# BUSINESS-ENVIRONMENT-AND-CONCEPTS Q&As

Certified Public Accountant (Business Environment & Concept)

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**QUESTION 1**

The partners of College Assoc., a general partnership, decided to dissolve the partnership and agreed that none of the partners would continue to use the partnership name. Under the Revised Uniform Partnership Act, which of the following events will occur on dissolution of the partnership?

| | Each partner's existing liability would be discharged | Each partner's apparent authority would continue |
|---|---|---|
| A. | Yes | Yes |
| B. | Yes | No |
| C. | No | Yes |
| D. | No | No |

A. Option A

B. Option B

C. Option C D. Option D

Correct Answer: C

Choice "c" is correct. "No - Yes."

Rule: Upon the dissolution of the partnership, each of the partners continues to have liability for partnership

debts. Upon dissolution of the partnership each of the partners will continue to have apparent authority.

The apparent authority of a partner can only be negated upon proper notice to third parties.

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

**QUESTION 2**

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 day-to-day business ordinarily would be operated by its:

A. Directors.

B. Stockholders.

C. Officers.

Correct Answer: C

Choice "c" is correct. Stockholders have no day-to-day control; management power of a corporation is vested in the directors, but they usually delegate day-to-day management duties to the officers.

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**QUESTION 3**

The Frame Supply Company has just acquired a large account and needs to increase its working capital by $100,000. The controller of the company has identified four alternative sources of funds, which are given below.

A. Pay a factor to buy the company\\'s receivables, which average $125,000 per month and have an average collection period of 30 days. The factor will advance up to 80 percent of the face value of receivables at 10 percent and charge a fee of 2 percent of all receivables purchased. The controller estimates that the firm would save $24,000 in collection expenses over the year. Assume the fee and interest are not deductible in advance.

B. Borrow $110,000 from a bank at 12 percent interest. A 9 percent compensating balance would be required.

C. Issue $110,000 of six-month commercial paper to net $100,000. (New paper would be issued every 6 months.)

D. Borrow $125,000 from a bank on a discount basis at 20 percent. No compensating balance would be required. Assume a 360-day year in all of your calculations.

The cost of Alternative D is:

A. 10.0 percent.

B. 20.0 percent.

C. 25.0 percent.

D. 40.0 percent.

Correct Answer: C

Choice "c" is correct.

$$25.0\text{ Percent} = \frac{\$25{,}000\text{ Interest}}{\$125{,}000 - \$25{,}000\text{ Discount}}$$

| | |
|---|---|
| Bank Loan | $125,000 |
| 20% Discount | (25,000) |
| Net Cash Proceeds | $100,000 |

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

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**QUESTION 4**

A company obtained a short-term bank loan of $250,000 at an annual interest rate of 6 percent. As a condition of the loan, the company is required to maintain a compensating balance of $50,000 in its checking account. The company\\'s checking account earns interest at an annual rate of 2 percent. Ordinarily, the company maintains a balance of $25,000 in its checking account for transaction purposes. What is the effective interest rate of the loan?

A. 6.44 percent.

B. 7.11 percent.

C. 5.80 percent.

D. 6.66 percent.

Correct Answer: A

Choice "a" is correct. 6.44%. To calculate the effective interest rate:

| | Useable Loan | | Rate | | Interest |
|---|---|---|---|---|---|
| Step 1 - Calculate the Actual Finance Charge: Actual Interest (Principal × Rate × Time) | 250,000 | × | 6% | = | $15,000 |
| Step 2 - Subtract any Interest Earned (if any) on **Additional** Required Compensating Balance $50,000 – 25,000 = | (25,000) | × | 2% | = | (500) |
| Net Interest Cost | 225,000 | | | | 14,500 |

Step 3 - $\dfrac{\text{Divide net interest cost}}{\text{By net loan proceeds useable}} = \dfrac{14{,}500}{(225{,}000)} = 6.44\%$

## QUESTION 5

Sylvan Corporation has the following capital structure:

| | |
|---|---|
| Debenture bonds | $10,000,000 |
| Preferred equity | 1,000,000 |
| Common equity | 39,000,000 |

The financial leverage of Sylvan Corp. would increase as a result of:

A. Issuing common stock and using the proceeds to retire preferred stock.

B. Issuing common stock and using the proceeds to retire debenture bonds.

C. Financing its future investments with a higher percentage of bonds.

D. Financing its future investments with a higher percentage of equity funds.

Correct Answer: C

Choice "c" is correct. Financial leverage increases when the debt to equity ratio increases. Using a higher percentage of debt (bonds) for future investments would increase financial leverage. Choice "a" is incorrect. This results in no change in total equity and, consequently, no change in financial

leverage.

Choice "b" is incorrect. This would result in increased equity and decreased debt, which would decrease

financial leverage.

Choice "d" is incorrect. This would increase equity, decrease the debt to equity ratio and decrease financial

leverage.

**QUESTION 6**

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 7**

Which one of the following represents methods for converting accounts receivable to cash?

A. Trade discounts, collection agencies, and credit approval.

B. Factoring, pledging, and electronic funds transfers.

C. Cash discounts, collection agencies, and electronic funds transfers.

D. Trade discounts, cash discounts, and electronic funds transfers.

Correct Answer: C

Choice "c" is correct. The following are methods of converting accounts receivable (AR) into cash:

1.

Collection agencies - used to collect overdue AR.

2.

Factoring AR - selling AR to a factor for cash.

3.

Cash discounts - offering cash discounts to customers for paying AR quickly (or paying at all). For example: 2/10, net 30.

4.

Electronic fund transfers - a method of payment, which electronically transfers funds between banks.

Therefore, only choice "c" matches the above list.

Choice "a" is incorrect. Trade discounts offer discounts on future merchandise purchases offered to trade

customers. These discounts do not turn AR into cash.

Choice "b" is incorrect. Pledging AR as collateral on a loan does not convert AR into cash.

Choice "d" is incorrect, per choice for "a" above.

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**QUESTION 8**

Heather, Erika, and Shelby are members in HES LLC. Heather works 40 hours per week and Erika and Shelby work 20 hours per week. Heather contributed $30,000 to the LLC and Erika and Shelby contributed $60,000 each. Erika and Shelby have each originated 45% of the LLC\\'s business and Heather has originated the other 10%. If HES were a general partnership, who controls management?

A. Heather, because she works the most.

B. Erika and Shelby equally because they contributed the most.

C. Heather, Erika, and Shelby equally because of state law.

D. Erika and Shelby, because they originate most of the work.

Correct Answer: C

Choice "c" is correct.

Rule: Absent an agreement to the contrary, partners have equal management authority.

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

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**QUESTION 9**

Under the Revised Model Business Corporation Act, when a corporation\\'s bylaws grant stockholders preemptive rights, which of the following rights is(are) included in that grant?

| | *The right to a proportionate share of corporate assets remaining on corporate dissolution* | *The right to purchase a proportionate share of newly issued stock* |
|---|---|---|
| **A.** | Yes | Yes |
| **B.** | Yes | No |
| **C.** | No | Yes |
| **D.** | No | No |

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: C

Rule: Preemptive rights provide a shareholder with a right of first refusal to buy a share of newly issued

shares sufficient to maintain the shareholder\\'s proportionate share of rights in any newly issued shares.

Rule: Preemptive rights do not provide a shareholder with the right to a proportionate share of corporate

assets on dissolution.

Choice "c" is correct. "No - Yes."

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

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**QUESTION 10**

Which of the following forms of business can be formed with only one individual owning the business?

| | Sole Proprietorship | Limited Liability Company | Partnership |
|---|---|---|---|
| A. | Yes | Yes | Yes |
| B. | Yes | Yes | No |
| C. | Yes | No | Yes |
| D. | No | No | No |

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: B

Choice "b" is correct. A sole proprietorship and (in most states) a limited liability company can be formed

with only one owner. A partnership requires two or more partners.

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

**QUESTION 11**

In general, which of the following statements is correct with respect to a limited partnership?

A. A limited partner will be personally liable for partnership debts incurred in the ordinary course of the partnership\\'s business.

B. A limited partner is unable to participate in the management of the partnership in the same manner as general partners and still retain limited liability.

C. A limited partner\\'s death or incompetency will cause the partnership to dissolve.

D. A limited partner is an agent of the partnership and has the authority to bind the partnership to contracts.

Correct Answer: B

Choice "b" is correct. While the general rule is that a limited partner has no liability on partnership debts except to the extent of his agreed-upon contribution, the limited partner will lose this limited liability if he takes part in control of the business, which generally means a limited partner may not manage the business on a day-to-day basis as a general partner could. Choice "a" is incorrect. Limited partners are not personally liable for partnership debts; their liability generally is limited to their contributions. Choice "c" is incorrect. Death or incapacity of a general partner will cause a dissolution, but the same is not true of a limited partner. Choice "d" is incorrect. A limited partner is more like a shareholder in a corporation than like a general partner. Limited partners are not agents of their partnerships and have no authority to bind their partnership on contracts.

**QUESTION 12**

Which of the following is not a type of major strategic framework that has proven useful for value chain analysis?

A. Core competencies analysis.

B. Customer preference analysis.

C. Industry structure analysis.

D. Segmentation analysis.

Correct Answer: B

Choice "b" is correct. Customer preference analysis is not a major strategic framework that has been proven to be useful for value chain analysis. Choices "a", "c", and "d" are incorrect, as the three major types of strategic frameworks that have been proven to be useful for value chain analysis are industry structure analysis, core competencies analysis, and segmentation analysis.

**QUESTION 13**

The local video store\\'s business increased by 12 percent after the movie theater raised its prices from $6.50 to $7.00. This is an example of:

A. Substitute goods.

B. Superior goods.

C. Complementary goods.

D. Independent goods.

Correct Answer: A

Choice "a" is correct. For substitute goods, as the price of one good goes up, the demand for another,

substitute good increases as consumers desire the lower-priced substitute good. Choice "b" is incorrect.

Superior goods. Just as the demand for inferior goods declines with an increase in the income level of a

consumer, superior goods will experience a spurt in demand as prices are raised. Choice "c" is incorrect.

The demands for mutually "complementary goods" fluctuate together (e.g., more cereal purchases are

accompanied by an increase in the demand for milk).

Choice "d" is incorrect. Independent goods have unrelated demand functions (e.g., bread and vacuum

cleaners).

**QUESTION 14**

Under the expenditure approach, GDP can be calculated as the sum of:

A. Consumption, money supply, government purchases, and exports.

B. Consumption, investment, transfer payments, and imports.

C. Consumption, investment, government purchases, and net exports.

D. Consumption, investment, government purchases, and foreign exchange.

Correct Answer: C

Choice "c" is correct. Under the expenditure approach, GDP is calculated as the sum of: consumption

expenditures + investment expenditures + government purchases + net exports.

Choice "a" is incorrect. See definition above.

Choice "b" is incorrect. See definition above.

Choice "d" is incorrect. See definition above.

**QUESTION 15**

The working capital financing policy that subjects the firm to the greatest risk of being unable to meet the firm\\'s maturing obligations is the policy that finances:

A. Fluctuating current assets with long-term debt.

B. Permanent current assets with long-term debt.

C. Permanent current assets with short-term debt.

D. Fluctuating current assets with short-term debt.

Correct Answer: C

Choice "c" is correct. The working capital financing policy that finances permanent current assets with short-term debt subjects the firm to the greatest risk of being unable to meet the firm\\'s maturing obligations. Choices "a" and "b" are incorrect because the use of long-term debt financing produces the smallest risk of being unable to meet maturing obligations. Choice "d" is incorrect because, although financing fluctuating current assets with short-term debt exposes the firm to some risk, it is not the greatest or the smallest.