

BUSINESS-ENVIRONMENT-AND- CONCEPTS^{Q&As}

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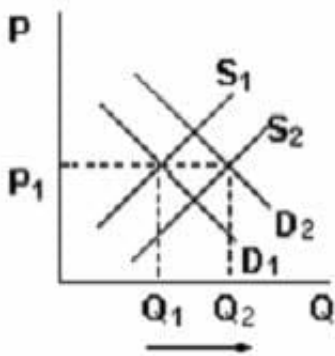


QUESTION 1

In any competitive market, an equal increase in both demand and supply can be expected to always:

- A. Increase both price and market-clearing quantity.
- B. Increase market-clearing quantity.
- C. Increase price.
- D. Decrease price.

Correct Answer: B



Choice "b" is correct. As illustrated above, a shift outward (increase) in supply increases quantity supplied at equilibrium. As illustrated, this is true even when demand increases.

Choice "a" is incorrect. As illustrated, price may stay the same but quantity will increase. Draw the graph!

Choices "c" and "d" are incorrect. Price may remain the same, but quantity will "always" increase.

QUESTION 2

Which one of the following management considerations is usually addressed first in strategic planning?

- A. Overall goals of the firm.
- B. Organizational structure.
- C. Recent annual budgets.
- D. Being an industry leader.

Correct Answer: A

Choice "a" is correct. Setting the overall goals of the firm is usually the starting point in strategic planning. Choice "b" is incorrect. The organizational structure will be partially determined by the goals of the firm. Choice "c" is incorrect.

Recent annual budgets may be reviewed as an aid in planning, but they are not the first consideration in strategic planning. In fact, they often are ignored. Choice "d" is incorrect. Being an industry leader may be or become a goal of the firm, but that would be determined during the strategic planning process.

QUESTION 3

Minon, Inc. purchased a long-term asset on the last day of the current year. What are the effects of this purchase on return on investment and residual income?

	<i>Return on</i>	<i>Residual</i>
	<u><i>Investment</i></u>	<u><i>income</i></u>
A.	Increase	Increase
B.	Decrease	Decrease
C.	Increase	Decrease
D.	Decrease	Increase

- A. Option A
- B. Option B
- C. Option C
- D. Option D

Correct Answer: B

Choice "b" is correct. The addition of an asset at year end serves to reduce both return on investment and residual income. The addition of an asset increases then denominator in the ROI computation and increases the threshold earnings required using the residual income approach. Both measures would suffer as a result of addition of assets. See illustration below:

Assumptions:

Income	\$ 100,000
Assets	\$1,000,000
Required return	10%
Additional asset	\$ 200,000

Return on Investment

	<u>Before</u>	<u>Purchase</u>	<u>After</u>
Income	\$ 100,000		\$ 100,000
Assets	\$1,000,000	\$200,000	\$1,200,000
Return	<u>10%</u>		<u>8%</u>

Residual Income

	<u>Before</u>	<u>Purchase</u>	<u>After</u>
Assets	\$1,000,000	\$200,000	\$1,200,000
Required Return	10%		10%
Required Income	\$ 100,000		\$ 120,000
Income	\$ 100,000		\$ 100,000
Difference	<u>\$ -</u>		<u>\$ (20,000)</u>

The purchase of the additional asset reduces ROI from 10% to 8% and produces negative residual

income.

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

QUESTION 4

As a company becomes more conservative in its working capital policy, it would tend to have a (n):

- A. Decrease in its acid-test ratio.
- B. Increase in the ratio of current assets to units of output.
- C. Increase in funds invested in common stock and a decrease in funds invested in marketable securities.
- D. Decrease in its level of permanent working capital.

Correct Answer: B

Choice "b" is correct. As a company becomes more conservative in its working capital policy, it would tend to have an increase in the ratio of current assets to units of output.

Choice "a" is incorrect. Acid-test ratio would tend to increase with conservatism.

Choice "c" is incorrect. Marketable securities investments would tend to increase while common stock investments would tend to decrease.

Choice "d" is incorrect. Permanent working capital would tend to increase.

QUESTION 5

A company enters into an agreement with a firm who will factor the company's accounts receivable. The

factor agrees to buy the company's receivables, which average \$100,000 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 an annual rate of 10 percent and charge a fee of 2 percent on all receivables purchased. The controller of the company estimates that the company would save \$18,000 in collection expenses over the year. Fees and interest are not deducted in advance. Assuming a 360-day year, what is the annual cost of financing?

- A. 12.0 percent.
- B. 14.0 percent.
- C. 16.0 percent.
- D. 17.5 percent.

Correct Answer: D

Choice "d" is correct. 17.5% annual cost of financing.

	<u>A/R</u>			<u>Cost to Company</u>
Amount of A/R Submitted	\$100,000	×	2% × 360/30 =	\$24,000
Amount Not Advanced	<u>(20,000)</u>			
Amount to Calculate Interest Exp	80,000	×	10% =	<u>8,000</u>
Cost to Company				32,000
Less Collection Expense Saved				<u>(18,000)</u>
Net Cost				<u>\$14,000</u>

$$\frac{\text{Net cost}}{\text{Amt advance}} = \frac{\$14,000}{\$80,000} = 17.5\% \text{ Annual cost of financing}$$

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