Financial & Managerial Accounting for Undergraduates
2nd Edition
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PRACTICE QUIZ

Chapter 25: Capital Budgeting

1. What is capital budgeting?

a. Planning short-term investments in productive assets
b. Planning long-term investments in productive assets
c. Planning long-term investments in current liabilities
d. None of the above

2. Which of the following is an element of capital budgeting?

a. Identify potential investments
b. Select investments to be undertaken
c. Monitor the selected investments
d. All of the above

3. Which of the following sources of capital are used to calculate the weighted average cost of capital (WACC)?

a. Accounts Receivable
b. Preferred and Common stock
c. Cash
d. All of the above

4. $100 received 3 years from now, at a discount rate of 10%, has a present value of approximately?

a. $71
b. $73
c. $75
d. $83

5. $100 received 20 years from now, at a discount rate of 15%, has a present value of approximately?

a. $6
b. $9
c. $12
d. $14

6. If a company has a cost of capital of 12%, their minimum rate of return (hurdle rate) is expected to be?

a. 11%
b. 11.9%
c. 12%
d. Greater than 12%

Reference the following information for Questions 7-9.

Valentino's Stage Productions is taking on a new project. The project is expected to increase net income by $1,000,000 for each of the next 3 years. The equipment needed will cost $7,000,000. Valentino's hurdle rate is 12% and has the following capital structure.

Bond issuance:	20% of total funds, requires 15% interest per year
Bank loan:	60% of total funds, requires 9.5% interest per year
Preferred Stock issuance:	20% of total funds, requires 5% dividend per year

7. What is Valentino's weighted average cost of capital?

a. 8.0%
b. 8.4%
c. 9.7%
d. 10.1%

8. What is Valentino's average rate of return on the new project?

a. 9.29%
b. 11.29%
c. 28.57%
d. 40.00%

9. Should Valentino invest in the project?

a. No, the average rate of return does not exceed the hurdle rate
b. No, the average rate of return exceeds the hurdle rate
c. Yes, the average rate of return does not exceed the hurdle rate
d. Yes, the average rate of return exceeds the hurdle rate

10. Robinson Bottling Co. reported Sales of $220,000, Cost of Goods Sold of $87,000 (including depreciation expense of $10,000), and Office Expenses of $11,000. The tax rate is 15%. The company has no significant changes in Accounts Receivable, Inventory, Accounts Payable, Prepaid Expenses, or Unearned Revenue.

What are Robinson's net after-tax cash flows?

a. $103,700
b. $105,200
c. $110,800
d. $113,700

SOLUTIONS

Chapter 25: Capital Budgeting

1. b

2. d

3. b

4. c

5. a

6. d

7. c

8. c

9. d

10. d