BUSINESS-ENVIRONMENT-AND-CONCEPTS Q&As

Certified Public Accountant (Business Environment & Concept)

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QUESTION 1

Kemple Cleaning Services is a newly established janitorial firm, and the owner is deciding which type of checking account to open. Kemple is planning to keep a $500 minimum balance in the account for emergencies and plans to write an average of 80 checks per month. The bank charges $10 per month plus a $0.10 per check charge for a standard business checking account with no minimum balance. Kemple also has the option of a premium business checking account, which requires a $2,500 minimum balance but has no monthly fees or per check charges. If Kemple\\'s cost of funds is 10 percent, which account should Kemple choose?

A. Standard account, since the savings is $34 per year.

B. Premium account, since the savings is $34 per year.

C. Standard account, since the savings is $16 per year.

D. Premium account, since the savings is $16 per year.

Correct Answer: D

Choice "d" is correct. The total cost for a standard account is:

Monthly charge		$ 10
Per check charge ($.10 × 80 checks)		8
Total per month		$ 18
Total per year standard ($18 × 12)	$216	

Cost per year for premium is cost of the extra amount ($2,000) that Kemple must maintain in the account.

Total per year premium (10% ?$2,000) = $200

The premium account will save $16.

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

QUESTION 2

Within the framework of the aggregate demand/aggregate supply model, an increase in short run aggregate supply will cause:

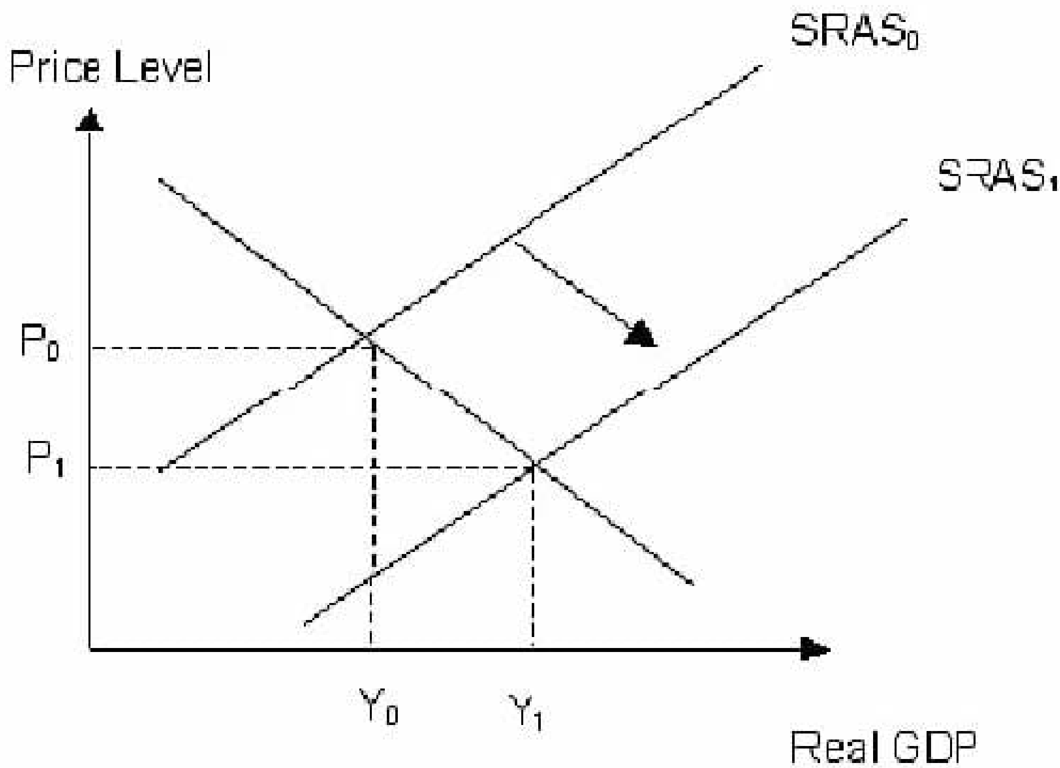
A. Real output to expand and the price level to fall.

B. Real output to decline and the price level to rise.

C. Real output to expand and the price level to rise.

D. Real output to decline and the price level to fall.

Correct Answer: A



Choice "a" is correct. A shift right in short run aggregate supply causes output to increase and the price

level to fall.

Choice "b" is incorrect. Real output would rise, not fall.

Choice "c" is incorrect. The price level would fall, not rise.

Choice "d" is incorrect. Real output would rise, not fall.

QUESTION 3

Eller, Fort and Owens are members of Venture Associates, LLC. Trent Corp. brought a breach of contract suit against Venture for a contract executed by Eller as an agent of the LLC. If Trent prevails, Trent will generally be able to collect the judgment from:

A. The LLC\\'s assets only.

B. The personal assets of Eller, Fort and Owens jointly.

C. Eller\\'s personal assets only after LLC assets are exhausted.

D. Eller\\'s personal assets only.

Correct Answer: A

Choice "a" is correct.

Rule: Members of an LLC are not personally liable for the LLC\\'s obligations. Moreover, an agent is not

liable on a contract the agent enters into on behalf of a disclosed principal. Here, the contract was entered

into by Eller on behalf of Venture, an LLC, and Eller disclosed that he was acting only as an agent of

Venture. Thus, Trent Corp. can collect from the LLC\\'S assets only.

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

QUESTION 4

A disadvantage of the net present value method of capital expenditure evaluation is that it:

A. Is calculated using sensitivity analysis.

B. Does not provide the true rate of return on investment.

C. Is difficult to apply because it uses a trial and error approach.

D. Is difficult to adapt for risk.

Correct Answer: B

Choice "b" is correct. The net present value (NPV) method of capital expenditure evaluation does not provide the true rate of return on investment. The NPV indicates whether or not an investment will earn the "hurdle rate" used in the NPV calculation. If the NPV is positive, the return on investment will exceed the hurdle rate. If the NPV is negative, the return on investment will be less than the hurdle rate. If the NPV is zero, the return on investment will be exactly equal to the hurdle rate. Choice "a" is incorrect. Sensitivity analysis is a "what if" technique that asks how a given organization will change if the original estimates used in the capital budgeting model are changed. Choice "c" is incorrect. NPV calculations do not use a trial and error approach. Choice "d" is incorrect. NPV method is not difficult to adapt for risk. To adapt for increased risk, a higher hurdle rate is used. To adapt for less risk, a lower hurdle rate is used.

QUESTION 5

A company with $4.8 million in credit sales per year plans to relax its credit standards, projecting that this will increase credit sales by $720,000. The company\\'s average collection period for new customers is expected to be 75 days; and the payment behavior of the existing customers is not expected to change. Variable costs are 80 percent of sales. The firm\\'s opportunity cost is 20 percent before taxes. Assuming a 360-day year, what is the company\\'s benefit (loss) on the planned change in credit terms?

A. $28,800

B. $144,000

C. $120,000

D. $126,000

Correct Answer: C

Choice "c" is correct. $120,000 benefit on the planned change in credit standards.

			Opportunity Cost	
Sales	$720,000			
Variable Costs (80%)	576,000	× 75/360 =	$120,000 =	75 Days' Costs O/S
Variable Margin	144,000			
			× 20%	Opportunity Cost Rate
Less Opportunity Cost	(24,000)		$ 24,000	
Benefit	$120,000			

This question pertains to the economic benefit associated with a change in credit terms.

The question tells us that the credit sales will increase by $720,000 if we relax our credit terms. We know variable costs are 80%, so we will earn $144,000 as a result of the expanded sales. The 20% contribution margin is equal to the 20% opportunity cost so there is no better investment of our resources for the expanded credit sales relative to its margin.

What about the variable costs, though?

We have $576,000 in variable costs that will be outstanding, pro rata, 75 days of the year. So the resources we will use to produce our sales is 75/360ths of $576,000, or $120,000 at any given time during the year. These $120,000 in resources could earn 20% annual return or $24,000. The $24,000 opportunity cost, compared to the $144,000 margin results in a $120,000 benefit in relaxing credit terms.

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

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