



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

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QUESTION 1

Which of the following requirements must be met to have a valid partnership exist?

I. Co-ownership of all property used in a business.

II.

Co-ownership of a business for profit.

A.

I only.

B.

II only.

C.

Both I and II.

D.

Neither I nor II.

Correct Answer: B

Choice "b" is correct.

Rule: A partnership is defined as an association of two or more persons who agree to carry on as coowners a business for profit. Thus, II is necessary. However, there is no requirement that all property used in the business be co-owned; it may be owned by individual partners. Thus I is not necessary.

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

QUESTION 2

Osgood Products has announced that it plans to finance future investments so that the firm will achieve an optimum capital structure. Which one of the following corporate objectives is consistent with the announcement?

A. Maximize earnings per share.

B. Minimize the cost of debt.

C. Maximize the net worth of the firm.

D. Minimize the cost of equity.

Correct Answer: C



Choice "c" is correct. The optimal capital structure is the financial structure that would theoretically maximize shareholder wealth by maximizing the net worth of the company. Choices "a", "b", and "d" are incorrect. Strategies (not objectives) for creating an optimal capital structure to maximize net worth include:

1.
Maximizing earnings per share (choice "a").
2.
Minimizing the cost of debt (choice "b").
3.
Minimizing the cost of equity (choice "d").
4.
Maximizing cash flow (choice not given).

QUESTION 3

An industry that is oligopolistic would be best characterized by:

- A. One firm selling a product with no close substitutes.
- B. Significant barriers to entry.
- C. Horizontal or flat demand curves for the output of individual firms.
- D. The absence of significant economies of scale.

Correct Answer: B

Choice "b" is correct. Oligopoly market conditions are characterized by:

?Few firms in the market ?Significant barriers to entry ?Differentiated products ?Fixed (or semi fixed) prices ?Kinked demand curves

Choice "a" is incorrect. This is an example of monopoly. Choice "c" is incorrect. Horizontal demand curves represent demand that is perfectly price elastic (buyers will only pay one price for any quantity of a product). This occurs in perfectly competitive markets. Choice "d" is incorrect. This is characteristic of perfect competition, as there are no barriers to entry ("size doesn't matter") in perfect competition.

QUESTION 4

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 a source of funds which is given below:

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 on 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. Assume a 360-day year in all of



your calculations. The cost of factoring is:

- A. 12.0 percent.
- B. 14.8 percent.
- C. 16.0 percent.
- D. 20.0 percent.

Correct Answer: C

Choice "c" is correct.

	AR	x Fee	x Days in yr/ days in period	Subtotals
AR Submitted	\$125,000	2%	360/30	\$30,000
Amount withheld	<u>(25,000)</u>			
Amount subject to interest	100,000	10%/12	360/30	<u>10,000</u>
Cost to company				40,000
Less: Expenses saved due to outsourcing				<u>(24,000)</u>
Net cost				<u>\$16,000</u>

Net cost/average amount invested = \$16,000/\$100,000 = 16%

QUESTION 5

MFC Corporation has 100,000 shares of stock outstanding. Below is part of MFC's Statement of Financial Position for the last fiscal year.

MFC Corporation Statement of Financial Position - Selected Items December 31, 1996

Cash	\$455,000
Accounts receivable	900,000
Inventory	650,000
Prepaid assets	45,000
Accrued liabilities	285,000
Accounts payable	550,000
Current portion, long-term notes payable	65,000



What is the maximum amount MFC can pay in cash dividends per share and maintain a minimum current ratio of 2 to 1? Assume that all accounts other than cash remain unchanged.

- A. \$2.05
- B. \$2.50
- C. \$3.35
- D. \$3.80

Correct Answer: B

Choice "b" is correct. The current ratio is found by dividing current assets by current liabilities. Presently current assets are:

Cash	\$ 455,000
Accounts receivable	900,000
Inventory	650,000
Prepaid assets	<u>45,000</u>
Total current assets	\$2,050,000
Current liabilities total	
Accrued liabilities	\$ 285,000
Accounts payable	550,000
Current portion of LT debt	<u>65,000</u>
Total	\$ 900,000

Because current liabilities must be two times current liabilities, the current assets cannot go below \$1,800,000. Thus current assets can go down:

$$\begin{array}{r} \$2,050,000 \\ - 1,800,000 \\ \hline \text{or } \$ 250,000 \end{array}$$

On a per share basis this is \$250,000 / 100,000 shares or \$2.50 per share. Choices "a", "c", and "d" are incorrect, per the above calculation.

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