BUSINESS-ENVIRONMENT-AND-CONCEPTS[Q&As]

Certified Public Accountant (Business Environment & Concept)

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QUESTION 1

In 1990, Amber Corp., a closely held corporation, was formed by Adams, Frank, and Berg as incorporators and stockholders. Adams, Frank, and Berg executed a written voting agreement which provided that they would vote for each other as directors and officers. In 1994, stock in the corporation was offered to the public. This resulted in an additional 300 stockholders. After the offering, Adams holds 25%, Frank holds 15%, and Berg holds 15% of all issued and outstanding stock. Adams, Frank, and Berg have been directors and officers of the corporation since the corporation was formed. Regular meetings of the board of directors and annual stockholders meetings have been held. For this question refer to the formation of Amber Corp. and the rights and duties of its stockholders, directors, and officers. Amber Corp.\\'s officers ordinarily would be elected by its:

A. Stockholders.

B. Directors.

C. Outgoing officers.

Correct Answer: B

Choice "b" is correct. Officers usually are selected by the directors.

QUESTION 2

Jackson Distributors sells to retail stores on credit terms of 2/10, net 30. Daily sales average 150 units at a price of $300 each. Assuming that all sales are on credit and 60 percent of customers take the discount and pay on Day 10 while the rest of the customers pay on Day 30, the amount of Jackson\\'s accounts receivable is:

A. $990,000

B. $900,000

C. $810,000

D. $450,000

Correct Answer: C

Choice "c" is correct. $810,000 accounts receivable.

	60%		40%		100%
Unit Sales Price	$ 300		$ 300		$ 300
Daily Sales Average Units	× 90		× 60		× 150
Daily Sales	$27,000		$18,000		$ 45,000
Days Outstanding	× 10		× 30		
	270,000	+	540,000	=	$810,000

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

QUESTION 3

A firm with a higher degree of operating leverage when compared to the industry average implies that the:

A. Firm has higher variable costs.

B. Firm\\'s profits are more sensitive to changes in sales volume.

C. Firm is more profitable.

D. Firm uses a significant amount of debt financing.

Correct Answer: B

Rule: Operating leverage is the presence of fixed costs in operations, which allows a small change in sales to produce a larger relative change in profits. Choice "b" is correct. A firm with a higher degree of operating leverage when compared to the industry average implies that the firm\\'s profits are more sensitive to changes in sales volume.

Choice "a" is incorrect. Higher variable costs imply a lower degree of operating leverage.

Choice "c" is incorrect. Profits will depend upon sales.

Choice "d" is incorrect. A firm using a significant amount of debt financing has a higher degree of "financial

leverage."

QUESTION 4

Lark, a partner in DSJ, a general partnership, wishes to withdraw from the partnership and sell Lark\\'s interest to Ward. All of the other partners in DSJ have agreed to admit Ward as a partner and to hold Lark harmless for the past, present, and future liabilities of DSJ. As a result of Lark\\'s withdrawal and Ward\\'s admission to the partnership, Ward:

A. Acquired only the right to receive Ward\\'s share of DSJ profits.

B. Has the right to participate in DSJ\\'s management.

C. Is personally liable for partnership liabilities arising before and after being admitted as a partner.

D. Must contribute cash or property to DSJ to be admitted with the same rights as the other partners.

Correct Answer: B

Choice "b" is correct. The general rule is that the mere assignment of a partner\\'s interest does not make the assignee a partner. One may become a partner only with the consent of all other partners. Here, all other partner\\'s consented to Ward\\'s becoming a partner. Thus, Ward is a partner with full rights to participate in management. Choice "a" is incorrect. The general rule is that the mere assignment of a partner\\'s interest does not make the assignee a partner. One may become a partner only with the consent of all other partners. Here, all other partner\\'s consented to Ward\\'s becoming a partner. Thus, Ward is a partner with full partner rights. Choice "c" is incorrect. An incoming partner is not liable for debts that the partnership incurred before admission beyond the incoming partner\\'s contribution, but is fully liable for debts incurred after becoming a partner. Choice "d" is incorrect. A partnership is a consensual relationship; there is no requirement of a contribution to become a partner.

QUESTION 5

Kore Industries is analyzing a capital investment proposal for new equipment to produce a product over the next eight years. The analyst is attempting to determine the appropriate "end-of-life" cash flows for the analysis. At the end of eight years, the equipment must be removed from the plant and will have a net book value of zero, a tax basis of $75,000, a cost to remove of $40,000, and scrap salvage value of $10,000. Kore\\'s effective tax rate is 40 percent. What is the appropriate "end-of-life" cash flow related to these items that should be used in the analysis?

A. $27,000

B. $12,000

C. $(18,000)

D. $(30,000)

Correct Answer: B

Choice "b" is correct. $12,000 "end-of-life" cash flow.

The $75,000 loss on disposal is a non-cash reduction in taxable income that will reduce taxes paid by

$30,000 (75,000 ?40%).

The cost to remove the equipment is a cash expense that will reduce taxable income by $40,000 and

reduce taxes paid by $16,000 (40,000 ?40%), resulting in a net cash expense of $24,000 ($40,000 minus

$16,000, or $40,000 ?60%).

The $10,000 salvage value will increase after-tax cash flow by $6,000 (10,000 ?60%).

	Pre-Tax Bases			40% Tax		Net Cash	
Items	Per Tax	Per Books		Inflow (Outflow)		Inflow (Outflow)	Activity
Equip Value	(75)	0		30		30	Tax disposal loss
Removal	(40)	(40)		16		(24)	Removal cost
Salvage	10	10		(4)		6	Salvage sale
Net	(105)	30	–	42	=	12	"End-of-life" Cash inflow

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