BUSINESS-ENVIRONMENT-AND-CONCEPTS Q&As

Certified Public Accountant (Business Environment & Concept)

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QUESTION 1

Management accountants are frequently asked to analyze various decision situations including the following.

I. The cost of a special device that is necessary if a special order is accepted.

II. The cost proposed annually for the plant service for the grounds at corporate headquarters.

III. Joint production costs incurred, to be considered in a sell-at-split versus a process-further decision.

IV.

The costs associated with alternative uses of plant space, to be considered in a make/buy decision.

V.

The cost of obsolete inventory acquired several years ago, to be considered in a keep-versus disposal decision.

The cost described in situation II above is a:

A. Prime cost.

B. Sunk cost.

C. Discretionary cost.

D. Relevant cost.

Correct Answer: C

Choice "c" is correct. Discretionary cost. The proposed cost for plant service for the grounds at corporate

headquarters is an example of an avoidable cost that is discretionary.

Choice "a" is incorrect. Prime costs are direct materials and direct labor.

Choice "b" is incorrect. Sunk costs are costs previously incurred and not relevant.

Choice "d" is incorrect. Relevant costs are expected future costs that vary with the action taken.

QUESTION 2

Under which one of the following conditions is the internal rate of return method less reliable than the net present value technique?

A. When the net present value of the project is equal to zero.

B. When income taxes are considered in the analysis.

C. When both benefits and costs are included, but each is separately discounted to the present.

D. When there are several alternating periods of net cash inflows and net cash outflows.

Correct Answer: D

Choice "d" is correct. The internal rate of return (IRR) method is less reliable than the net present value (NPV) technique when there are several alternating periods of net cash inflows and net cash outflows or the amounts of cash flows differ significantly. The IRR is strictly a percentage measure of return, while the NPV is an absolute measure. Due to this difference, the timing or amount of cash flows under IRR can be misleading when compared to the NPV method. Example: If an investment of $50 earns $100. Then, 100/50 = 200% return If an investment of $50,000 earns $25,000 then, 25,000/50,000 = 50% return IRR suggests it is best to invest $50 to earn $100 and a 200% return while the NPV method will indicate a larger NPV for the $50,000 investment. Choices "a", "b", and "c" are incorrect. These conditions do not make the IRR method less reliable than the NPV method.

QUESTION 3

Vested, Inc. made some changes in operations and provided the following information:

	Year 2	Year 3
Operating revenues	$ 900,000	$1,100,000
Operating expenses	650,000	700,000
Operating assets	1,200,000	2,000,000

What percentage represents the return on investment for year 3?

A. 28.57%

B. 25%

C. 20.31%

D. 20%

Correct Answer: B

Choice "b" is correct. Return on investment is the ratio of operating income to average operating assets and is computed as follows based on Year 2 and Year 3 data:

Operating revenue (Year 3)		$1,100,000
Operating expense (Year 3)		(700,000)
Operating income		400,000
Operating assets (Year 2)	1,200,000	
Operating assets (Year 3)	2,000,000	
Total	3,200,000	
	31	
Average operating assets (÷ 2)		1,600,000
Return on investment		25.00%

Choice "a" is incorrect per the above computation.

Choice "c is incorrect. The year 3 return on investment is not computed by combining revenues, expenses, and assets for all year\\'s presented. Choice "d" is incorrect. The year 3 return on investment is based on the average assets (($1,200,000 + $2,000,000)/2 = $1,600,000), not simply on the total assets at the end of year 3 ($2,000,000).

QUESTION 4

The limited liability of the shareholders of a closely-held corporation will most likely be disregarded if the shareholders:

A. Lend money to the corporation.

B. Are also corporate officers, directors, or employees.

C. Undercapitalized the corporation when it was formed.

D. Formed the corporation solely to limit their personal liability.

Correct Answer: C

Choice "c" is correct. The "corporate veil" can be pierced in situations in which the corporation was undercapitalized at formation, where it is the alter ego of the shareholders, or when it used to perpetrate a fraud. Choice "a" is incorrect. Shareholders may lend money to their corporation. This does not make such shareholders personally liable for the corporation\\'s debt. Choice "b" is incorrect. Officers, directors, and employees are not personally liable for the corporation\\'s debt, and there is no reason to change this role merely because such persons also own shares. Choice "d" is incorrect. The desire to limit liability is a valid reason to adopt the corporate form and will not, by itself, allow the "corporate veil" to be pierced.

QUESTION 5

The Waymand family typically ate hamburger as a regular staple in their diet. In the last few years, the family income has doubled, and they have now replaced hamburger with steak as a regular staple in their diet. This is an example where the demand for hamburger:

A. Is relatively elastic.

B. Is perfectly elastic.

C. Responds as an inferior good.

D. Is perfectly inelastic.

Correct Answer: C

Choice "c" is correct. An inferior good is one for which the demand declines as income increases. A normal good would experience an increase in demand in response to an increase in income. Because the demand for hamburger went down as income increased, it is an inferior good. Choices "a", "b", and "d" are incorrect. The elasticity of demand for a good is calculated by measuring the change in quantity demanded over the change in price (not income). The question does not have sufficient information to calculate the elasticity of the demand for hamburger.