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QUESTION 1

From the view point of the investor, which of the following securities provides the least risk?

A. Mortgage bond.

B. Subordinated debenture.

C. Income bond.

D. Debentures.

Correct Answer: A

A mortgage bond is secured with specific fixed assets, usually real property. Thus, under the rights enumerated in the bond indenture, creditors will be able to receive payments from liquidation of the properly in case of default. In a bankruptcy proceeding, these amounts are paid before any transfers are made to other creditors, including those preferences. Hence, mortgage bonds are less risky than the others listed.

QUESTION 2

Topcon Company produces two components:A-1and A-2.The unit throughput contribution margins for A-1 and A-2 are $150 and $300.respectively. Each component must proceed through two processes: Operation 1 and Operation 2.The capacity of Operation 1 is 180 machine hours, with A-1 and A-2 requiring 1 hour and 3 hours, respectively .Furthermore.Tocon can sell only 45 units of A-1 and 100 units of A-2 However, Taconic considering expanding Operation 1\\'s Capacity by 90 machine hours at a cost of $80 per hour. Assuming that Operation 2 has sufficient capacity to handle any additional output from Operation 1, Toucan should produce. Units of A-1 Unties of A-2

A. 180 0

B. 45 100

C. 45 75

D. 0 60

Correct Answer: C

A-1\\'s throughput contribution margin per unit of the scarce resource (the internal binding constraint) is $150($150 UCM + 1machining hour) A-2\\'s throughput contribution margin per unit of the scarce resource is $100($300 UCM + 3 machine hours). Consequently, Topcon should produce as much A-1 as it can sell (45 units).If Topcon adds 90 machine hours to increase the capacity of Operation 1 to 270 hours(108+90), it cannot produce assertion units do A-1 because the external binding constraint has been not been relaxed.However,it can produce additional units of A-2 Given that the UCM per machine hour of A-2 is $100 and that the cost is $80 per hour adding capacity to Operation 1 is profitable.Thus,tocon should use 45 machine hour to produce 45 units of A-1 The remaining 225 machine hours (270-45) should be used to produce 75 units (225+ 3 hours) of A-2 The latter amount is within the external binging constraint.

QUESTION 3

In order to increase production capacity, Gunning Industries is considering replacing an existing production machine with a new technologically improved machine effective January 1. The following information is being considered by Gunning Industries:

The new machine would be purchased for $160,000 in cash. Shipping, installation, and testing would cost an additional $30,000.

The new machine is expected to increase annual sales by 20,000 units at a sales price of $40 per unit.

Incremental operating costs include $30 per unit in variable costs and total fixed costs of $40,000 per year.

The investment in the new machine will require an immediate increase in working capital of $35,000. This cash outflow will be recovered after 5 years.

Gunning uses straight-line depreciation for financial reporting and tax reporting purposes. The new machine has an estimated useful life of 5 years and zero salvage value.

Gunning is subject to a 40% corporate income tax rate. Gunning uses the net present value method to analyze investments and will employ the following factors and rates:

Period	Present Value of $1 at 10%	Present Value of an Ordinary Annuity of $1 at 10%
1	.909	.909
2	.826	1.736
3	.751	2.487
4	.683	3.170
5	.621	3.791

The acquisition of the new production machine by Gunning Industries will contribute a discounted net-oftax contribution margin of

A. $242,624

B. $303,280

C. $363,936

D. $454,920

Correct Answer: D

The new machine will increase sales by 20,000 units a year. The increase in the pretax total contribution margin will be $200,000 per year [20,000 units x ($40 SP -- $30 VC)], and the annual increase in the after tax contribution margin will be $120,000 [$200,000 x (1.0-- .4)]. The present value of the after-tax increase in the contribution margin over the 5-year useful life of the machine is $454,920 ($120,000 x 3.791 PV o f an ordinary annuity for 5 years at 10%).

QUESTION 4

Brown and Company uses the internal rate of return (IRR) method to evaluate capital projects. Brown is considering four independent projects with the following IRRs:

Project	IRR
I	10%
II	12%
III	14%
IV	15%

Brown\\'s cost of capital is 13%. Which one of the following project options should Brown accept based on IRR?

A. Projects I and II only.

B. Projects Ill and IV only.

C. Project IV only.

D. Projects I, II, Ill and IV.

Correct Answer: B

When sufficient funds are available, any capital project whose internal rate of return (IRR) exceeds the company cost of capital should be accepted.

QUESTION 5

Market-based pricing bases prices on

A. The choice of products offered as accessions and those offered as standard features.

B. The products perceived value and the competitor\\'s actions.

C. A relativity low ratio of price to quality delivered.

D. Differentiation of prices by geographic region.

Correct Answer: B

Market-based pricing bases prices on the product\\'s perceived value and competitors\\' actions rather than on the seller\\'s cost. Announce variables in the marketing mix (image, seller\\'s reputation, warranties. customer service, and channel attributes) augment the perceived value