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# **BUSINESS-ENVIRONMENT-AND- CONCEPTS<sup>Q&As</sup>**

Certified Public Accountant (Business Environment & Concept)

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### QUESTION 1

Corbin Inc. can issue three-month commercial paper with a face value of \$1,000,000 for \$980,000. Transaction costs would be \$1,200. The effective annualized percentage cost of the financing, based on a 360-day year, would be:

- A. 2.16%
- B. 8.48%
- C. 8.65%
- D. 8.00%

Correct Answer: C

Choice "c" is correct. The cost to issue the commercial paper is the \$20,000 original issue discount (\$1 million - \$980,000), plus transaction costs of \$1,200 for a total of \$21,200. Therefore, it costs \$21,200 to borrow \$980,000 for 3 months.

The 3-month interest cost is 2.16% ( $\$21,200 / \$980,000$ ).

The annual interest cost is 8.65%

Choices "a", "b", and "d" are incorrect, per the above calculation.

### QUESTION 2

The following selected data pertain to the Darwin Division of Beagle Co. for 1994:

Sales	\$400,000
Operating income	40,000
Capital turnover	4
Imputed interest rate	10%

What was Darwin's 1994 residual income?

- A. \$0
- B. \$4,000
- C. \$10,000
- D. \$30,000

Correct Answer: D

Choice "d" is correct. Residual income is income less the imputed interest rate times average invested capital. Capital



turnover is equal to sales / average invested capital.

$$\begin{aligned}\text{Average invested capital} &= (\$400,000 \div 4) \\ &= \$100,000 \\ \text{Residual income} &= \$40,000 - (10\% \times \$100,000) \\ &= \underline{\underline{\$30,000}}\end{aligned}$$

Choice "a" is incorrect. Residual income is greater than zero. The imputed interest rate times average invested capital needs to be compared with operating income.

Choice "b" is incorrect. Residual income is not simply the imputed interest rate times operating income.

The imputed interest rate times average invested capital needs to be compared with operating income.

Choice "c" is incorrect. Residual income is not simply imputed interest rate times average invested capital.

The operating income must be considered.

### QUESTION 3

The imputed interest rate used in the residual income approach for performance measurement and evaluation can best be characterized as the:

- A. Historical weighted average cost of capital for the company.
- B. Average return on investment that has been earned by the company over a particular time period.
- C. Average return on assets employed over a particular time period.
- D. Average prime lending rate for the year being evaluated.

Correct Answer: A

Choice "a" is correct. Historical weighted average cost of capital is usually used as the target or hurdle rate in the residual income approach.

Choices "b", "c", and "d" are incorrect, per the above definition.

### QUESTION 4

Grey and Carr entered into a written partnership agreement to operate a hardware store. Their agreement was silent as to the duration of the partnership. Grey wishes to withdraw from the partnership. Which of the following statements is correct?

- A. Unless Carr consents to a withdrawal, Grey must apply to a court and obtain a decree allowing withdrawal.
- B. Grey may not withdraw unless Carr consents.



- C. Grey may withdraw only after notice of the proposed dissolution is given to all partnership creditors.
- D. Grey may withdraw from the partnership at any time.

Correct Answer: D

Choice "d" is correct.

Rule: Where a partnership agreement does not state the duration of the partnership, the partners may withdraw at any time. The partner need not obtain consent of the other partners or of the court.

Choices "a" and "b" are incorrect, per the above rule.

Choice "c" is incorrect. A partner has no duty to inform creditors of his intent to withdraw in order for the withdrawal to be effective (although notice is needed to limit the partner's personal liability).

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#### QUESTION 5

To decrease the money supply, the Fed might:

- A. Sell government securities on the open market.
- B. Buy government securities on the open market.
- C. Decrease the required reserve ratio.
- D. Lower the discount rate.

Correct Answer: A

Choice "a" is correct. To decrease the money supply, the Fed can: (1) sell government securities in the open market, (2) increase the discount rate, and (3) increase the required reserve ratio.

Choice "b" is incorrect. The Fed should sell (not buy) securities on the open market.

Choice "c" is incorrect. The Fed should increase (not decrease) the required reserve ratio.

Choice "d" is incorrect. The Fed should increase (not decrease) the discount rate.

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