**Multiple Choice Questions (Chapters 6-7):**

1. When a firm has the opportunity to add a project that will utilize excess factory capacity (that is currently not being used), which costs should be used to help determine if the added project should be undertaken? 

|  |  |
| --- | --- |
| A. | allocated overhead costs |

|  |  |
| --- | --- |
| B. | sunk costs |

|  |  |
| --- | --- |
| **C.** | incremental costs |

|  |  |
| --- | --- |
| D. | average costs |

2. A reduction in the sales of existing products caused by the introduction of a new product is an example of: 

|  |  |
| --- | --- |
| **A.** | incidental effects. |

|  |  |
| --- | --- |
| B. | opportunity costs. |

|  |  |
| --- | --- |
| C. | sunk costs. |

|  |  |
| --- | --- |
| D. | allocated overhead costs. |

3. When Honda develops a new engine the incidental effects might include the following:  
  
I) demand for replacement parts;  
II) profits from the sale of repair services;  
III) offer modified or improved versions of the new engine for other uses 

|  |  |
| --- | --- |
| A. | I only |

|  |  |
| --- | --- |
| B. | I and II only |

|  |  |
| --- | --- |
| **C.** | I, II, and III |

|  |  |
| --- | --- |
| D. | I and III only |

4. Net working capital is best represented as:  
  
I) short-term assets;  
II) short-term liabilities;  
III) long-term assets;  
IV) long-term liabilities 

|  |  |
| --- | --- |
| A. | I only |

|  |  |
| --- | --- |
| **B.** | (I - II) |

|  |  |
| --- | --- |
| C. | (III - I) |

|  |  |
| --- | --- |
| D. | (III - IV) |

5. One should consider net working capital (NWC) in project cash flows because: 

|  |  |
| --- | --- |
| **A.** | typically, firms must invest cash in short-term assets to produce finished goods. |

|  |  |
| --- | --- |
| B. | NWC represents sunk costs. |

|  |  |
| --- | --- |
| C. | firms need positive NPV projects for investment. |

|  |  |
| --- | --- |
| D. | inclusion of NWC typically increases calculated NPV. |

6. For the case of an electric car project, the following costs should be treated as incremental costs when deciding whether to go ahead with the project EXCEPT: 

|  |  |
| --- | --- |
| A. | the consequent reduction in sales of the company's existing gasoline models (i.e., incidental effects). |

|  |  |
| --- | --- |
| **B.** | interest payments on debt incurred to finance the project. |

|  |  |
| --- | --- |
| C. | the value of tools that will be transferred to the project from the company's existing plants instead of being sold. |

|  |  |
| --- | --- |
| D. | the expenditure on new plants and equipment. |

7. Money that a firm has already spent, or committed to spend regardless of whether a project is taken, is called: 

|  |  |
| --- | --- |
| A. | fixed cost. |

|  |  |
| --- | --- |
| B. | opportunity cost. |

|  |  |
| --- | --- |
| **C.** | sunk cost. |

|  |  |
| --- | --- |
| D. | incremental cost. |

8. For project Z, year 5 inventories increase by $6,000, accounts receivable by $4,000, and accounts payable by $3,000. Calculate the increase or decrease in working capital for year 5. 

|  |  |
| --- | --- |
| A. | increases by $5,000 |

|  |  |
| --- | --- |
| B. | decreases by $1,000 |

|  |  |
| --- | --- |
| **C.** | increases by $7,000 |

|  |  |
| --- | --- |
| D. | decreases by $7,000 |

Change in working capital = 6000 + 4000 - 3000 = +7,000.

9. If depreciation is $100,000 and the marginal tax rate is 35%, then the tax shield due to depreciation is: 

|  |  |
| --- | --- |
| **A.** | $35,000 |

|  |  |
| --- | --- |
| B. | $100,000 |

|  |  |
| --- | --- |
| C. | $65,000 |

|  |  |
| --- | --- |
| D. | cannot be determined from the information given |

Tax shield effect = (100,000)(0.35) = 35,000.

10. The following are measures used by firms when making capital budgeting decisions EXCEPT: 

|  |  |
| --- | --- |
| A. | payback period. |

|  |  |
| --- | --- |
| B. | internal rate of return. |

|  |  |
| --- | --- |
| **C.** | P/E ratio. |

|  |  |
| --- | --- |
| D. | net present value. |

11. Given the following cash flows for project A: *C*0 = -1,000, *C*1 = +600, *C*2 = +400, and *C*3 = +1,500, calculate the payback period. 

|  |  |
| --- | --- |
| A. | one year |

|  |  |
| --- | --- |
| **B.** | two years |

|  |  |
| --- | --- |
| C. | three years |

|  |  |
| --- | --- |
| D. | cannot be determined |

12. If an investment project has an IRR equal to the cost of capital, the NPV for that project is: 

|  |  |
| --- | --- |
| A. | positive. |

|  |  |
| --- | --- |
| B. | negative. |

|  |  |
| --- | --- |
| **C.** | zero. |

|  |  |
| --- | --- |
| D. | unable to determine. |

13. The IRR is defined as: 

|  |  |
| --- | --- |
| **A.** | the discount rate that makes a project's NPV equal to zero. |

|  |  |
| --- | --- |
| B. | the difference between the cost of capital and the present value of the cash flows. |

|  |  |
| --- | --- |
| C. | the discount rate used in the NPV method. |

|  |  |
| --- | --- |
| D. | the discount rate used in the discounted payback period method. |

14. If the sign of the cash flows for a project changes two times, then the project likely has: 

|  |  |
| --- | --- |
| A. | one IRR. |

|  |  |
| --- | --- |
| **B.** | two IRRs. |

|  |  |
| --- | --- |
| C. | three IRRs. |

|  |  |
| --- | --- |
| D. | four IRRs. |