Test Bank for Gapenskis Understanding Healthcare Financial Management 8th Edition by Pink

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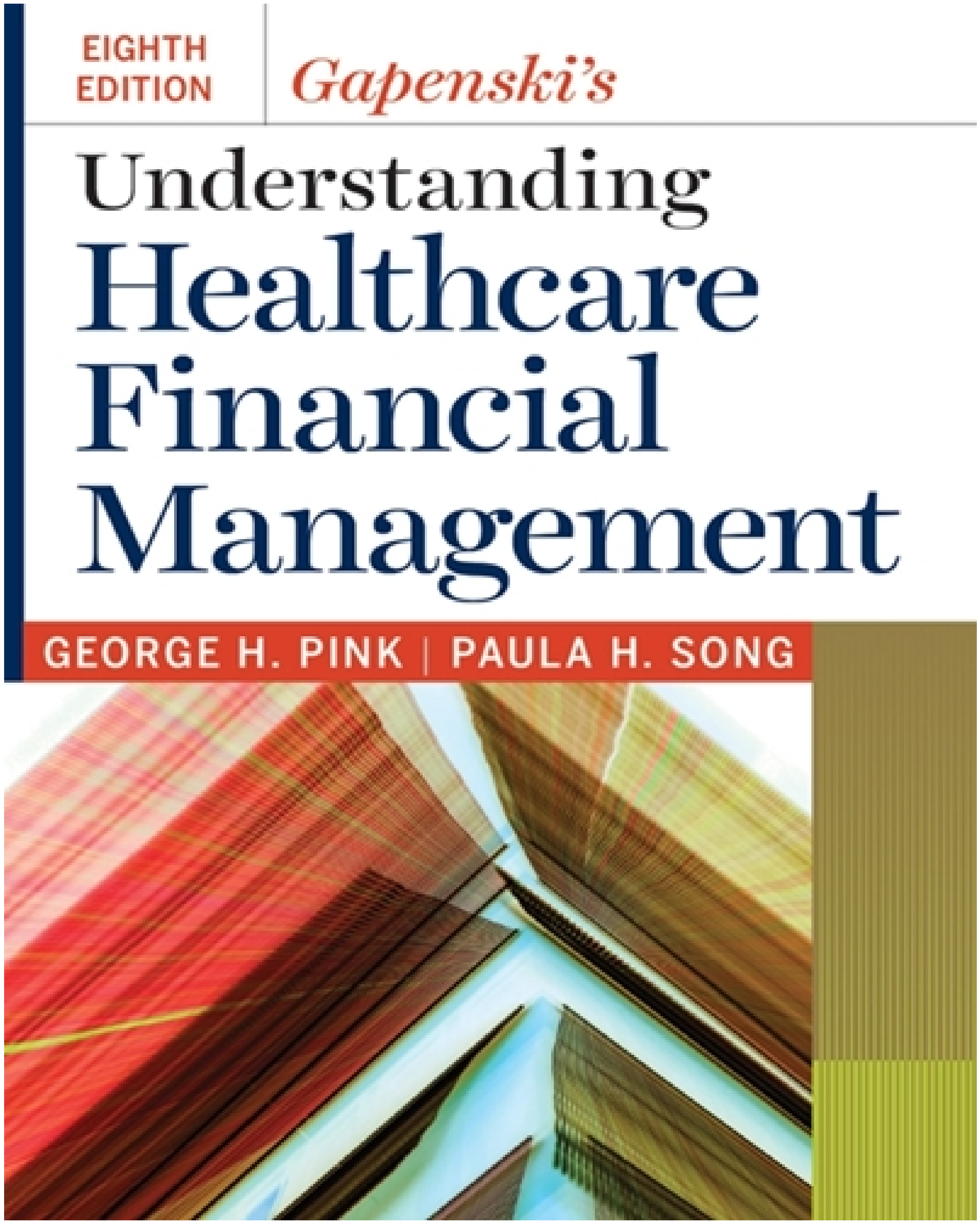

Test Bank

1. ch12-001
Sensitivity analysis measures how much a project's NPV is affected by changes in input variables such as volume and labor costs. Other things held constant, the steeper the plotted sensitivity line, the more sensitive the project's profitability is to the changes in the input variable.

*a. True
b. False

2. ch12-002
A medical group practice is considering offering a new service with risk that is greater than the average risk of the business. In evaluating this investment, the decision maker should

a. increase the IRR of the project to reflect the greater risk.
b. increase the NPV of the project to reflect the greater risk.
c. reject the project, because its acceptance would increase the risk of the business.
d. ignore the risk differential if the project represents only a small fraction of the total assets of the firm.
*e. increase the cost of capital applied to the project to make it greater than the business's corporate cost of capital.

3. ch12-003
Which of the following statements about project risk analysis techniques is most correct?

a. Sensitivity analysis considers the joint (combined) impact of changes in uncertain input variables on profitability.
*b. Scenario analysis considers the joint (combined) impact of changes in uncertain input variables on profitability.
c. Scenario analysis, as it is done in practice, usually involves four scenarios.
d. When standard deviation of NPV is used to measure risk, the smaller the value the greater the risk.
e. In a sensitivity analysis graph, the steeper the plot lines, the lower the risk.

4. ch12-004
WeCare HMO is evaluating a new project. It has a coefficient of variation (CV) of 5, while the HMO's average project has a CV of 2-3. The business's corporate cost of capital is 10 percent, and the typical adjustment for project risk is 3 percentage points. What is the appropriate project cost of capital?

a. 7 percent
b. 10 percent
*c. 13 percent
d. 16 percent
e. 19 percent

5. ch12-005
Which of the following statements about the qualitative approach to project risk assessment is most correct?

a. Qualitative risk assessment involves the answers to a series of yes/no questions.
b. Typically, "yes" answers are assigned one point and "no" answers zero points.
c. The higher the score, the greater the risk.
d. Typically, qualitative risk assessment is used in conjunction with a quantitative risk assessment (as opposed to replacing a quantitative risk assessment).
*e. All of the above statements are correct.

6. ch12-006
Large corporations with multiple divisions in different business lines typically estimate divisional costs of capital along with the corporate cost of capital.

*a. True
b. False

7. ch12-007
Which of the following statements about capital rationing is most correct?

*a. Capital rationing occurs when a business does not have the capital necessary to fund all acceptable projects.
b. Capital rationing occurs when a business has more capital available than needed to fund all acceptable projects.
c. Under capital rationing, the typical approach is to accept all projects with negative NPVs.
d. Both a. and b. are correct.
e. Answers a., b., and c. are correct.

8. ch12-008
In a thorough capital budgeting analysis, once a project cost of capital has been assigned that incorporates any differential project risk, the analyst should rerun the risk analysis to ensure that the new (adjusted) discount rate does not change the results.

a. True
*b. False

9. ch12-009
Which of the following statements about capital budgeting risk analysis techniques is false?

a. Payback period provides a rough measure of a project's liquidity.

b. Scenario analysis gives managers an idea of the worst possible outcome.
*c. Scenario analysis usually is based on five or more scenarios.
d. Scenario analysis can provide a quantitative measure of a project's risk.
e. Payback period provides a rough measure of a project's risk.

10. ch12-010
Which of the following statements concerning Monte Carlo simulation is false?

a. Monte Carlo simulation can be performed on personal computers.
b. Monte Carlo simulation uses continuous distributions to proxy input variable uncertainty.
c. Monte Carlo simulation produces a very large number (thousands) of project scenarios.
*d. The inputs required to perform a Monte Carlo simulation are as easy to develop as in a traditional scenario analysis.
e. The output of a Monte Carlo simulation contains several useful measures such as expected NPV, probability of a positive NPV, and maximum and minimum NPVs.

11. ch12-011
Assume a healthcare organization is analyzing a capital investment project with greater risk than that of the organization's average project. Which of the following cost of capital alternatives would be most appropriate for analyzing the project's net present value?

a. The rate of return available on a standard savings account because it is known with certainty
b. The corporate cost of capital
c. The rate of return available on a money market fund where the firm invests its short-term cash reserves
*d. The rate of return available on alternative investment opportunities of similar risk to the project being considered
e. The expected rate of inflation

12. ch12-012
The ultimate goal in project risk analysis is to ensure that the cost of capital used as the discount rate in a project's ROI analysis is as high as possible.

a. True
*b. False

13. ch12-013
The type of risk most relevant for projects being evaluated by investor-owned businesses is:

a. Stand-alone risk
b. Corporate risk

*c. Market risk
d. Answers a. and c. are correct
e. Answers a., b., and c. are correct

14. ch12-014
When a project’s returns are expected to be negatively correlated with market returns, stand-alone risk is a good proxy for market risk.

a. True
*b. False

15. ch12-015
The nature of a project’s component cash flow distributions and their correlation with one another determine a project’s

*a. stand-alone risk.
b. corporate risk.
c. market risk.
d. Answers a., b., and c. are correct.
e. None of the above answers is correct.

16. ch12-016
The strengths of scenario analysis as compared to sensitivity analysis include which of the following?

a. Scenario analysis considers the sensitivity of NPV to changes in key variables, the likely range of variable values, and the interactions among variables.
b. Scenario analysis allows for the calculation of a project’s coefficient of variation so that the riskiness of projects can be compared to the firm’s average project.
c. Scenario analysis provides all necessary information about both a project’s risk and profitability in a single step.
*d. Answers a. and b. are correct.
e. Answers a., b., and c. are correct.

17. ch12-017
Which of the following statements about project risk analysis is most correct?

a. When calculating NPV for cash flows of higher-than-average risk, the discount rate should always be adjusted upward to reflect the corporate cost of capital plus a risk premium.
b. A weakness of the certainty equivalent method of adjusting project cash flows for risk is that it does not allow individual cash flows to be adjusted to reflect their own unique risk.
c. The risk-adjusted discount rate method of valuation assigns equal risk to all project cash flows since a constant discount rate is applied over the life of the project.

*d. The certainty equivalent value of a net cash outflow will be higher (in absolute value) than the expected value if the cash outflow has greater than average risk.
e. None of the above statements is correct.

18. ch12-018
As long as managers are confident that risk has been adequately incorporated in the capital budgeting process, projects with a negative NPV should never be accepted.

a. True
*b. False

19. ch12-019
In a capital rationing situation, the profitability index may be used in place of NPV to choose among projects.

*a. True
b. False

20. ch12-020
Which of the following alternatives provides the most information about a project's riskiness?

a. Sensitivity analysis
b. Scenario analysis
*c. Monte Carlo simulation
d. Certainty equivalent method
e. Risk-adjusted discount rate method

21. ch12-021
In a capital budgeting context, which of the following are not real (managerial) options?

a. The option to expand a service line into additional markets
*b. The option to retire callable debt
c. The option to convert a service line into a related service
d. The option to abandon a service line
e. The option to lower project costs by replacing physicians with physician extenders

22. ch12-022
Although it is common to adjust a project cost of capital for differential risk, adjustments are never made to account for differential debt capacity.

a. True
*b. False

23. ch12-023
Assume a non-normal project (one with an inflow followed by a series of outflows) is considered to have above-average risk. Which of the following statements best reflects the proper risk adjustment?

*a. The discount rate is decreased to reflect the greater risk.
b. The discount rate is increased to reflect the greater risk.
c. The discount rate is left unchanged.
d. The discount rate is halved.
e. The discount rate is doubled.

1. ch02-001
Which of the following basic characteristics is required to make health insurance “work”?

a. Pooling of losses
b. Payment only for random losses
c. Risk transfer
d. Indemnification
*e. All of the above characteristics are required.

2. ch02-002
Which of the following are problems that commonly arise in health insurance programs?

a. Adverse selection
b. Moral hazard
c. Premiums that remain too low to make a profit
*d. Both a. and b. arise.
e. Problems a., b., and c. all arise.

2. ch02-002
Which of the following are problems that commonly arise in health insurance programs?

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4. ch02-004
The Affordable Care Act (ACA) limits the degree to which insurers can use underwriting provisions to protect against adverse selection.

*a. True
b. False

5. ch02-005
Which of the following statements about moral hazard is most correct?

a. Moral hazard means those individuals with greater health risk are more likely to purchase health insurance.
b. Unfortunately, there is nothing that insurers can do to combat the moral hazard problem other than increase premium rates.
*c. Moral hazard is the overuse of healthcare services or foregoing of prevention because the insured individual does not bear the full costs of the consequences.
d. Health insurers reduce the moral hazard problem by including preexisting condition clauses in insurance contracts.

e. Businesses that provide health insurance reduce the moral hazard problem by limiting the program to those employees under age 50.

6. ch02-006
The typical health provider's revenues are roughly evenly split between payments by patients and payments by third-party payers (insurers).

a. True
*b. False

7. ch02-007
Which of the following statements about Medicare is correct?

a. Medicare is administered by the Centers for Medicare & Medicaid Services (CMS).
b. Medicare coverage consists of Parts A, B, C, and D.
c. Medicare beneficiaries pay neither deductibles nor copayments for healthcare services received.
*d. Statements a. and b. are both correct.
e. Statements a., b., and c. are all correct.

8. ch02-008
Which of the following statements about insurance plans and premium rate setting is most correct?

*a. Insurers set premium rates to include both the costs of providing healthcare services and the costs of providing (administering) the insurance plan, including profits.
b. A single method is used to set premium rates: the fee-for-service approach.
c. A single method is used to set premium rates: the cost approach.
d. Although premiums may be set using several different methods, healthcare providers are all paid on a per member per month basis.
e. None of the statements above is correct.

9. ch02-009
Assume that the target number of inpatient days per year for each member of a managed care plan is 0.3 days and the negotiated hospital payment rate is $1,000 per day. What is the PMPM (per member per month) cost for inpatient (hospital) services?

a. $20
*b. $25
c. $30
d. $35
e. $40

10. ch02-010
Assume that each of 1,000 members of a managed care plan is expected to make four primary care visits per year. In addition, each primary care physician can handle 5,000 visits per year and requires $200,000 in total compensation. What is the PMPM (per member per month) cost for primary care services?

*a. $13.33
b. $15.00
c. $16.66
d. $20.00
e. $23.33

11. ch02-011
In the demographic approach to rate setting, it is necessary to know the gender distribution of the covered population, but it is not necessary to know the age distribution.

a. True
*b. False

12. ch02-012
Which of the following statements about consumer-directed health plans (CDHPs) is correct?

a. CDHPs are designed to influence consumer behavior.
b. CDHPs have high deductibles.
c. Personal health financing accounts play an important role in CDHPs.
d. Statements a. and b. are both correct.
*e. Statements a., b., and c. are all correct.

13. ch02-013
Assume that each of 1,000 members of a managed care plan is expected to make 1.5 specialist visits per year. Each specialist physician can handle 3,000 visits per year and requires $300,000 in total compensation. What is the PMPM (per member per month) cost for specialist physician services?

a. $11.00
*b. $12.50
c. $14.00
d. $15.50
e. $17.00

14. ch02-014
Which of the following costs typically are included when a managed care plan determines the total premium amount?

a. Hospital inpatient care costs
b. Physician care costs

c. Plan administrative costs
d. Answers a. and b. are both included.
*e. Answers a., b., and c. are all included.

15. ch02-015
In value-based insurance, patients' copayments are based on the relative value of the services provided as opposed to the costs of the services provided.

*a. True
b. False