The answer to the question is highlighted in red. Explanations are highlighted in green.

2. Express Press evaluates many different capital budgeting projects each year. The risks of the projects often differ significantly, from very little risk to risks that are substantially greater than the average risk associated with the firm. If Express Press always uses its weighted average cost of capital, or average required rate of return, to evaluate all of its capital budgeting projects, then the company might make an incorrect decision, or a mistake, by
   a. accepting projects that actually should be rejected.
   b. accepting projects with internal rates of return that are too high.
   c. rejecting projects that actually should be rejected.
   d. rejecting projects with internal rates of return that are lower than the appropriate risk-adjusted required rate of return.
   e. accepting projects that actually should be accepted.

If Express Press (EP) uses the firm’s average required rate of return, which is also called the weighted average cost of capital (WACC or k), to evaluate all capital budgeting projects, regardless of risk, then higher-than-normal-risk projects will be evaluated with a rate of return that is too low and lower-than-normal-risk projects will be evaluated with a return that is too high. The WACC should be used to evaluate average-risk projects; a risk-adjusted rate of return should be used to evaluate projects that have risks significantly different than average.

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