

FINANCIAL MANAGEMENT MODEL EXAM

1. Which of the following is a key reason for the emergence of financial management?
 - A. Increasing complexity of financial markets and instruments
 - B. Decline in the importance of financial decision-making
 - C. Limited availability of financial data and information
 - D. Decreasing need for financial planning and forecasting

Answer: A

2. Afomiya plans to invest an equal amount of Birr 2,000 in an equity fund every year-end beginning this year. The expected annual return on the fund is 15 percent. She plans to invest for 20 years. How much could she expect to have at the end of 20 years?
 - A. Birr 237,620
 - B. Birr 176,424
 - C. Birr 204,887
 - D. Birr 178,424

Answer: C

3. Suppose an investor wants to have Birr 10 million to retire 45 years from now. How much would she have to invest today with an annual rate of return equal to 15 percent?
 - A. Birr 18,561
 - B. Birr 17,844
 - C. Birr 20,003
 - D. Birr 21,345

Answer: A

4. Which of the following statements regarding a 30-year monthly payment amortized mortgage with a nominal interest rate of 10% is *correct*?
 - A. The monthly payments will decline over time.
 - B. A smaller proportion of the last monthly payment will be interest, and a larger proportion will be principal, than for the first monthly payment.
 - C. The total dollar amount of principal being paid off each month gets smaller as the loan approaches maturity.
 - D. The amount representing interest in the first payment would be higher if the nominal interest rate were 7% rather than 10%.

Answer: B

5. You want to buy a new sports car 3 years from now, and you plan to save Birr 4,200 per year, beginning immediately. You will make 3 deposits in an account that pays 5.2% interest. Under these assumptions, how much will you have 3 years from today?
 - A. Birr 13,956.42
 - B. Birr 14,654.24
 - C. Birr 15,386.95
 - D. Birr 16,156.30

Answer: C

6. Your aunt is about to retire, and she wants to buy an annuity that will provide her with Birr 65,000 of income a year for 25 years, with the first payment coming immediately. The going rate on such annuities is 6.25%. How much would it cost her to buy the annuity today?
 - A. Birr 739,281.38
 - B. Birr 778,190.93
 - C. Birr 819,148.35
 - D. Birr 862,261.42

Answer: B

7. The weighted average cost of capital for a firm is the:
 - A. Discount rate which the firm should apply to all of the projects it undertakes.
 - B. Overall rate which the firm must earn on its existing assets to maintain the value of its stock.
 - C. Rate the firm should expect to pay on its next bond issue.
 - D. Maximum rate which the firm should require on any projects it undertakes

Answer: B

8. Which one of the following statements is correct concerning the weighted average cost of capital (WACC)?
 - A. The WACC may decrease as a firm's debt-equity ratio increases.
 - B. When computing the WACC, the weight assigned to the preferred stock is based on the coupon rate multiplied by the par value of the stock.
 - C. A firm's WACC will decrease as the corporate tax rate decreases.
 - D. The weight of the common stock used in the computation of the WACC is based on the number of shares outstanding multiplied by the book value per share.

Answer: A

9. MEDROC Industries is expected to pay an annual dividend of Birr 1.30 a share next month. The market price of the stock is Birr 24.80 and the growth rate is 3 percent. What is the firm's cost of equity?
A. 7.58 percent B. 7.91 percent C. 8.24 percent D. 8.40 percent
Answer: C
10. The use of which of the following would lead to correct decisions when comparing mutually exclusive investments?
A. Profitability index B. Net present value C. Average accounting returns D. Payback period
Answer: B
11. To show how successfully your business performed during a period of time, you would report its revenues and expenses in the
A. Balance sheet. C. Income statement.
B. Statement of cash flows. D. Retained earnings statement.
Answer: C
12. Component percentages indicate the relative size of each item included in a total. Which of the following statements is true?
A. Income statement items are expressed as a percentage of net income and balance sheet items as a percentage of total assets.
B. Income statement items are expressed as a percentage of sales and balance sheet items as a percentage of total assets.
C. Income statement items are expressed as a percentage of net income and balance sheet items as a percentage of net worth.
D. Both income statement and balance sheet items are expressed as a percentage of net worth.
Answer: B
13. The financial ratio intended to measure the effectiveness with which management has utilized the resources of the business, regardless of how these resources are financed, is:
A. Gross profit rate. B. Current ratio. C. Return on assets. D. Return on equity.
Answer: C
14. The present value of a set of cash flows is:
A. The weighted average of present values of individual cash flows
B. The sum of individual cash flows which are then discounted.
C. The sum of the present values of the individual cash flows
D. Always greater than the present value of the investment
Answer: C
15. Which of the following statements is true?
A. Regardless of the value of the interest rate, increasing the compounding frequency will decrease the future value.
B. Regardless of the value of the interest rate, increasing the compounding frequency will increase the future value.
C. There is a relationship between the future value of investment and the effect of compounding frequency. At high interest rates, increases in compounding frequency will decrease the future value.
D. There is a relationship between the future value of investment and the effect of compounding frequency. At low interest rates, increases in compounding frequency will decrease the future value
Answer: B
16. Zeta Corporation has issued a Birr 1,000 face value zero-coupon bond. Which of the following values is closest to the correct price for the bond if the appropriate discount rate is 4% and the bond matures in 8 years?
A. 960. B. 730. C. 1,000. D. 1,350
Answer: B
17. In 2 years you are to receive Rs.10, 000. If the interest rate were to suddenly decrease, the present value of that future amount to you would _____.
A. Fall. B. Rise. C. Remain unchanged. D. Cannot be determined.

Answer: B

18. Interest paid (earned) on both the original principal borrowed (lent) and previous interest earned is often referred to as ____.
- A. Present value. B. Simple interest. C. Future value. D. Compound interest.

Answer: D

19. Cost of the project is 6,00,000 , life of the project is 5 years annual cash flow is 2,00,000 cut off rate is 10% the discounted payback period is ____.
- A. 2 yrs. B. 2 yrs. 6 months. C. 3 yrs. D. 3 yrs. 9 months

Answer: D

20. Which of the following is not considered a capital component for the purpose of calculating the weighted average cost of capital (WACC) as it applies to capital budgeting?
- A. Long-term debt. B. Common stock. C. Accounts payable and accruals. D. Preferred stock

Answer: C

21. A firm estimates that its proposed capital budget will force it to issue new common stock, which has a greater cost than the cost of retained earnings. The firm, however, would like to avoid issuing costly new common stock. Which of the following steps would mitigate the firm's need to raise new common stock?
- A. Increasing the company's dividend payout ratio for the upcoming year.
B. Reducing the company's debt ratio for the upcoming year.
C. Increasing the company's proposed capital budget.
D. Increasing the company's debt ratio for the upcoming year.

Answer: B

22. If a company's required rate of return is 10% and, in using the net present value method, a project's net present value is zero, this indicates that the
- A. Project's rate of return exceeds 10%.
B. Project's rate of return is less than the minimum rate required.
C. Project earns a rate of return of 10%.
D. Project earns a rate of return of 0%.

Answer: C

23. When a capital budgeting project generates a positive net present value, this means that the project earns a return higher than the
- A. Internal rate of return. C. Annual rate of return.
B. Required rate of return. D. Present value index

Answer: B

24. XYZ Ltd. has a Debt Equity Ratio of 1.5 as compared to 1.3 Industry average. It means that the firm has:
- A. Higher Liquidity C. Higher Financial Risk,
B. Higher Profitability D. Higher Capital Employed

Answer: C

25. A company is forecasting an increase in sales and is using the AFN model to forecast the additional capital that they need to raise. Which of the following factors are likely to increase the additional funds needed (AFN)?
- A. The company has a lot of excess capacity.
B. The company has a high dividend payout ratio.
C. The company has a lot of spontaneous liabilities that increase as sales increase.
D. The company has a high profit margin.

Answer: B

26. Which statement about common stockholders is incorrect?
- A. Common stockholders have first claim on the firm's assets during bankruptcy
B. Common stockholders have a voting right.
C. Common stockholders are the ultimate owners of a corporation.
D. Common stockholders have a residual claim on the firm's cash flows

Answer: A

27. What would the future value of Birr 125 be after 8 years at 8.5% compound interest?

- A. Birr 205.83 B. Birr 216.67 C. Birr 228.07 D. Birr 240.08

Answer: D

28. You own some Garment equipment that must be replaced. Two different suppliers present a purchase and installation plan for your consideration. This is an example of a business decision involving ____ projects.

- A. Mutually exclusive B. independent C. working capital D. positive NPV

Answer: A

29. If a project with conventional cash flows has an internal rate of return less than the required return, then:

- A. The profitability index is less than one.
B. The internal rate of return must be zero.
C. The payback period is equal to the maximum acceptable period.
D. The payback period is less than the maximum acceptable period

Answer: A

30. An investment generates Birr 1.10 in present value benefits for each dollar of invested costs. This conclusion was most likely reached by calculating the projects:

- A. Net present value C. Profitability index
B. Internal rate of return D. Payback period

Answer: C

31. Which of the following decision rules is best for evaluating projects for which cash flows beyond a specified point in time, and the time value of money, can both be ignored?

- A. Payback C. Net present value
B. Average accounting return D. Profitability index

Answer: A

32. The internal rate of return (IRR) rule can be best stated as:

- A. An investment is acceptable if its IRR is exactly equal to its net present value (NPV).
B. An investment is acceptable if its IRR is exactly equal to zero.
C. An investment is acceptable if its IRR is less than the required return, else it should be rejected.
D. An investment is acceptable if its IRR exceeds the required return, else it should be rejected

Answer: D

33. The current annual dividend of Zemzem bank is birr 0.20 while its stock is selling at 30.90. The required rate of return for the stockholders is 10%. What is the expected rate of growth for the company?

- A. 9.29% B. 8.29% C. 7.29% D. 10.29%

Answer: A

34. The payback rule can be best stated as:

- A. An investment is acceptable if its calculated payback period is less than some Pre specified number of years.
B. An investment should be accepted if the payback is positive and rejected if it is negative.
C. An investment should be rejected if the payback is positive and accepted if it is negative.
D. An investment is acceptable if its calculated payback period is greater than some pre specified number of years.

Answer: A

35. The net present value (NPV) rule can be best stated as:

- A. An investment should be accepted if, and only if, the NPV is exactly equal to zero.
B. An investment should be rejected if the NPV is positive and accepted if it is negative.
C. An investment should be accepted if the NPV is positive and rejected if it is negative.
D. An investment with greater cash inflows than cash outflows, regardless of when the cash flows occur, will always have a positive NPV and therefore should always be accepted

Answer: C