

DCF Practice Test Questions and Answers

1. Payback Method Limitations

- A) Calculates actual economic return earned by the project over its life
- B) - Payback ignores time value of money
 - Payback ignores cash flows beyond the payback point
- C) - Simplicity - easy to calculate, easy to understand
 - Screening Investment projects - provides a tool for rough screening of investment proposals
 - Risk of project - provides insight into risk of the project - earlier cash flows are considered more certain than later years.
- D) a technique used that adjusts for time value of money making cash flows over time comparable

2. Discounted cash flow analysis

- A) - unrealistic status quo
 - Hurdle (discount) rates are too high
 - Time horizons are too narrow
 - difficulty of gaining approval for large projects
 - exclusion of benefits that are difficult to quantify
 - greater uncertainty about operating cash flows of new untested technology investments
- B) a technique used that adjusts for time value of money making cash flows over time comparable
- C) calculates the present value of future cash flows of a project - Four steps needed to complete a NPV analysis of an investment proposal.
 1. Prepare table showing cash flows during each year
 2. Calculate present value of each cash flow using the required rate of return
 3. Calculate NPV = sum of present values of the cash flows in each period
 4. NPV if positive means project is acceptable on financial grounds, higher NPV more acceptable the project. Other strategic and quantitative issues need to be considered in decision
- D) - Payback ignores time value of money
 - Payback ignores cash flows beyond the payback point

3. Infinite series of equal payments

- A) Annuity
- B) Perpetuity
- C) Amortized Loans
- D) Ordinary Annuity

4. Beginning Balance x Interest Rate

- A) Formulas for Amortization Table: Ending Balance
- B) Perpetuity
- C) Formulas for Amortization Table: Principal Payment
- D) Formulas for Amortization Table: Interest Paid

Answers: 1-B 2-B 3-B 4-D

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