Accountant

IMA-CMA-Part-2

Strategic Financial Management

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Question: 1

Capital budgeting considers all but which of the following factors?

A. The cost of the project
B. The cash flow of a project
C. The net investment for the organization
D. The rate of return of the project

Answer: D

Explanation:
The rate of return of the project. Capital budgeting is the process that tells a business whether a certain project or expenditure would be worth pursuing. Capital budgeting uses discounted cash flow methods, internal rates of return calculations, net present value methods, and payback periods to help make this decision. A value is assigned to the cash flow expected to be realized from the project or purchase of a real asset extending from time of acquisition through project completion or the life of the asset. Once cash flow is determined, it is discounted to its present value. Also considered in the capital budgeting process is the net investment for the organization: the cost of the project plus any installation costs less any proceeds from the disposal of the project. This process requires that a business look at the various costs and benefits involved in each of the investment alternatives being considered.

Question: 2

In forecasting cash flows on capital projects, which time horizon is most sensible for which type of organization?

A. Five years— for a slow growing company
B. One year— for a high-growth company
C. 10 years— for a company that dominates its market
D. Three years— for a startup business

Answer: C

Explanation:
10 years— for a company that dominates its market. Before forecasting cash flows for a capital project begins, a business must arrive at a forecast period; the duration of time in which the investment will generate cash flow in excess of its cost. A good rule of thumb is a 10-year forecast period for a business in a dominant market position, one year for a slow-growing organization, and five years for solid businesses with a proven sales record. Once the forecasting period is selected, a

business can forecast revenue growth (future sales and profit margins). Although cash flows from the specific project are being forecast, they must be relevant in that they would affect a change to the business' existing overall cash flow.

Question: 3

Internal rate of return is a better valuation method than net present value when.„

A. cash flow fluctuates between accounting periods
B. investing in a project by acquiring additional capital
C. valuing mortgages and bonds
D. valuing real estate investments

Answer: C

Explanation:
Valuing mortgages and bonds. Internal rate of return is a discount rate that has a result of a net present value of zero. This discount rate is the expected return on the investment. Its used to decide if a long-term investment should be made. It's used most commonly for mortgages and bonds. Mortgages provide one cash inflow and a series of cash outflows, providing a consistent cash flow pattern and stable repayment schedule. Internal rate of return also works when comparing bonds with identical yields and terms. Net present value is used to evaluate which long-term project an organization should undertake. It evaluates the size and timing of future cash flows from a project and then discounts the cash flows to determine a dollar value for the cash flow in present dollars. Internal rate of return is easier to interpret than net present value.

Question: 4

Which capital budgeting method is most often used to determine the value of a business?

A. Discounted cash flow analysis
B. Weighted average cost of capital
C. Internal rate of return
D. Net present value

Answer: A

Explanation:
Discounted cash flow analysis. Discounted cash flow analysis, used most often in business valuation, is a capital budgeting method that looks at the income and costs of an activity, project, or investment and evaluates each to determine a present value. It takes into consideration the flow of future cash income, the risk involved, and the timing of the cash flow. Because income is received over time, the further out the cash inflow, the higher the discount rate. The weighted average cost of capital is a method that helps a business decide whether or not to invest in a project by acquiring additional capital, either debt or equity. Weighted average cost of capital is used to measure the cost of capital for a project.

Question: 5

What assumption can be made when using payback period to compare two or more investments?

A. Trial and error is used to determine future cash flows
B. Limits must be set on the amount of investment
C. Investments with shorter payback periods have more liquidity and less risk
D. Investments with longer payback periods have more liquidity and more risk

Answer: C

Explanation:
Investments with shorter payback periods have more liquidity and less risk. The payback period is the amount of time in which the cost of an investment is recovered, calculated by dividing initial investment cost by the annual cash inflows. The payback method assumes that annual cash inflows are equal from year to year. If they re not equal, a trial and error method needs to be assumed to determine an estimated payback period. When comparing two or more projects or investments, the better choice is the investment or project with the shortest payback period because of the assumption that shorter payback periods result in more liquidity and less risk.

Question: 6

Which is NOT a true measure of profitability?

A. Payback method
B. Net present value
C. Internal rate of return
D. Discounted cash flow

Answer: A

Explanation:
Payback method. Payback method is not a true measure of profitability like net present value, internal rate of return, or discounted cash flow. The advantage of using the payback method is that it considers the risk involved in investing in a project. The disadvantages of using the payback method are that it does not take the time value of money into consideration, cash flows that occur after the payback period are not included in the calculation, and it does not factor in the scale or size of the investment.

Question: 7

Which factor is not considered in a capital investment decision?

A. Rate of return on the investment

B. The time period in which the investment will be repaid
C. The risk that the investment may not be repaid or repaid at the expected rate
D. Future cash flows received from the investment

Answer: D

Explanation:
Future cash flows received from the investment. Capital investment decisions are made based, in large part, on the expected rate of return. The rate of return is dependent upon the amount, timing, risk and time value of money. The amount, expressed as a percentage, is how much money the investment is expected to return. The timing is length of time that will elapse until the money will be repaid. The sooner the money is repaid, the higher the rate of return. The risk depends on how likely the money can be repaid at the expected rate within the expected time period, and if it can be repaid at all. The time value of money takes the present value of the future income into consideration. With riskier investments, the present value of the money returned in the future is less than the current value of the money.

Question: 8

How are projects and investments valued when making capital investment decisions?

A. Discounted cash flow and rate of return
B. Discounted cash flow and net present value
C. Rate of return and internal rate of return
D. Net present value and weighted average cost of capital

Answer: B

Explanation:
Discounted cash flow and net present value. Deciding the scope and feasibility of a capital investment involves determining if positive net present value exists. The net present value calculation is applied using an appropriate discount rate. The project also needs to return a positive cash flow, one significant enough to provide a return to those who funded the project. Capital investment decisions are based on financing fixed assets and the capital structure of the financing. These decisions should only be pursued when the project maximizes the benefit to the business in the way of profits and value.

Question: 9

What effect does the financing of capital investments have on a company's future stability and profitability?

A. Increases risk and decreases rate of return
B. Decreases risk and decreases control
C. Increases cash flow and increases risk
D. Decreases cash flow and increases risk

Answer: D

Explanation:
Decreases cash flow and increases risk. Capital investment financing affects a business' cash flow and contributes to the risk involved with the business' long-term viability. Capital investment financing could be a mix of debt and equity, with debt service being a liability that affects overall cash flow. Debt financing requires that the organization pay interest payment to service the debt. Equity financing does not produce the risk involved with debt financing. but it usually costs more and the business' owners will have a smaller ownership stake.

Question: 10

What statistical calculations are used to measure the amount of risk involved with an investment decision?

A. Net present value and cash equivalent coefficient
B. Standard deviation and cash equivalent coefficient
C. Standard deviation and coefficient of variation
D. Coefficient of variation and net present value

Answer: C

Explanation:
Standard deviation and coefficient of variation. Risk is measured using standard deviation and coefficient of variation statistics. Risk is the possibility that an investment will return an amount different than expected. It is a measure of the volatility of return on investment. The rule of risk is that a higher risk level would correspond to a higher return on investment, as compensation for the high risk. Risk analysis is a means to measure the amount of risk involved with investment decisions.

Question: 11

Analysts attempt to measure the effect of a wrong decision on a company's profits, costs, and sales by performing.„

A. risk analysis
B. sensitivity analysis
C. certainty equivalent
D. real options analysis

Answer: B

Explanation:
Sensitivity analysis. Sensitivity analysis is a method for dealing with wrong decisions,

allowing the organization to review various decision alternatives using a "what-if' approach. It predicts the outcome of a wrong decision by looking at its effects on profits, costs, and sales. Sensitivity analysis also looks at what could happen if conditions related to a decision should change in the future, including ones both within and beyond the control of the organization. A certainty equivalent is the rate of return that an organization would need to realize in order for it to make a decision that has a higher level of risk and a higher, but uncertain, return on investment. Real options analysis is a method used in decision making to determine the best courses action to take with respect to future events.

Question: 12

What is an advantage of using real options analysis to determine the value of an investment decision?

A. Determines the volatility of return on the investment
B. Helps an organization deal with wrong decisions
C. The investment is measured against risk-free investments
D. Uncertainties are considered in the decision

Answer: D

Explanation:
Uncertainties are considered in the decision. A real option is a business' choice to pursue or not pursue a course of action with respect to an investment decision. Real options analysis, therefore, weighs these choices by evaluating potential outcomes arising from decisions. This approach gives a business the opportunity to think about what assets are at its disposal, an allows an organization to not only make a decision based on certainty, but to add uncertainties into the decision making process. Risk is the possibility that an investment will return an amount different than expected. It is a measure of the volatility of return on investment. Sensitivity analysis is a method for dealing with wrong decisions. A certainty equivalent is the rate of return that an organization would need to realize in order for it to make a decision that has a higher level of risk and a higher, but uncertain, return on investment. It measures this return against other risk-free investments.

Question: 13

To whom, or in which document, must a financial manager report an organization's fraudulent activity, once detected?

A. To the board of directors
B. To the appropriate authorities
C. In the financial statements
D. In the annual report

Answer: B

Explanation:

To the appropriate authorities. A financial manager is expected to report illegal or fraudulent activity within an organization to the appropriate authorities. A financial manager must uphold several ethical behaviors and avoid conflicts of interest. Financial information must be prepared objectively and according to regulation, and presented fairly and accurately to shareholders, management and regulators, without shielding items that may be perceived as performance failures. A financial manager is also bound to uphold laws and regulations, and be objective, and must avoid both conflicts of economic interest and conflicts of professional interest.

Question: 14

Which of the following behaviors is NOT considered to lead to unethical behavior?

A. Slight exaggerations on performance evaluations
B. Disrespect for authority
C. Whistle blowing
D. Using untruthful sales practices to generate customers

Answer: C

Explanation:
Whistle blowing. The reasons for unethical behavior in the workplace are as varied as the individuals in that workplace. Organizational goals and standards may lead to unethical behavior. If managers and employees feel pressured to attain goals and standards, they may falsely submit records that do not accurately represent the work performed. The expectation of reaching a specified return on investment may lead to financial records being manipulated to show a higher return. Personality conflicts may lead to unethical behavior. When a subordinate lacks respect or confidence in a superior, that subordinate may take actions that undermine the superior's authority. In the decision making process, one or more individuals may unreasonably influence the group to vote in their favor and not in the best interest of the organization. Competition can also lead to unethical behavior. In order to generate sales, an individual or organization may revert to bribes or untruthful sales practices in order to obtain customers and revenues.

Question: 15

How does the Racketeer Influenced and Corrupt Organizations Act (RICO) prohibit organizations from participating in racketeering activities?

A. Proceeds from racketeering activities cannot be used to invest in a corporation
B. Imposes fines and prison terms for racketeering activities
C. Requires organizations to file reports with the Securities And Exchange Commission
D. Promotes corporate social responsibility

Answer: A

Explanation:
Proceeds from racketeering activities cannot be used to invest in a corporation. The

Racketeer Influenced and Corrupt Organizations Act (RICO) was enacted in 1970 as a means of punishing organizations that participated in certain types of criminal activities. The original purpose of RICO was to eliminate the proliferation of organized crime in the US These racketeering activities include gambling, bribery, extortion, bankruptcy fraud, mail fraud, securities fraud, prostitution, narcotics trafficking, loan sharking, and murder. Under the provisions of RICO, proceeds from racketeering activities cannot be used to purchase an interest in an organization, and no individual associated with an organization may conduct racketeering activity through that organization. Individuals convicted of a RICO violation can be fined and sentenced to no more than 20 years in prison and must forfeit any ownership in the organization in which the racketeering activity was transacted.

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