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Chapter Quiz

(See related pages)

Results Reporter

Out of 11 questions, you answered 0 correctly with a final grade of 0%

0 correct (0%)
11 incorrect (100%)
0 unanswered (0%)

Your Results:

The correct answer for each question is indicated by a ✓.

1

INCORRECT

Shareholders' equity is best defined as:

- ✓ ☒ A) the total market value of a firm's assets.
☐ B) the summation of the net profits retained by a firm from its inception.
☐ C) a residual claim on the value of a firm's assets after the firm's debts have been paid.
☐ D) the total amount received by a firm from the sale of equity securities.
☐ E) the distribution of a firm's profits to its shareholders.

Feedback: Shareholders' equity is the value of the assets which remains after the liabilities are paid.

2

INCORRECT

Finance includes decisions related to a firm's:

- ✓ ☒ A) net working capital, such as determining the appropriate amount of long-term debt to be acquired to finance a new capital project.
☐ B) capital budgeting, such as determining the optimal level of inventory.
☐ C) capital structure, such as determining the extent to which debt should be used to finance the firm's operations.
☐ D) capital expenditures, such as deciding when a supplier should be paid.
☐ E) net working capital, such as determining the amount to be distributed as a dividend.

Feedback: Financing capital purchases is a capital structure decision.

3

INCORRECT

The ideal capital structure for a firm is the mixture of debt and equity that:

- ☐ A) equates the level of debt to the level of equity.
☐ B) minimizes the long-term debt.
☐ C) minimizes the annual interest expense.
☐ D) maximizes both the level of debt and the level of equity.
☐ E) maximizes the value of the firm.

Feedback: The ideal capital structure maximizes the value of the firm.

4

INCORRECT

Which one of the following functions should be assigned to the controller, rather than the treasurer?

- ☐ A) Cash management
☐ B) Financial planning
☐ C) Capital expenditure
☐ D) Tax planning
☐ E) Credit management

Feedback: A capital expenditure is a treasury function.

5

INCORRECT

Which one of the following best describes the top priority for a financial manager?

- ☐ A) Maximize the current accounting profits by utilizing the most favorable accounting methods
☐ B) Minimize the level of inventory held by the firm
☐ C) Maximize the net working capital of the firm
☐ D) Maximize the current value per share of the existing stock
☐ E) Minimize the total amount of taxes which the firm must pay

Feedback: The top priority is maximizing the current value per share of the existing stock.

6
INCORRECT

The treasurer and controller generally report to the:

- ☐ A) president.
- ☒ B) chief executive officer (CEO).
- ☐ C) board of directors.
- ☒ D) chief financial officer (CFO).
- ☐ E) chief operations officer (COO).

Feedback: The treasurer and controller report to the CFO.

7
INCORRECT

The allocation of manufacturing costs to various units of production is a function wh assigned to the:

- ☐ A) treasurer.
- ☒ B) chief operations officer.
- ☒ C) controller.
- ☐ D) chairman of the board.
- ☐ E) vice president of operations.

Feedback: Allocating costs is a function of the controller.

8
INCORRECT

Capital budgeting is the process of:

- ☒ A) determining how to raise the money required to fund a project.
- ☐ B) choosing how much cash to keep on hand.
- ☐ C) deciding the amount of earnings that should be distributed to shareholders.
- ☒ D) managing a firm's long-term assets.
- ☐ E) deciding which marketable securities to purchase.

Feedback: Raising money is a capital structure decision.

9
INCORRECT

Most investors prefer cash _____ and have a(n) _____ risk.

- ☒ A) sooner rather than later; preference for
- ☒ B) sooner rather than later; aversion to
- ☐ C) sooner rather than later; neutral stance towards
- ☐ D) later rather than sooner; preference for
- ☐ E) later rather than sooner; aversion to

Feedback: Most investors have an aversion to risk.

10
INCORRECT

The cash flows from a firm can be distributed to:
I. shareholders.
II. debtholders.
III. the government.
IV. the firm itself.

- A) I only
- B) I and II only
- C) I and III only
- D) I, III, and IV only
- E) I, II, III, and IV

Feedback: The cash flows of a firm can be distributed to shareholders, debtholders, the government, or retained by the firm itself.

11
INCORRECT

The number of authorized shares is established in the:

- A) corporate by-laws.
- B) initial minutes of the board of directors' meeting.
- C) articles of incorporation.
- D) financial statements of the firm.
- E) statutes of the state of incorporation.

Feedback: The articles of incorporation establish the number of authorized shares.

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Chapter Quiz

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Results Reporter

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1 correct (10%)

9 incorrect (90%)

0 unanswered (0%)

Your Results:

The correct answer for each question is indicated by a ✓.

1

INCORRECT

Which one of the following is a current liability?

- ☒ A) account receivable
☐ B) mortgage payable over thirty years
☒ C) account payable
☐ D) inventory
☐ E) retained earnings

Feedback: An account receivable is a current asset.

2

INCORRECT

Which of the following are components of stockholders' equity?

- I. common stock
 II. capital surplus
 III. long-term debt
 IV. retained earnings

- ☒ A) I and IV only
☐ B) I and II only
☐ C) II and III only
☐ D) II and IV only
☒ E) I, II, and IV only

Feedback: True, but capital surplus is also part of stockholders' equity.

3

INCORRECT

An asset which _____ is defined as a liquid asset.

- ☐ A) cost less than its current value
☐ B) declines in value each year
☐ C) is used to manufacture a product
☐ D) has a physical presence
☐ E) is readily and easily converted to cash

Feedback: A liquid asset is one which can readily and easily be converted to cash, generally within one year.

4

INCORRECT

DJ Companies sold \$20,000 in stock and issued \$15,000 in debt this past year. The also repaid \$18,000 on its loans and paid \$3,200 in interest. During the year, DJ

Companies paid quarterly dividends which totaled to \$8,000 for the year and earned net income of \$22,300. The beginning balances at the start of the year were:

Preferred stock - \$10,000
 Treasury stock - \$5,000
 Long-term debt - \$41,000
 Accumulated retained earnings - \$78,600
 Capital surplus - \$22,300
 Common stock - \$50,000

What is the book value of stockholders' equity at the end of the year?

- ☐ A) \$177,900
☐ B) \$187,900
☐ C) \$185,200
☐ D) \$190,200
☐ E) \$200,200

Feedback: The stockholders' equity at the beginning of the year was \$155,900 and the increase in equity for the year was \$34,300.

5
INCORRECT

The financial records of Taylor and Daughter, show current assets of \$850 and net fixed assets of \$2,450. The firm has \$700 in liabilities, which is the amount the firm would have to pay today to extinguish its debt. The firm estimates that it could sell its current assets for \$800 and its fixed assets for \$1,990. What is the market value of the stockholders' equity?

- ☒ A) \$250
- ☐ B) \$800
- ☐ C) \$1,200
- ☒ D) \$2,090
- ☐ E) \$2,600

Feedback: The market value of the stockholders' equity = \$800 + \$1,990 - \$700 = \$2,090.

6
INCORRECT

A firm's balance sheet shows current assets of \$410, net fixed assets of \$685, long-term debt of \$320, and owners' equity of \$590. What is the value of the firm's current liabilities?

- ☐ A) \$35
- ☒ B) \$165
- ☒ C) \$185
- ☐ D) \$225
- ☐ E) \$825

Feedback: Current liabilities = \$410 + \$685 - \$320 - \$590 = \$185.

7
INCORRECT

The balance sheet of the Wilson's Market shows current assets of \$38,700. These assets could probably be sold today for \$35,000 cash. The firm owes \$32,600 to its short-term creditors and \$52,000 to its long-term creditors. The equipment of the firm has a book value of \$74,800 and a market value of \$78,900. What is the book value of the stockholders' equity?

- ☐ A) \$400
- ☒ B) \$600
- ☐ C) \$1,300
- ☒ D) \$28,900
- ☐ E) \$29,300

Feedback: Book value of stockholders' equity = \$38,700 + \$74,800 - \$32,600 - \$52,000 = \$28,900.

8 CORRECT

Which one of the following is a long-term liability?

- ☒ A) deferred taxes
- ☐ B) accounts payable
- ☐ C) capital surplus
- ☐ D) notes payable
- ☐ E) treasury stock

Feedback: You are correct!

9
INCORRECT

A firm has cash of \$15, accounts payable of \$18, inventory of \$102, net fixed assets of \$147, accounts receivable of \$31, and stockholder's equity of \$87. The current assets equal _____ and the long-term debt is:

- ☐ A) \$148; \$187.
- ☐ B) \$148; \$190.
- ☐ C) \$148; \$208.
- ☐ D) \$295; \$190.
- ☐ E) \$295; \$208.

Feedback: Current assets = \$15 + \$102 + \$31 = \$148. Long-term debt = \$148 + \$18 - \$87 = \$190.

10
INCORRECT

An accrued expense is classified as:

- ☐ A) a current asset.
- ☐ B) a fixed asset.
- ☐ C) a current liability.
- ☐ D) a long-term liability.
- ☐ E) stockholders' equity.

Feedback: An accrued expense is a current liability.

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Chapter Quiz

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Results Reporter

Out of 10 questions, you answered 4 correctly with a final grade of 40%

4 correct (40%)

6 incorrect (60%)

0 unanswered (0%)

Your Results:

The correct answer for each question is indicated by a ✓.

1 CORRECT

A common-size income statement expresses all accounts as a percentage of:



- ☒ A) sales.
- ☐ B) EBIT.
- ☐ C) EBIT plus depreciation.
- ☐ D) taxable income.
- ☐ E) net income.

Feedback: You are correct!

2

INCORRECT

Common-size statements are designed to primarily address the problems encountered when comparing firms of varying:



- ☐ A) sizes.
- ☒ B) industries.
- ☐ C) geographic locations.
- ☐ D) accounting standards.
- ☐ E) management structures.

Feedback: Common-size statements primarily address the problem of size.

3

INCORRECT

A common-size balance sheet expresses accounts as a percentage of:

- ☐ A) current assets.
- ☒ B) fixed assets.
- ☐ C) total assets.
- ☐ D) total liabilities.
- ☐ E) total equity.

Feedback: Balance sheet accounts are expressed as a percentage of total assets.

4

INCORRECT

Iowa Farm Machine Sales has current assets of \$368,450, net fixed assets of \$1.23 million, and total liabilities of \$674,230. On a common-size balance sheet, current assets will be expressed as _____ percent.

- A) 23.1
- B) 30.0
- C) 39.9
- D) 18.6
- E) 28.4

Feedback: $\$368,450 / (\$368,450 + \$1,230,000) = 23.1\%$

5 CORRECT

The net income as shown on the common-size income statement for the past three years for Connor and Company is 6.3 percent, 6.9 percent, and 7.1 percent, respectively. This indicates that the firm is:

- A) increasing in size.
- B) improving its profit per sales dollar.
- C) increasing its total profits.
- D) increasing its profits at the same rate as its sales growth.
- E) paying less in taxes.

Feedback: You are correct!

Feedback: You are correct!

6 CORRECT

Avalon Manufacturing has a cost of goods sold of \$680,130 and a net income of \$41 on total sales of \$1,211,407. Total assets are \$981,500. A common-size income statement will show cost of goods sold of _____ percent and a net profit of _____ percent.



- ☒ A) 56.1; 3.4
☐ B) 56.1; 4.2
☐ C) 69.3; 3.4
☐ D) 69.3; 3.9
☐ E) 69.3; 4.2

Feedback: You are correct!

7
INCORRECT

Which one of the following statements concerning the current ratio is correct?



- ☒ A) Using book values to compute the current ratio is unacceptable because the market values of the current assets tend to deviate significantly from the book values.
☐ B) The current ratio is computed by dividing current liabilities by current assets.
☐ C) The current ratio will always be greater than the quick ratio in companies that carry inventory.
☐ D) The current ratio measures the long-run liquidity position of a firm.
☐ E) The higher the current ratio, the more cash a firm has on hand.

Feedback: The book and market values of current accounts are generally relatively similar.

8
INCORRECT

The _____ is a liquidity ratio.



- ☐ A) return on assets
☐ B) total asset turnover
☐ C) cash ratio
☐ D) times interest earned ratio
☐ E) profit margin

Feedback: Total asset turnover is an asset utilization ratio.

9
INCORRECT

_____ ratios are designed to determine a firm's long-run ability to meet its obligations.



- ☐ A) Liquidity
☐ B) Asset turnover
☐ C) Profitability
☐ D) Financial leverage
☐ E) Market value

Feedback: Liquidity ratios measure short-run, not long-run, solvency.

10
CORRECT

The total asset turnover ratio measures the:

- ☐ A) ability of the combined assets of a firm to generate sales.
☐ B) length of time it takes a firm to completely replace its fixed assets.
☐ C) amount of net income a firm generates per dollar of total assets.
☐ D) operating income per dollar of assets owned by a firm.
☐ E) amount of sales each dollar of fixed assets generates.

Feedback: You are correct!

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Results Reporter

Out of 10 questions, you answered 1 correctly with a final grade of 10%

1 correct (10%)
9 incorrect (90%)
0 unanswered (0%)

Your Results:

The correct answer for each question is indicated by a ✓.

1
INCORRECT

You are planning to move next year. You recently told your best friend that you have decided to sell all of your current furniture just prior to moving as you do not want to transport it across the country. Your friend offered to pay you \$2,000 next year for your furniture. What is your friend's offer worth today if you can earn 6 percent on your money?

- ☒ A) \$1,779.99
- ☐ B) \$1,818.22
- ☒ C) \$1,886.79
- ☐ D) \$2,000.00
- ☐ E) \$2,120.00

2
INCORRECT

All else constant, the present value _____ when the discount rate increases.

- ☒ A) increases
- ☒ B) decreases
- ☐ C) remains constant
- ☐ D) can either increase or decrease
- ☐ E) can either remain constant or decrease

3
INCORRECT

Terry is considering purchasing a used tractor and restoring it. He estimates that his restoration cost including his labor, in today's dollars, will be \$21,400. He also estimates that he can resell the tractor 1 year from now at a price of \$24,000. Should Terry undertake this project if he requires a 9.5 percent rate of return? Why or why not?

- A) Yes; because the price of \$24,000 provides a return in excess of 9.5 percent
- B) Yes; because the selling price is greater than the cost.
- C) No; because the present value of the sales price is less than \$21,400.
- D) No; because the net present value is -\$102.16.
- E) No; because the net present value is \$517.81.

4 CORRECT

Paul is considering a business investment which is guaranteed to pay \$4,000 one year from today. What is the maximum amount Paul should pay today for this investment if he wants to earn a 9.75 percent rate of return?

- A) \$3,411.68
- B) \$3,644.65
- C) \$3,661.67
- D) \$3,689.02
- E) \$3,701.08

5
INCORRECT

Ann is considering buying an office building at a cost of \$199,900. She estimates that she can resell the building after one year at a price of \$229,500. What discount rate approximately equates those two prices?

- A) 21.37 percent
- B) 16.02 percent
- C) 14.81 percent
- D) 11.48 percent
- E) 29.63 percent

- 6**
INCORRECT
- Feedback:** $\$199,900 = \$229,500 / (1 + r)$
- The Corner Art Store owns a painting which it displays in its showroom. The painting currently valued at \$1,350 but is currently not for sale. The value of the painting is increasing by 7.4 percent annually. Which one of the following prices best represent value of the painting next year should the store decide to sell it at that time?
- ☒ A) \$1,350
- ☐ B) \$1,400
- ✓ ☐ C) \$1,450
- ☐ D) \$1,500
- ☐ E) \$1,550
- 7**
INCORRECT
- Feedback:** $FV = \$1,350 \times (1 + .074)$
- On your 5th birthday, your grandparents opened an investment account in your name and made an initial deposit of \$2,500. The account pays 4.5 percent interest. How much will you have in the account on your 21st birthday if you don't add or withdraw any money before then?
- ☐ A) \$4,711.68
- ☒ B) \$5,002.10
- ✓ ☐ C) \$5,055.93
- ☐ D) \$5,207.19
- ☐ E) \$5,211.14
- 8**
INCORRECT
- Today, you are investing \$27,500 in a new project. The project will return \$8,000, \$9,500, and \$11,000 at the end of each of the next three years, respectively. What is the net present value of this project at a 9 percent discount rate?
- ✓ ☐ A) -\$3,670.57
- ☒ B) -\$3,209.11
- ☐ C) \$3,711.09
- ☐ D) \$3,787.88
- ☐ E) \$3,901.11
- 9**
INCORRECT
- Your goal is to have \$15,000 in your savings account 3 years from now so that you can purchase a home. Which one of the following statements is correct given this situation? Assume that you only make one initial deposit into the savings account.
- ☒ A) The higher the interest rate on your savings, the larger the amount that you need to deposit today to fund this account.
- ☐ B) If you deposit \$7,500 today and earn 7 percent interest, you will reach your goal in 3 years.
- ✓ ☐ C) If you have \$10,000 to deposit today, you will need to earn at least 15 percent interest to reach your goal.
- ☐ D) The less money you have to deposit today into the account, the greater the interest rate must be if you are to reach your goal of \$15,000.
- ☐ E) You will have to deposit \$12,460 today if the interest you can earn is 4.7 percent.
- 10**
INCORRECT
- What is the future value of \$12,000 received today if it is invested at 10.5 percent compounded annually for 25 years?
- ☐ A) \$131,484.77
- ☐ B) \$145,625.76
- ☐ C) \$147,475.83
- ☐ D) \$152,521.75
- ☐ E) \$153,374.89

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9 incorrect (90%)
0 unanswered (0%)

Your Results:

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1
INCORRECT

The dollar value a project adds to a firm can be computed using which one of the following analytical methods?

- ☐ A) Payback
☒ B) Profitability index
☐ C) Net present value
☐ D) Internal rate of return
☐ E) Average accounting return

Feedback: The profitability index is a benefit to cost ratio, not a total benefit value.

2
INCORRECT

Eastern Express is considering a project with an initial investment of \$218,400. Clyc the general manager, estimates the project will generate additional revenues of \$7 a year for the next 4 years. How much value will this project add to the firm if the required rate of return is 15.4 percent?

- ☒ A) -\$2,599.18
☐ B) \$1,406.19
☐ C) \$9,008.74
☐ D) \$23,406.08
☐ E) \$38,117.13

Feedback: The value added is equivalent to the NPV of the project.

3
INCORRECT

You need to borrow \$2,500 quickly and Slimey Joe, the neighborhood loan shark, w it to you if you promise to repay him \$300 a month for the next year. Suppose that . cost of funds is 2 percent per month. From Joe's point of view, what is the net prese value of this deal?

- ☐ A) \$429.18
☐ B) \$487.08
☐ C) \$542.16
☐ D) \$672.60
☐ E) \$708.34

Feedback: The NPV is the present value of the payments minus the initial loan amount

4
INCORRECT

What is the net present value of the following set of cash flows if the required retur 12.3 percent?

$Yr_0 = -\$244,900$; $Yr_1 = \$16,300$; $Yr_2 = \$102,900$; $Yr_3 = \$141,700$; and $Yr_4 = \$137,5$

- ☐ A) -\$21,407.18
☐ B) -\$2,619.03
☐ C) \$22,407.01
☐ D) \$37,715.07
☐ E) \$54,116.23

Feedback: The first cash flow is a cash outflow at time zero.

5
INCORRECT

California Squeaker is considering creating a new website at a cost of \$526,000. Th website will provide the latest news and gossip from around the state for an annua per subscriber of \$8.95 a year. The company expects to collect fees totaling \$44,750 year 1, \$89,500 in year 2, and \$304,300 per year for years 3 through 5. After year 5 company believes the website will be worthless due to technological advancements What is the potential value to the firm from this project given a 16 percent discount

- ☐ A) \$62,406.91



- ☐ B) \$86,986.17
- ☐ C) \$102,008.49
- ☐ D) \$121,603.13
- ☐ E) \$146,900.03

Feedback: The potential value is the NPV of the project.

6 CORRECT

Would you accept a project which is expected to pay \$8,600 a year for 7 years if the initial investment is \$39,800 and your required return is 13.65 percent? Why or why



- ☒ A) No; The NPV is -\$2,523.
- ☐ B) No; The NPV is -\$989.
- ☐ C) No; The NPV is -\$413.
- ☐ D) Yes; The NPV is \$3,011.
- ☐ E) Yes; The NPV is \$3,336.

Feedback: You are correct!

7

INCORRECT

Which of the following are strengths of the NPV method of analysis?

- I. The consideration of every cash flow related to a project.
- II. The analysis is based on cash flows.
- III. The profits and losses expected over the life of a project are considered.
- IV. Time value of money is considered.

- ☐ A) I and II only
- ☒ B) II and IV only
- ☐ C) I, III, and IV only
- ☐ D) II, III, and IV only



- ☐ E) I, II, and IV only

Feedback: Correct, but every cash flow related to the project is also considered.

8

INCORRECT

Which of the following statements are correct?

- I. The NPV of a project will increase if the required discount rate is decreased.
- II. A financial manager acts in the shareholders' best interests by identifying and implementing positive NPV projects.
- III. The discount rate used in the NPV computation is the opportunity cost of the project.
- IV. A project with an NPV equal to zero is earning a return exactly equal to its required return.

- ☒ A) I and II only
- ☐ B) II and III only
- ☐ C) II, III, and IV only



- ☐ D) I, II, and IV only
- ☐ E) I, II, III, and IV

Feedback: Statements III and IV are also correct.

9

INCORRECT

You are considering a project that costs \$156,700 and has expected cash flows of \$31,000, \$58,300, and \$113,600 per year over the next three years, respectively. What is the net present value of the project if the appropriate discount rate is 14.7 percent?

- A) -\$10,077.43
- B) -\$7,251.43
- C) \$4,616.08
- D) \$13,909.18
- E) \$14,141.41

Feedback: The NPV is -\$10,077.43 which means the project should be rejected.

10

INCORRECT

Net present value:

- A) is equal to the initial investment in a project.
- B) is a dollar comparison of a project's cost to the present value of the project's benefits.
- C) is equal to zero when the discount rate applied is less than the internal rate of return (IRR).
- D) is simplified by the fact that the discount rate applicable to an individual project is easy to determine.
- E) requires a firm to set an arbitrary cutoff point in time for determining whether a project should be accepted.

Feedback: If the required discount rate is less than the IRR, the NPV will be positive.

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Results Reporter

Out of 10 questions, you answered 4 correctly with a final grade of 40%

4 correct (40%)

6 incorrect (60%)

0 unanswered (0%)

Your Results:

The correct answer for each question is indicated by a ✓.

1 CORRECT

The manager of Home Food Sales is trying to decide whether or not the firm should repair one of its delivery trucks. The chief mechanic has stated that "It would be a waste of money not to repair it because we just spent \$2,200 on repairs last month." What is the major problem with this argument?

- ✓ ☒ A) It ignores the opportunity cost of the money that has been spent.
- ☐ B) It includes sunk costs in the decision.
- ☐ C) It includes opportunity costs in the decision.
- ☐ D) It includes changes in net working capital.
- ☐ E) It includes financing costs in the decision.

Feedback: You are correct!

2 INCORRECT

It is important to identify and use only incremental cash flows in capital investment decisions:

- ✓ ☒ A) because they are simple to identify.
- ☐ B) only when allocated costs are present.
- ☐ C) because ultimately it is the change in a firm's overall future cash flows that matter.
- ☐ D) in order to accommodate unforeseen changes that might occur.
- ☐ E) whenever sunk costs are involved.

Feedback: Incremental cash flows should be used whether or not allocated costs are involved.

3 CORRECT

Incremental cash flows should include the:

I. sunk costs.
II. opportunity costs.
III. erosion effects.
IV. effects of synergy.

- ☐ A) I and II only
- ☐ B) I, III, and IV only
- ☐ C) II and III only
- ☐ D) II, III, and IV only
- ☐ E) I, II, III, and IV

Feedback: You are correct!

4 INCORRECT

Boyd and Sons purchased 14.5 acres of industrial property 2 years ago at a cost of \$1.45 million. Since that time, the firm has spent \$220,000 on land improvements such that the current market value of the land is estimated at \$1.45 million. The operations manager has been assigned the task of analyzing the construction of a new manufacturing plant located on that site. This manager has developed cost estimates for the building and contents of \$24.6 million along with \$1.1 million for additional land improvements and preparation. Based on this information, the financial manager should estimate the incremental cash flow for the plant project as _____ million.

- ☐ A) \$25.70
- ☐ B) \$25.92
- ☐ C) \$26.05
- ☐ D) \$27.02
- ☐ E) \$27.15

Feedback: The opportunity cost of the land, the cost of the building and its contents, and the additional monies which must be spent on the site should be included.

~
INCORRECT

A.B. Cooper purchased a piece of land 3 years ago for \$124,000 and subsequently added \$68,000 in improvements. There are two options for future use of the land: 1) the land can be sold today for \$213,000 aftertax; or 2) your company can destroy the past improvements and build a factory on the land. When evaluating the factory option, what amount, if any, should be included for the use of the land?

- ☐ A) \$0
- ☒ B) \$124,000
- ☐ C) \$145,000
- ☐ D) \$192,000
- ☒ E) \$213,000

Feedback: The opportunity cost is the current market value of the land.

6 CORRECT

Which one of the following is least likely to cause erosion?

- ☒ A) A gas station owner expands his building to make room for a convenience store.
- ☐ B) You begin selling coffee in single-serving foil pouches along side your regular sized cans.
- ☐ C) You build a Taco Heaven just down the street from the Chili Dog Haven you own.
- ☐ D) Your grocery store begins to carry additional flavors of ice cream.
- ☐ E) The concession stand at the local ball field begins to sell both hot dogs and hamburgers, rather than just hot dogs.

Feedback: You are correct!

7
INCORRECT

Over the past five years, your company scientists spent \$3.6 million developing a new engine additive which they recently began marketing. Today, those same scientists have proven that the additive can also be used as a cleaning fluid if additional chemicals are added to the mixture. As the financial manager of the firm, you are being assigned the task of determining whether or not the cleaning fluid should be produced and sold. In your analysis, the original \$3.6 million R&D costs should be treated as:

- ☒ A) a cash outflow at time $T = -5$.
- ☐ B) an annual operating cost of \$.72 million for each of the next 5 years.
- ☐ C) an annual cash outflow of \$.72 million for each of the past 5 years.
- ☐ D) an opportunity cost and included as a cash outflow at time $T = 0$.
- ☒ E) a sunk cost, and therefore excluded from the analysis.

Feedback:

The \$3.6 million R&D is a sunk cost.

8 CORRECT

Your company currently manufactures the "Priced Right" line of golf clubs. The board of directors wants you to look at replacing that line with a new "Straight Hit" line of clubs. Which one of the following should NOT be included in your analysis of the proposed "Straight Hit" project?

- ☐ A) \$400,000 drop in sales from terminating the "Priced Right" line of clubs
- ☐ B) \$150,000 market value of land currently owned by the firm that will be used for the project
- ☒ C) \$200,000 already spent on research and development to create the new line of clubs
- ☐ D) \$350,000 you will pay to Fred Frimstone to promote your new clubs
- ☐ E) \$125,000 you expect to receive from selling the equipment used to produce "Priced Right" clubs

Feedback: You are correct!

9
INCORRECT

Brett is deciding whether or not to drop one of the college courses in which he is currently enrolled. If he drops the course, he will forfeit half of the money spent on tuition. However, by dropping the course, he can increase the number of hours he works each week. Which of the following statements is accurate based on Brett's situation?
I. Remaining in the class incurs an opportunity cost equal to Brett's foregone wages.
II. The tuition is irrelevant to the decision because it is a sunk cost.
III. The time and energy put into the course thus far is a sunk cost.

- ☐ A) I only
- ☐ B) I and II only
- ☐ C) I and III only
- ☐ D) II and III only
- ☐ E) I, II, and III

Feedback: Correct, but the time and energy invested thus far is a sunk cost.

10
INCORRECT

When evaluating a capital budgeting project, you ignore all cash flows of the firm except those that change when a project is implemented. The cash flows you are trying to isolate are referred to as:

- ☐ A) capital expenditures.
- ☐ B) operating cash flows.
- ☐ C) incremental cash flows.
- ☐ D) allocated costs.
- ☐ E) opportunity costs.

opportunity costs.

Feedback: Operating cash flows are generally only a portion of the cash flows you are isolating.

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