Interest rate risk
  - d. Finding the yield to maturity
- 2. Bond features
  - a. Debt or equity



- b. Long-term debt
- c. The indenture
  - 1) Terms of a bond
  - 2) Security
  - 3) Seniority
  - 4) Repayment
  - 5) The call provision
  - 6) Protective covenants

### 3. Bond ratings

## B. Stock valuation

- 1. Common stock valuation
  - a. Cash flows
    - 1) Zero growth
    - 2) Constant growth
    - 3) Nonconstant growth
    - 4) Two-stage growth
  - b. Components of the required return
  - c. Stock valuation using multiples
- 2. Features of common and preferred stocks
  - a. Common stock features
    - 1) Shareholder rights
    - 2) Proxy voting
    - 3) Classes of stock
    - 4) Other rights
    - 5) Dividends
  - b. Preferred stock features
    - 1) Stated value
    - 2) Cumulative and noncumulative dividends
- 3. The stock markets
  - a. Dealers and brokers
  - b. Organization of the NYSE
  - c. NASDAQ operations
  - d. Stock market reporting

## C. Capital budgeting decision criteria

- 1. Net present value
  - a. The payback rule

- 1) Defining the rule
- 2) Analyzing the rule
- 3) Positive traits of the rule
- b. The discounted payback
- c. The average accounting return
- d. The internal rate of return (IRR)
  - 1) Problems with the IRR
    - a) Nonconventional cash flows
    - b) Mutually exclusive investments
  - 2) Positive traits of the IRR
  - 3) The modified internal rate of return (MIRR)
    - a) The discounting approach
    - b) The reinvestment approach
    - c) The combination approach
  - 4) The profitability index
  - 5) The practice of capital budgeting

## D. Evaluating risk in capital budget

- 1. Scenario analyses
  - a. Scenario analyses
  - b. Sensitivity analyses
  - c. Simulation analyses
- 2. Break-even analysis
  - a. Fixed and variable costs
    - 1) Variable costs
    - 2) Fixed costs
    - 3) Total costs
  - b. Accounting break-even
  - c. Uses for the accounting break-even
- 3. Operating cash flow, sales volume, and break-even
  - a. Accounting break-even and cash flow
    - 1) The base case

- 2) Calculating the break-even level
- 3) Payback and break-even
- b. Sales volume and operating cash flow
- c. Cash flow, accounting, and financial break-even points
  - 1) Cash break-even
  - 2) Financial break-even
- 4. Operating leverage
  - a. Basic idea
  - b. Implications of operating leverage
  - c. Measuring operating leverage
  - d. Operating leverage and break-even
- 5. Capital rationing
  - a. Soft rationing
  - b. Hard rationing
- E. Risk and return**
  - 1. Capital market history
    - a. Returns
      - 1) Dollar returns
      - 2) Percentage returns
    - b. Historical record
    - c. Variability of returns
      - 1) Frequency distributions and variability
      - 2) Historical variance and standard deviation
      - 3) Normal distribution
      - 4) Using capital market history
      - 5) Stock market risk premium
- F. Return, risk, and the security market line**
  - 1. Portfolios
    - a. Portfolio weights
    - b. Portfolio expected returns
    - c. Portfolio variance
  - 2. Expected and unexpected returns
    - a. News and announcements
- G. Dividends and payout policy**
  - 1. Cash dividends and dividend payment
    - a. Cash dividends
    - b. Standard method of cash dividend payment
    - c. Dividend payment: a chronology
    - d. Ex-dividend date
  - 2. Dividend policy
    - a. Homemade dividends
  - 3. Real-world factors favoring low dividend payout
    - a. Taxes
    - b. Flotation costs
    - c. Dividend restrictions
  - 4. Real-world factors favoring high dividend payout
    - a. Desire for current income
    - b. Tax and other benefits
      - 1) Corporate investors
      - 2) Tax-exempt investors
  - 5. A resolution of real-world factors
    - a. Information content of dividends
    - b. The clientele effect
  - 6. Stock repurchases: an alternative to cash dividends
    - a. Cash dividends vs. repurchase
    - b. Real-world considerations in repurchase
    - c. Share repurchase and EPS
  - 7. Dividend and payout policies
    - a. Dividends and dividend payers
    - b. Corporations smooth dividends
  - 8. Stock dividends and stock splits
    - a. Details about stock dividends and stock splits
    - b. Value of stock dividends and stock splits
    - c. Reverse splits
- H. Cash and liquidity management**
  - 1. Reasons for holding cash

- a. The speculative and precautionary motives
  - b. The transaction motive
  - c. Compensating balances
  - d. Costs of holding cash
  - e. Cash management vs. liquidity management
2. Understanding float
    - a. Disbursement float
    - b. Collection float and net float
    - c. Float management
      - 1) Measuring float
      - 2) Cost of the float
      - 3) Ethical and legal questions
    - d. Electronic data interchange and check 21
  3. Cash collection and concentration
    - a. Components of collection time
    - b. Cash collection
    - c. Lockboxes
    - d. Cash concentration
    - e. Accelerating collections
  4. Managing cash disbursements
    - a. Increasing disbursement float
    - b. Controlling disbursements
      - 1) Zero-balance accounts
      - 2) Controlled disbursement accounts
  5. Investing idle cash
    - a. Temporary cash surpluses
      - 1) Seasonal or cyclical activities
      - 2) Planned or possible expenditures
    - b. Characteristics
      - 1) Maturity
      - 2) Default risk
      - 3) Marketability
      - 4) Taxes
  6. Determining the target cash balance
    - a. The BAT model
      - 1) The opportunity costs
      - 2) The trading costs
      - 3) The total cost
      - 4) The solution
    - b. The Miller-Orr model
    - c. Implication of the BAT and Miller-Orr models
    - d. Other factors influencing the target cash balance
- I. **Credit and inventory management**
    1. Credit and receivables
      - a. Components of credit policy
      - b. The cash flows from granting credit
      - c. The investment in receivables
    2. Terms of the sale
      - a. The basic form
      - b. The credit period
        - 1) The invoice date
        - 2) Length of the credit period
      - c. Cash discounts
        - 1) Cost of the credit
        - 2) Trade discounts
        - 3) The cash discount and the ACP
      - d. Credit instruments
    3. Analyzing credit policy
      - a. Credit policy effects
      - b. Evaluating a proposed credit policy
        - 1) NPV of switching policies
        - 2) A break-even application
    4. Optimal credit policy
      - a. The total credit cost curve
      - b. Organizing the credit function
    5. Credit analysis
      - a. When should credit be granted?
        - 1) A one-time sale
        - 2) Repeat business

- b. Credit information
- c. Credit evaluation and scoring
- 6. Collection policy
  - a. Monitoring receivables
  - b. Collection effort
- 7. Inventory management
  - a. The financial manager and inventory policy
  - b. Inventory types
  - c. Inventory costs
- 8. Inventory management techniques
  - a. The ABC approach
  - b. The economic order quantity (EOQ) model
    - 1) Inventory depletion
    - 2) Carrying costs
    - 3) Restocking costs
    - 4) Total costs
  - c. Extensions to the EOQ model
    - 1) Safety checks
    - 2) Reorder points
  - d. Managing derived-demand inventories
    - 1) Materials requirements planning
    - 2) Just-in-time inventory
- 9. Credit policy analysis
  - a. Two alternative approaches
    - 1) The one-shot approach
    - 2) The accounts receivable approach
  - b. Discounts and default risk
    - 1) NPV of the credit decision
    - 2) A break-even application

## V. Legal and Social Environment

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**10** PERCENT OF EXAM | **14** HOURS OF STUDY

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**Ch. 1**, Introduction to Corporate Finance

**Ch. 15**, Raising Capital

---

### A. Introduction to finance

1. Types of business organization
  - a. Sole proprietorship
  - b. Partnership
  - c. Corporation
2. The goal of financial management
  - a. Financial management goals
  - b. Sarbanes-Oxley
3. Agency problems and control of the corporation
  - a. Agency relationships
    - 1) Management goals
    - 2) Managerial compensation
    - 3) Control of the firm
    - 4) Stakeholders
4. Financial markets and the corporation
  - a. Cash flows
  - b. Primary vs. secondary markets
    - 1) Primary
    - 2) Secondary
    - 3) Dealer vs. auction
    - 4) Trading corporate securities
    - 5) Listing

### B. Raising capital

1. The financing life cycle of a firm: early-stage financing and venture capital
  - a. Venture capital
2. Selling securities to the public
3. Alternative issue methods
4. Underwriters
  - a. Choosing an underwriter
  - b. Types of underwriting

- 1) Firm commitment underwriting
  - 2) Best efforts underwriting
  - 3) Dutch auction underwriting
- c. The aftermarket
- d. The green shoe provision
- e. Lockup agreements
- f. The quiet period
5. IPOs and underpricing
6. New equity sales and the value of the firm
7. The costs of issuing securities
  - a. The costs of selling stock to the public
8. Rights
  - a. The mechanics of a rights offering
  - b. Number of rights needed to purchase a share
  - c. The value of a right
  - d. Ex rights
  - e. The underwriting arrangements
  - f. Effects on shareholders
9. Dilution
  - a. Dilution of proportionate ownership
  - b. Dilution of value: book vs. market values
10. Issuing long-term debt
11. Shelf registration



## SECTION THREE

# Sample Questions

The questions that follow will not be on the exam. They illustrate the style of questions found on this exam. Answer rationales can be found on pages 19–21 of this guide.

1. Thompson's Jet Skis has an operating cash flow of \$218. Depreciation is \$45 and interest paid is \$35. A net total of \$69 was paid on long-term debt. The firm spent \$180 on fixed assets and increased net working capital by \$38. What is the amount of the cash flow to stockholders?
  - 1) -\$28
  - 2) \$28
  - 3) -\$104
  - 4) \$114
2. Which financial ratios measure a firm's ability to pay its bills over the short run without undue stress?
  - 1) profitability
  - 2) asset management
  - 3) long-term solvency
  - 4) short-term solvency
3. What is the management of a firm's short-term assets and liabilities called?
  - 1) working capital management
  - 2) equity management
  - 3) capital budgeting
  - 4) capital structure
4. Which process analyzes which lender to use and the best type of long-term loan for a particular project?
  - 1) capital budgeting
  - 2) capital structure decision
  - 3) working capital management
  - 4) net working capital decision
5. What provides a forecast of currency receipts and disbursements for the next planning period?
  - 1) statement of cash flows
  - 2) receivables analysis
  - 3) credit analysis
  - 4) cash budget
6. Which is a cost that should not be considered in a project decision?
  - 1) opportunity
  - 2) sunk
  - 3) erosion
  - 4) financing
7. Which of the following is an example of systematic (market) risk?
  - 1) Airline pilots go on strike.
  - 2) The price of lumber declines sharply.
  - 3) A hurricane hits a tourist destination.
  - 4) The Federal Reserve increases interest rates.
8. Systematic risk (market risk) is measured by which of the following?
  - 1) beta
  - 2) the mean
  - 3) the standard deviation
  - 4) the arithmetic average

9. Which is a symmetrical, bell-shaped frequency distribution that is completely defined by its mean and standard deviation?
- 1) bi-modal distribution
  - 2) Gamma distribution
  - 3) normal distribution
  - 4) uniform distribution
10. What term refers to the preference in position of lenders and is also a general term used to label debt?
- 1) seniority
  - 2) security
  - 3) negative covenant
  - 4) positive covenant
11. Standard deviation measures which type of risk?
- 1) economic
  - 2) systematic
  - 3) total
  - 4) unsystematic
12. All else being held constant, as the variable cost per unit increases, which of the following occurs?
- 1) Operating cash flow increases.
  - 2) Contribution margin decreases.
  - 3) Sensitivity to fixed costs decreases.
  - 4) Degree of operating leverage decreases.
13. Which are payments made out of a firm's earnings to its owners in the form of cash or stock?
- 1) dividends
  - 2) stock splits
  - 3) distributions
  - 4) share repurchases
14. Which stock valuation model determines the current stock price by dividing the next annual dividend amount by the excess of the discount rate, less the dividend growth rate?
- 1) capital pricing
  - 2) dividend growth
  - 3) differential growth
  - 4) earnings capitalization
15. What is the difference between the present value of an investment and its cost?
- 1) net present value
  - 2) profitability index
  - 3) internal rate of return
  - 4) discounted payback period
16. What does the beta of a security provide?
- An estimate of the
- 1) market risk premium
  - 2) systematic risk of the security
  - 3) slope of the capital market line
  - 4) slope of the security market line
17. How is the standard deviation for a set of stock returns calculated?
- 1) average squared difference between the actual return and the average return
  - 2) positive square root of the average return
  - 3) positive square root of the variance
  - 4) variance squared
18. When was the Sarbanes-Oxley Act enacted?
- 1) 1952
  - 2) 1967
  - 3) 2002
  - 4) 2006
19. In which market does the original sale of securities by governments and corporations to the general public occur?
- 1) liquidation market
  - 2) primary market
  - 3) proprietary market
  - 4) secondary market

## SECTION FOUR

# Rationales

### 1. (IB4b2)

- 1) See 3).
- 2) See 3).
- \*3) Cash flow of the firm = \$218 (operating cash flow) - \$38 (increased net working capital) - \$180 (amount firm spent) = \$0; Cash flow to creditors = \$35 (interest paid) - (-\$69 (net total paid on long-term debt)) = \$104; Cash flow to stockholders = \$0 - \$104 = -\$104**
- 4) See 3).

### 2. (IC1c1)

- 1) Profitability ratios are used to measure how competently a corporation uses its resources and handles its production.
- 2) Asset management ratios are used to measure how competently a corporation uses its resources to create sales.
- 3) Long-term solvency ratios are used to measure a corporation's long-term capacity to meet its financial leverage.
- \*4) Short-term solvency ratios are used to measure a corporation's liquidity or its capacity to pay its bills over the short run without financial stress.**

### 3. (IA2c)

- \*1) Working capital management is the administration of a corporation's immediate assets and liabilities.**
- 2) See 1).
- 3) Capital budgeting is the method of preparation and organization of a corporation's long-term investments.
- 4) A corporation's capital structure is the particular combination of long-term debt and equity the corporation uses to fund operations.

### 4. (IA2b)

- 1) Capital budgeting is the method of preparation and organization of a corporation's long-term investments.
- \*2) A corporation's capital structure is the particular combination of long-term debt and equity the corporation uses to fund operations.**
- 3) Working capital management is the administration of a corporation's immediate assets and liabilities.
- 4) Net working capital refers to the immediate assets minus immediate liabilities.

### 5. (IG1d)

- 1) A corporation's fiscal statement that reviews its supply and application of currency over a particular time period is called a statement of cash flows.
- 2) See 4).
- 3) A credit analysis is the method of determining the likelihood that clients will not reimburse.
- \*4) A cash budget is an estimate of monetary revenue and expenditures for an upcoming time period.**

**\*correct answer**

#### 6. (IIB1)

- 1) An opportunity cost is the most expensive option that is given up if a particular venture is taken on.
- \*2) **A sunk cost is an expenditure that has previously been incurred and consequently should not be considered in a venture decision.**
- 3) Erosion costs are the cash flows of a new development that come at the expense of a corporation's existing developments.
- 4) Financing costs are the specific combination of debt and equity a corporation decides to apply in funding a project. Financing costs are a managerial decision and largely establish how project cash flows are divided between owners and creditors.

#### 7. (IIB1)

- 1) See 4).
- 2) See 4).
- 3) See 4).
- \*4) **A systematic (market) risk is a threat that involves a large quantity of assets, each to a greater or lesser degree. Doubts about financial circumstances such as interest rates or inflation are instances of systematic risk.**

#### 8. (IIIE4)

- \*1) **The quantity of systematic risk contained in a specific risky asset in comparison to the systematic risk contained in an average risky asset is referred to as the beta coefficient.**
- 2) The mean is the average.
- 3) The standard deviation is the positive square root of the variance. The variance is the average squared variation between the actual return and the average return.
- 4) See 1).

#### 9. (IVE1c3)

- 1) See 3).
- 2) See 3).
- \* 3) **A symmetrical, bell-shaped frequency distribution that is defined by its mean and standard deviation is called a normal distribution.**
- 4) See 3).

\*correct answer

#### 10. (IVA2c)

- \*1) **Seniority specifies the preference in position over other lenders, and debts are occasionally labeled as senior or junior to designate seniority.**
- 2) Debt securities are classified according to the collateral and mortgages used to guard the bondholder.
- 3) A protective covenant is an agreement restricting specific actions that may be taken during the life of a loan. It is frequently used to guard the lender's interest.
- 4) See 3).

#### 11. (IIIE3d)

- 1) See 3).
- 2) A systematic (market) risk is a threat that involves a large quantity of assets, each to a greater or lesser degree. Doubts about financial circumstances such as interest rates or inflation are instances of systematic risk.
- \*3) **Total risk = systematic risk plus unsystematic risk.**
- 4) Unsystematic risk is risk that affects an individual asset or small collection of assets.

#### 12. (IVD2b)

- 1) Operating cash flow = earnings before interest and taxes, plus depreciation, minus taxes. Variable cost per unit is not considered in this calculation.
- \*2) **The difference between selling price and variable cost is called the contribution margin per unit, and it would decrease in this calculation.**
- 3) Costs that do not vary when the amount produced varies during a specific period of time are called fixed costs.
- 4) The extent to which a corporation or venture relies on fixed costs is referred to as operating leverage.

**13. (IVB2a5)**

- \*1) Payments by a corporation to shareholders, made in either currency or stock, are called dividends.**
- 2) A boost in a corporation's outstanding shares without any variation in owner's equity is referred to as a stock split.
- 3) A payment by a corporation to its owners from supplies other than current or accrued retained earnings is referred to as a distribution.
- 4) See 1).

**14. (IVB1a2)**

- 1) See 2).
- \*2) Capital gains yield is also called the dividend growth rate and is the speed at which the worth of an asset matures.**
- 3) See 2).
- 4) See 2).

**15. (IVD1)**

- \*1) The disparity between an asset's market price and its actual price is referred to as the investment's net present value.**
- 2) The present value of an investment's potential cash flows divided by its original cost is referred to as the profitability index.
- 3) The reduced rate that makes the net present value (NPV) of an asset zero is called the internal rate of return (IRR).
- 4) The duration of time necessary for an asset's discounted cash flows to equal its preliminary price is referred to as the discounted payback period.

**16. (IIIE4b)**

- 1) Market risk premium is the slope of the security market line and is calculated by subtracting the risk-free rate from the expected return on a market portfolio.
- \*2) The quantity of systematic risk contained in a specific risky asset in comparison to the systematic risk contained in an average risky asset is referred to as the beta coefficient.**
- 3) See 2).
- 4) See 1).

**17. (IVE1c2)**

- 1) This is variance.
- 2) See 3).
- \*3) The standard deviation is the positive square root of the variance.**
- 4) See 3).

**18. (VA2b)**

- 1) See 3).
- 2) See 3).
- \*3) In reaction to corporate scandal at companies such as Enron, WorldCom, Tyco, and Adelphia, Congress passed the Sarbanes-Oxley Act in 2002. The act is supposed to guard investors from corporate maltreatment.**
- 4) See 3).

**19. (VA4b1)**

- 1) See 2).
- \*2) A primary market transaction occurs when a corporation is the seller and the transaction increases funds for the corporation.**
- 3) See 2).
- 4) A secondary transaction involves one owner or creditor selling to another.

**\*correct answer**



## SECTION FIVE

# Taking the Exam

## Registering for Your Exam

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## On the Day of Your Exam

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### On the Day of Your Exam

Remember to:

- dress comfortably: the computer will not mind that you're wearing your favorite relaxation outfit
- arrive at the test site rested and prepared to concentrate for an extended period
- allow sufficient time to travel, park, and locate the test center
- be prepared for possible variations in temperature at the test center due to weather changes or energy conservation measures
- bring your ID, but otherwise, don't weigh yourself down with belongings that will have to be kept in a locker during the test.

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Examination	Credit Hrs.
<b>Arts and Sciences</b>	
Abnormal Psychology.....	3*
Anatomy & Physiology.....	6
Anatomy and Physiology I.....	3
Anatomy and Physiology II.....	3
Basic Genetics.....	3
Bioethics.....	3*
Calculus.....	4
College Writing.....	3
Contemporary Mathematics.....	3
Cultural Diversity.....	3*
Earth Science.....	3
English Composition†.....	6
Ethics: Theory & Practice†.....	3*
Foundations of Gerontology.....	3*
General Chemistry I.....	3
Interpersonal Communication.....	3
Introduction to Macroeconomics.....	3
Introduction to Microeconomics.....	3
Introduction to Music.....	3
Introduction to Philosophy.....	3
Introduction to Psychology.....	3
Introduction to Sociology.....	3
Juvenile Delinquency.....	3*
Life Span Developmental Psychology.....	3
Microbiology.....	3
Organizational Behavior.....	3*
Pathophysiology.....	3*
Physics.....	6
Political Science.....	3
Precalculus Algebra.....	3
Psychology of Adulthood & Aging.....	3*
Research Methods in Psychology.....	3*
Social Psychology.....	3*
Spanish Language.....	6
Statistics.....	3
World Conflicts Since 1900.....	3*
World Population.....	3*
<b>Business</b>	
Business Ethics.....	3*
Business Law.....	3
Ethics: Theory & Practice†.....	3*

Examination	Credit Hrs.
<b>Business (CONTINUED)</b>	
Financial Accounting.....	3
Human Resource Management.....	3*
Labor Relations.....	3*
Managerial Accounting.....	3
Operations Management.....	3*
Organizational Behavior.....	3*
Principles of Finance.....	3*
Principles of Management.....	3
Principles of Marketing.....	3
Quantitative Analysis.....	3*
Workplace Communication with Computers.....	3
<b>Education</b>	
Literacy Instruction in the Elementary School.....	6*
<b>Nursing: Associate Level</b>	
Essentials of Nursing Care: Health Safety <sup>①</sup> .....	3
Essentials of Nursing Care: Health Differences <sup>①</sup> .....	3
Foundations in Nursing Practice <sup>①</sup> .....	3
Reproductive Health <sup>①</sup> .....	3
Health Differences Across the Life Span 1 <sup>①</sup> .....	3
Health Differences Across the Life Span 2 <sup>①</sup> .....	3
Health Differences Across the Life Span 3 <sup>①</sup> .....	3
Transition to the Professional Nurse Role <sup>①</sup> .....	3
Fundamentals of Nursing**.....	8
Maternal & Child Nursing (associate)**.....	6
<b>Nursing: Baccalaureate Level</b>	
Community-Focused Nursing**.....	4*
Research in Nursing**.....	3*
Adult Nursing**.....	8*
Maternal & Child Nursing (baccalaureate)**.....	8*
Psychiatric/Mental Health Nursing**.....	8*

\* Upper-level college credit

\*\* This exam does not apply toward the Excelsior College nursing degrees.

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