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**QUESTION 1**

Which of the following ratios is appropriate for the evaluation of accounts receivable?

- A. Days sales outstanding.
- B. Return on total assets.
- C. Collection to debt ratio.
- D. Current ratio.

Correct Answer: A

Explanation:

Choice "a" is correct. Among the ratios listed, the ratio that is appropriate for the evaluation of accounts receivable is the number of days sales are outstanding. Sales are related to accounts receivable, so the more days the sales are outstanding, the longer the receivables are outstanding.

Choice "b" is incorrect. Return on total assets is not appropriate for the evaluation of accounts receivable. It is appropriate for the evaluation of return and of total assets, but not for the evaluation of account receivable specifically.

Choice "c" is incorrect. The collection to debt ratio has nothing to do with the evaluation of accounts receivable.

Choice "d" is incorrect. The current ratio is appropriate for the evaluation of liquidity (one of the ways to evaluate liquidity) but has nothing to do with the evaluation of accounts receivable, other than that accounts receivable is in the numerator of the current ratio.

QUESTION 2

In ABC Food Co.'s 1990 single-step income statement, the section titled "Revenues" consisted of the following: In the revenues section of its 1990 income statement, ABC Food should have reported total revenues of:



Net sales revenue		\$187,000
Results from discontinued operations:		
Loss from operations of component (net of \$1,200 tax effect)	\$(2,400)	
Gain on disposal of component (net of \$7,200 tax effect)	<u>14,400</u>	12,000
Interest revenue		10,200
Gain on sale of equipment		<u>4,700</u>
Total revenues		\$213,900

A. \$216,300

B. \$215,400

C. \$203,700

D. \$201,900

Correct Answer: D

Explanation:

Choice "d" is correct. \$201,900.

Revenues (in a single step income statement) include:

Net sales revenue (of goods & services)	\$187,000
Interest revenue (and dividends earned)	10,200
Gain on sale of equipment	<u>4,700</u>
Total revenues	201,900

The various amounts from discontinued operations should be included in discontinued operations, not in revenues.

QUESTION 3

The benefits of debt financing over equity financing are likely to be highest in which of the following situations?

- A. High marginal tax rates and few noninterest tax benefits.
- B. Low marginal tax rates and few noninterest tax benefits.
- C. High marginal tax rates and many noninterest tax benefits.
- D. Low marginal tax rates and many noninterest tax benefits.

Correct Answer: A



Explanation: Choice "a" is correct. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high (because interest on debt is deductible for tax purposes) and if there are few noninterest tax benefits (because there is little or no reason to depart from debt financing). Choice "b" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high, not low (because interest on debt is deductible for tax purposes), and if there are few noninterest tax benefits. Choice "c" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high (because interest on debt is deductible for tax purposes) and if there are few, not many, noninterest tax benefits. Choice "d" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high, not low (because interest on debt is deductible for tax purposes), and if there are few, not many, noninterest tax benefits.

QUESTION 4

A limited liability company taxed under subchapter K of the Internal Revenue Code (the partnership subchapter):

- A. Must pay federal income tax.
- B. Is generally not considered a legal entity separate and apart from its owners.
- C. Must have written articles of organization.
- D. Must provide for apportionment of liability for the company's debts.

Correct Answer: C

Explanation:

Choice "c" is correct. A limited liability company must have written articles of organization, which must be filed with the state.

Choice "a" is incorrect. An LLC taxed under subchapter K of the Internal Revenue Code (the partnership subchapter) does not pay federal income tax; the members are taxed on their share of the LLC's income.

Choice "b" is incorrect. Unlike a general partnership, but like a corporation and a limited partnership, an LLC is considered a legal entity separate and apart from its owners.

Choice "d" is incorrect. An LLC does not have to provide for apportionment of liability for LLC debts; the members of an LLC have limited liability.

QUESTION 5

In 1990, ABC 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 ABC Corp. and the rights and duties of its stockholders, directors, and officers. ABC Corp.'s initial bylaws ordinarily would be adopted by its:



A. Stockholders.

B. Officers.

C. Directors.

Correct Answer: C

Explanation:

Choice "c" is correct. Bylaws usually are adopted by the initial directors.

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