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QUESTION 1

The following data were collected from the records of the shipping department of a company:

Month	Units Shipped	Cost of Shipping Supplies
1	7,000	$35,000
2	5,000	25,000
3	3,000	14,900
4	13,000	65,000
5	11,000	55,200
6	10,000	50,200
7	15,000	74,900

The cost of shipping supplies is most likely to be a

A. Variable cost.

B. Fixed cost.

C. Step cost.

D. Semi-fixed cost.

Correct Answer: A

Variable costs are constant per unit but fluctuate in total with activity or volume (the rate of use of capacity). The cost per unit for shipping supplies is relatively constant at about $5, so this cost is variable.

QUESTION 2

Regis Company manufactures plugs used in its manufacturing cycle at a cost of $36 per unit that includes $8 of fixed overhead. Regis needs 30,000 of these plugs annually, and Orlan Company has offered to sell these units to Regis at $33 per unit. If Regis decides to purchase the plugs, $80,000 of the annual fixed overhead applied will be eliminated, and the company may be able to rent the facility previously used for manufacturing the plugs.If the plugs are purchased and the facility rented, Regis Company wishes to realize $100,000 in savings annually. To achieve this goal, the minimum annual rent on the facility must be

A. $10,000

B. $40,000

C. $70,000

D. $190,000

Correct Answer: D

Without regard to rental of idle production capacity, the company will lose $3 per unit ($33 purchase price -- $30 relevant cost) by purchasing the plugs. The total annual loss will be $90,000 (30,000 units x $3). Consequently, to achieve the targeted savings, the minimum annual rent must be $190,000 ($90,000 loss from purchasing + $100,000 targeted savings).

QUESTION 3

Carco, Inc. wants to use discounted cash flow techniques when analyzing its capital investment projects. The company is aware of the uncertainly involved in estimating future cash flows. A simple method some

companies employ to adjust for the uncertainly inherent in their estimates is to

A. Prepare a direct analysis of the probability of outcomes.

B. Use accelerated depreciation.

C. Adjust the minimum desired rate of return.

D. Increase the estimates of the cash flows.

Correct Answer: C

Uncertainly can be compensated for by adjusting the desired rate of return. If projects have relatively uncertain returns, a higher rate should be required. A lower rate of return may be acceptable given greater certainly. The concept is that with increased risk should come increased rewards1 i.e., a higher rate of return.

QUESTION 4

Which of the following responses is not an advantage to a corporation that uses the commercial paper market for short-term financing?

A. This market provides more funds at lower rates than other methods provide

B. The borrower avoids the expense of maintaining a compensating balance with a commercial bank.

C. There are no restrictions as to the type of corporation that can enter into this market.

D. This market provides a broad distribution for borrowing.

Correct Answer: C

Commercial paper is a short-term, unsecured note payable issued in large denominations by major companies with excellent credit ratings. Maturities usually do not exceed 270 days. Commercial paper is a lower cost source of funds than bank loans, and no compensating balance are required. Commercial paper provides a broad and efficient distribution of debt, and costly financing arrangements are avoided. The market is not open to all companies because only major corporations with high credit ratings can participate.

QUESTION 5

The amount of inventory that a company would tend to hold in stock would increase as the

A. Sales level falls to a permanently lower level.

B. Cost of carrying inventory decreases.

C. Variability\\' of sales decreases.

D. Cost of running out of stock decreases.

Correct Answer: B

Inventory management attempts to minimize the total costs of ordering, carrying inventory, and stock outs. Thus, affirm incurs carrying costs to reduce ordering and stock out costs. If the cost of carrying inventory declines, the inventory level must increase to minimize total inventory costs.

QUESTION 6

Short-term securities issued by the Federal Housing Administration are known as

A. Agency securities

B. Bankers\\' acceptances.

C. Commercial paper

D. Repurchase agreements.

Correct Answer: A

A short-term secunt1t issued by a corporation or agency created by the U.S. government, such as the Federal Housing Administration, is an agency security (agency issue). Among the largest issuers of agency securities (excluding the Treasury) are the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the other entities that provide credit to farmers and home buyers. Other issuers of home mortgage- backed securities include the Government National Mortgage Association (Ginnie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

QUESTION 7

In capital markets, the primary market is concerned with the provision of new funds for capital investments through

A. New issues of bond and stock securities.

B. Exchanges of existing bond and stock securities.

C. The sale of forward or future commodities contracts

D. New issues of bond and stock securities and exchanges of existing bond and stock securities

Correct Answer: A

The primary market is the market for new stocks and bonds In this market, wherein investment money flows directly to the issuer, securities are initially sold by investment bankers who purchase them from issuers and sell them through an underwriting group. Later transactions occur on securities exchanges or other markets.

QUESTION 8

Which one of the following costs would be relevant in short-term decision making?

A. Incremental fixed costs.

B. All costs of inventory.

C. Total variable costs that are the same in the considered alternatives.

D. Costs of fixed assets to be used in the alternatives.

Correct Answer: A

Relevant costs are those future costs that differ among the options. Incremental or differential cost is the difference in total cost between two decisions. Consequently, incremental fixed cost is a relevant cost.

QUESTION 9

A working capital technique that increases the payable float and therefore delays the outflow of cash is

A. Concentration banking.

B. A draft.

C. Electronic Data Interchange (EDI).

D. A lockbox system.

Correct Answer: B

Payment by draft, a three-party instrument in which the drawer orders the drawer to pay money to the payee, is a means of slowing cash outflows. A check is the most common type of draft. Check float arises from the delay between expenditure and the clearing of the check through the banking system.

QUESTION 10

Which of the following is the most significant reason that domestic governments and international organizations seek to eliminate cartels?

A. The increased sales price reduces the amount of corporate tax revenues payable to the government

B. True competition keeps prices as low as possible, thus increasing efficiency in the marketplace

C. Small business cannot survive or grow without government protection

D. The economic stability of developing countries depends on a global free market

Correct Answer: B

A cartel is an organization of sellers (e.g., the oil cartel OPEC) who undertake joint action to maximize member\\'s profits by controlling the supply and therefore the price of their product. Under the laws of many nations, such collusive conduct is illegal when engaged in by firma subject to those laws. The reason is that, as a result of the monopolistic and anticompetitive practices of cartels, supply is lower, prices re high, competition is restrained, and the relevant. Industry is less efficient. Accordingly, governmental and international organizations seek to protect consumers and the health of the domestic and global economy through anti-cartel efforts.

QUESTION 11

Which of the following is the most significant disadvantage of a cost-based transfer price?

A. Requires internally developed information

B. Imposes market effects on company operations.

C. Requires externally developed information.

D. May not promote long-term efficiencies.

Correct Answer: CD

A cost-based transfer price is a price charged in an intracompany transaction that covers only the selling subunits costs. However, by ignoring relevant alternative market prices, a company may pay more than is necessary to produce goods and services internally.

QUESTION 12

The firm\\'s marginal cost of capital

A. Should be the same as the firm\\'s rate of return on equity.

B. Is unaffected by the firms capital structure.

C. Is inverse\\' related to the firm\\'s required rate of return used in capital budgeting.

D. Is a weighted average of the investors\\' required returns on debt and equity

Correct Answer: D

The marginal cost of capital is the cost of the next dollar of capital. The marginal cost continually increases because the lower cost sources of funds are used first. The marginal cost represents a weighted average of 1both debt and equity capital.

QUESTION 13

Which one of the following statements concerning cash flow determination for capital budgeting purposes is not correct?

A. Tax depreciation must be considered because it affects cash payments for taxes.

B. Book depreciation is relevant because it affects net income.

C. Sunk costs are not incremental flows and should not be included

D. Net working capital changes should be included in cash flow forecasts.

Correct Answer: B

Tax depreciation is relevant to cash flow analysis because it affects the amount of income taxes that must be paid. However, book depreciation is not relevant because it does not affect the amount of cash generated by an investment.

QUESTION 14

A weakness of the internal rate of return (IPP) approach for determining the acceptability of investments is that it

A. Does not consider the time value of money.

B. Is not a straightforward decision criterion.

C. Implicitly assumes that the firm is able to reinvest project cash flows at the firm\\'s cost of capital.

D. Implicitly assumes that the firm is able to reinvest project cash flows at the project\\'s internal rate of return.

Correct Answer: D

The IRR is the rate at which the discounted future cash flows equal the net investment (NPV = 0). One disadvantage of the method is that inflows from the early years are assumed to be reinvested at the IRP. This assumption may not be sound. Investments in the future may not earn as high a rate as is currently available.

QUESTION 15

A 10% stock dividend most likely

A. Increases the size of the firm.

B. Increases shareholders\\' wealth.

C. Decreases future earnings per share.

D. Decreases net income.

Correct Answer: C

A stock dividend is a transfer of equity from retained earnings to paid-in capital. The debit is to retained earnings, and the credits are to common stock and additional paid-in capital. Additional shares are outstanding following the stock dividend, but every shareholder maintains the same percentage of ownership. In effect, a stock dividend divides the pie (the corporation) into more pieces, but the pie is still the same size. Hence, a corporation will have a lower EPS and a lower bookvalue per share following a stock dividend, but every shareholder will be just as well off as previously. A stock dividend has no effect except on the composition of the shareholders\\' equity section of the balance sheet.