

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

Certified Public Accountant (Business Environment & Concept)

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- C. Must have written articles of organization.
- D. Must provide for apportionment of liability for the company's debts.

Correct Answer: C

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 4

Harvey Co. is evaluating a capital investment proposal for a new machine. The investment proposal shows the following information:

Initial cost	\$500,000
Life	10 years
Annual net cash inflows	\$200,000
Salvage value	\$100,000

If acquired, the machine will be depreciated using the straight-line method. The payback period for this investment is:

- A. 3.25 years.
- B. 2.67 years.
- C. 2.5 years.
- D. 2 years.

Correct Answer: C

Choice "c" is correct. With even cash flows, payback period is calculated as initial cost / annual net cash inflows. That is,  $\$500,000 / \$200,000 = 2.5$ . Choice "a" is incorrect. We could not determine an obvious approach to obtain this answer. It is incorrect per the calculation above. Choice "b" is incorrect. This answer is calculated as follows:  $(\text{initial cost} - \text{salvage value}) / (\text{annual net cash inflows} - \text{annual depreciation})$  or  $(\$500,000 - \$100,000) / (\$200,000 - \$50,000) = \$400,000 / \$150,000 = 2.67$ . With the payback period, depreciation should only be considered to the extent that it represents a tax shield. Choice "d" is incorrect. This answer appears to be the initial cost less salvage value divided by the annual net cash inflows  $((\$500,000 - \$100,000) / \$200,000 = 2.0)$ . Salvage value is not included in the correct calculation.

#### QUESTION 5

James Webb is the general manager of the Industrial Product Division, and his performance is measured using the residual income method. Webb is reviewing the following forecasted information for his division for next year.

<u>Category</u>	<u>Amount (thousands)</u>
Working capital	\$ 1,800
Revenue	30,000
Plant and equipment	17,200

If the imputed interest charge is 15 percent and Webb wants to achieve a residual income target of \$2 million, what will costs have to be in order to achieve the target?

- A. \$10,800,000
- B. \$23,620,000
- C. \$25,150,000
- D. \$25,690,000

Correct Answer: C

Choice "c" is correct. \$25,150,000 costs to achieve residual income target of \$2 million.

Working capital	\$ 1,800,000
Plant and equipment	<u>17,200,000</u>
Asset base	19,000,000
Times: Imputed interest rate	<u>15%</u>
Hurdle income	2,850,000
Add: Residual income target	<u>2,000,000</u>
Total target income	4,850,000
Revenue forecast	\$ 30,000,000
Less: Total target income	<u>(4,850,000)</u>
Required costs to achieve target	<u><u>\$ (25,150,000)</u></u>

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

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