Vendor: CPA

Exam Code: FIN

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Q & As: 80

QUESTION 1
Consider the following statements concerning financial options:

1. The time value of an option is the value assigned to the possibility that the price of the underlying item will move infavorof the option writer.
2. The time value of an option less its intrinsic value is equal to the option premium.

Which ONE of the following combinations (true/false) concerning the above statements is correct?

A. Statement 1 = True, Statement 2 = True
B. Statement 1 = True, Statement 2 = False
C. Statement 1 = False, Statement 2 = True
D. Statement 1 = False, Statement 2 = False

Correct Answer: D

QUESTION 2
The following statements about dividends and dividend policy were made at a recent meeting:

1. According to the residual theory of dividend policy, once a company has invested in or retained sufficient profits for future positive net present value opportunities, it should pay out the remaining profit as dividends.
2. Companies generally try to smooth out dividend payments by adjusting gradually to changes in earnings, so as to avoid sending out confusing signals to investors.
3. Scrip dividends enable a company to declare dividends but avoid paying out cash. Instead existing shareholders are given new shares in the business at no extra cost to the shareholders.

Which combination of the above statements is true?

A. 1, 2 and 3
B. 1 and 2 only
C. 1 and 3 only
D. 2 and 3 only

Correct Answer: A

QUESTION 3
Consider the following statements:

1. A beta factor measures the relationship between market returns and the returns of an individual security.
2. A share that has a beta of 1·0 will have an expected return equal to the risk-free rate.

Which ONE of the following combinations (true/false) is correct?

A. Statement 1 = True, Statement 2 = True
B. Statement 1 = True, Statement 2 = False
C. Statement 1 = False, Statement 2 = True
D. Statement 1 = False, Statement 2 = False

Correct Answer: B
QUESTION 4
Lydia Co is financed by one million $1 ordinary shares trading at $3 each and has $2,000,000

4·25% irredeemable loan notes which have a market value of $85 per $100. Lydia Co pays tax at 30%. An equivalent all-equity financed company would have a cost of capital of 10%. What is Lydia Co's cost of equity, according to Modigliani and Miller Proposition 2?

A. 12·68%
B. 12·33%
C. 12·28%
D. 11·98%

Correct Answer: D

QUESTION 5
A large multinational business wishes to manage its currency risk. It has been suggested that

1. Matching receipts and payments can be used to manage translation risk.
2. Matching assets and liabilities can be used to manage economic risk.

Which ONE of the following combinations (true/false) concerning the above statements is correct?

A. Statement 1 = True, Statement 2 = True
B. Statement 1 = True, Statement 2 = False
C. Statement 1 = False, Statement 2 = True
D. Statement 1 = False, Statement 2 = False

Correct Answer: C

QUESTION 6
Gobi Co has irredeemable 4% loan notes in issue with a nominal value of $20m. The current market value of the loan notes is $10 million and the tax rate is 25%. The equity shares of Gobi Co have a total marketcapitalizationof $30 million. The company's weighted average cost of capital is 10%. What is the cost of equity for Gobi Co?

A. 10.7%
B. 11.3%
C. 12.3%
D. 12.5%

Correct Answer: B

QUESTION 7
Napa Co has 100 million $0·25 ordinary shares in issue with a current market value of $1·20 per share. The cost of ordinary shares is estimated at 12%. The company also has $100 million 6% irredeemable loan notes in issue that are currently quoted at $60 per $100 nominal value. The tax rate is 20%. What is the weighted average cost of capital for Napa Co?

A. 11·3%
B. 10·6%
C. 8·8%
D. 7·2%

Correct Answer: B

QUESTION 8
A company sells 2,000,000 units of a particular product evenly throughout the year. The purchase price of the product is $22 per unit. The cost of placing an order is $20, the cost of holding one unit of stock for a year is $5 and the economic order quantity is 4,000 units. What is the total annual cost of trading in this product?

A. $44,230,000
B. $44,030,000
C. $44,020,000
D. $44,010,000

Correct Answer: C

QUESTION 9
It has been claimed that the weighted average cost of capital (WACC) should only be used to evaluate investment decisions, involving discounted cash flow calculations, where:

1. The proposed project does not alter the business risk profile of the business.
2. The WACC reflects the long-term capital structure of the business.

Which ONE of the following combinations (true/false) is correct?

A. Statement 1 = True, Statement 2 = True
B. Statement 1 = True, Statement 2 = False
C. Statement 1 = False, Statement 2 = True
D. Statement 1 = False, Statement 2 = False

Correct Answer: A

QUESTION 10
Kubilai Co, a listed company, is considering issuing additional equity capital. To ensure that all the new equity shares are sold, Kubilai Co wants to gain assurance that any shares not bought by the general public will be subscribed. What term correctly describes a firm which agrees to subscribe for the equity shares which are not taken up?

A. A sponsoring member firm
B. An issuing house
C. An underwriter
D. An intermediary

Correct Answer: C

QUESTION 11
The management of Uruk Co feels that the company is over-capitalizedand have cited the following statements to support their view:

1. Over-capitalizationis indicated by lower-than-average sales revenue to working capital ratio.
2. Over-capitalizationis indicated by higher-than-average debt to equity ratio.