

ANSWERS TO CONCEPT TEST

1. acceptable; greater than; unacceptable; less than
2. cash inflows; cost; positive; negative; value; owners; price
3. initial investment; cash inflows; acceptable; cutoff time period; timing; equally valuable; cutoff time period; cutoff time period; simplicity
4. cash inflows; initial outlay; acceptable; cutoff time period; cutoff time period; cutoff time period
5. average net income; average book value; acceptable; specified target level; accounting; book; cash flows; time value of money; target AAR
6. present value; cash inflows; cost; zero; acceptable; unacceptable
7. nonconventional; mutually exclusive
8. negative; positive; nonconventional;
9. independent; rejection; scale; timing; net present value; incremental
10. present value; cash inflows; initial investment; one; acceptable; initial investment; independent; mutually exclusive; net present value; incremental

PROBLEMS

For Problems 1-6, use the following cash flows for projects A and B:

A: (-\$2000, \$500, \$600, \$700, \$800)

B: (-\$2000, \$950, \$850, \$400, \$300)

1. Calculate the payback period for projects A and B.

2. If the discount rate is 12%, what is the discounted payback period for project A? For B?

3. Calculate the internal rate of return for projects A and B.

4. If A and B are mutually exclusive and the required rate of return is 5%, which should be accepted?