AICPA CPA-Business Practice Questions

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Question 1

Question Type: MultipleChoice

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:

Options:

A- Directors.
B- Stockholders.
C- Officers.

Answer:

C

Explanation:

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.

Question 2

Question Type: MultipleChoice

Williams, Inc. is interested in measuring its overall cost of capital and has gathered the following data. Under the terms described below, the company can sell unlimited amounts of all instruments.

* Williams can raise cash by selling $1,000, 8 percent, 20-year bonds with annual interest

payments.

In selling the issue, an average premium of $30 per bond would be received, and the firm must pay floatation costs of $30 per bond. The after-tax cost of funds is estimated to be 4.8 percent.

* Williams can sell 8 percent preferred stock at par value, $105 per share. The cost of issuing and selling the preferred stock is expected to be $5 per share.

* Williams' common stock is currently selling for $100 per share. The firm expects to pay cash dividends of $7 per share next year, and the dividends are expected to remain constant. The stock will have to be underpriced by $3 per share, and floatation costs are expected to amount to $5 per share.

* Williams expects to have available $100,000 of retained earnings in the coming year; once these retained earnings are exhausted, the firm will use new common stock as the form of common stock equity financing.

* Williams' preferred capital structure is:

Long-term debt 30%

Preferred stock 20

Common stock 50

The cost of funds from retained earnings for Williams, Inc. is:

Options:

A- 7.0 percent.
B- 7.4 percent.
C- 8.1 percent.
D- 7.8 percent.

Answer:

A

Explanation:

Choice 'a' is correct. 7.0 percent cost of funds from retained earnings.

The cost of retained earnings is equal to the rate of return required by the firm's common shareholders (or, in effect, the return 'lost' by them when the firm chooses to fund with retained earnings). While oftentimes this rate is somewhat subjective, we are given the facts to exactly answer the question in this case. The stock is currently selling for $100/share, and the dividend is given at $7/share.

$7 / $100 = 7%

Choices 'b', 'c', and 'd' are incorrect, per the above Explanation:/calculation.

Question 3

Question Type: MultipleChoice

Hedgehog International has a receivable valued at 500,000 local currency units from its foreign customer due in 90 days. The current spot rate of the local currency unit is $.60. Hedgehog purchases a put option to sell the local currency unit in 90 days for $.61 for a premium of $.005. The exchange rate for the local currency increases to $.63 in 90 days. What will Hedgehog do on the receivable's settlement date?

Options:

A- Hedgehog will exercise its option and sell the proceeds of its accounts receivable collection under the provisions of the option contract at a gain.
B- Hedgehog will not exercise the option and sell local currency units collected from its receivable at the spot rate.
C- Hedgehog will be indifferent as to whether it exercises the option or not.
D- Hedgehog will sell the option at the settlement date and combine its proceeds along with local currency units purchased at the spot rate to maximize its revenue.

Answer:

B

Explanation:

Choice 'b' is correct. Hedgehog will not exercise its option and will, instead convert the local currency units collected from the receivables to its domestic currency by selling that currency at the spot rate at the time of collection. The exercise of the option represents a less profitable alternative than sale of the accounts receivable proceeds at the spot rate at the time the receivables are collected. The exercise of the option in comparison to allowing the option to expire is computed as follows:

	Required LCU	Exchange @ Settlement	Put Price	Premium	Total	Payables Settlement
Settlement at spot	500,000	$0.63	$--	$--	$--	$315,000
Settlement with option	500,000	$--	$0.61	$0.005	$0.615	307,500
Net effect: Gain (Loss)						<7,500>

The premium is a sunk cost and is irrelevant to the Explanation: . Note that the premium is a factor in determining the net gain (loss) but not in deciding whether to exercise option.

Choices 'a', 'c', and 'd' are incorrect, per computation above.

Question 4

Question Type: MultipleChoice

The relevance of a particular cost to a decision is determined by:

Options:

A- Riskiness of the decision.
B- Number of decision variables.
C- Potential effect on the decision.
D- Accuracy of the cost.

Answer:

C

Explanation:

Choice 'c' is correct. The relevance of a particular cost to a decision is determined by potential effect on the decision. Relevant costs are expected future costs that vary with the action taken. All other costs are assumed to be constant and thus have no effect on the decision.

The relevance of a particular cost to a decision is not determined by:

A Riskiness of the decision.

B Number of decision variables.

D Accuracy of the cost.

Question 5

Question Type: MultipleChoice

Which of the following activities is considered a primary activity?

Options:

A- Delivery of products.
B- Procurement of materials.
C- Human resources.
D- Accounting.

Answer:

A

Explanation:

Choice 'a' is correct. Primary activities are those that are involved with the direct manufacture of products, the delivery of products through distribution channels, and the support of the product that exists after the sale is made (e.g., handling the raw materials, the manufacturing process, taking orders for the product, advertising the product, and servicing the product after it is sold).

Choices 'b', 'c', and 'd' are incorrect, as these are all considered support activities. Support activities are those activities that are performed by the support staff of an organization (e.g., purchasing of materials and supplies, development of the technology used, management of employees, accounting, finance, strategic planning, etc.).

Question 6

Question Type: MultipleChoice

In order to increase production capacity, Gunning Industries is considering replacing an existing production machine with a new technologically improved machine effective January 1, 1997. The following information is being considered by Gunning Industries.

* The new machine would be purchased for $160,000 in cash. Shipping, installation, and testing would cost an additional $30,000.

* The new machine is expected to increase annual sales by 20,000 units at a sales price of $40 per unit. Incremental operating costs are comprised of $30 per unit in variable costs and total fixed costs of $40,000 per year.

* The investment in the new machine will require an immediate increase in working capital of $35,000.

* Gunning uses straight-line depreciation for financial reporting and tax reporting purposes. The

new machine has an estimated useful life of five years and zero salvage value.

* Gunning is subject to a 40 percent corporate income tax rate.

Gunning uses the net present value method to analyze investments and will employ the following factors and rates.

Period	Present Value of $1 at 10%	Present Value of an Ordinary Annuity of $1 at 10%
1	.909	.909
2	.826	1.736
3	.751	2.487
4	.683	3.170
5	.621	3.791

The acquisition of the new production machine by Gunning Industries will contribute a discounted net-oftax contribution margin of:

Options:

A- $242,624
B- $303,280
C- $363,936
D- $454,920

Answer:

D

Explanation:

Choice 'd' is correct. $454,920 discounted net-of-tax contribution margin.

	$ per unit		units		$ In total @ 20,000 units	
Sales	40	×	20,000	=	800,000	Annual incremental revenue
Variable cost	(30)	×	20,000	=	(600,000)	Annual incremental expense
Contribution margin	10	×	20,000	=	200,000	Annual incremental contrib. margin
Less tax at 40%					80,000	
Net-of-tax contribution margin					120,000	
PV of annuity for 5 years					× 3.791	
Discounted net-of-tax contribution margin					$454,920	

Choices 'a', 'b', and 'c' are incorrect based on the above Explanation:.

Question 7

Question Type: MultipleChoice

Which one of the following provides a spontaneous source of financing for a firm?

Options:

A- Accounts payable.
B- Accounts receivable.
C- Debentures.
D- Preferred stock.

Answer:

A

Explanation:

Choice 'a' is correct. Accounts payable provide a spontaneous source of financing for a firm.

Choice 'b' is incorrect. Accounts receivable take time to factor.

Choices 'c' and 'd' are incorrect.

Each of the following take time to issue:

C Debentures.

D Preferred stock.

Question 8

Question Type: MultipleChoice

The following table contains Emerald Corp.'s quarterly revenues, in thousands, for the past three years. During that time, there were no major changes to Emerald's selling strategies and total capital investment.

Year	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.
Year 1	500	500	550	750
Year 2	525	550	600	800
Year 3	550	525	625	850

Which option best statements best describes the likely cause of the fluctuations in Emerald's revenues and the best response to those fluctuations?

Options:

A- The fluctuations are from changes in the economy, and Emerald should examine its cost structure for potential changes.
B- The fluctuations are from changes in the economy, and Emerald should manage its inventories and cash flow to match the cycle.
C- The fluctuations are from the seasonal demand for Emerald's products, and Emerald should examine its cost structure for potential changes.
D- The fluctuations are from the seasonal demand for Emerald's products, and Emerald should manage its inventories and cash flow to match the cycle.

Answer:

D

Explanation:

Choice 'd' is correct. Relatively stable demand over a three year period in each of the first three quarters of the year followed by an increase of between 40 and 50 percent in the final quarter of the year over average sales in the first three quarters in each of the three years presented is indicative of seasonal fluctuations in demand for Emerald's product that would require appropriate inventory management.

Choice 'a' is incorrect. The consistent volume levels and fluctuation percentages displayed for the activity in each quarter for each year are indicative of changes in seasonal demand rather than changes in the economy generally.

Choice 'b' is incorrect. The consistent volume levels and fluctuation percentages displayed for the activity in each quarter for each year are indicative of changes in seasonal demand rather than changes in the economy generally.

Choice 'c' is incorrect. Relatively stable demand over a three year period in each of the first three quarters of the year followed by an increase of between 40 and 50 percent in the final quarter of the year over average sales in the first three quarters in each of the three years presented is indicative of seasonal fluctuations in demand for Emerald's product. The company should be more attentive to the timing of inventory purchases to meet demand, however, rather than the company's overall cost structure.

Market Influences on Business Strategies

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