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Question 1

Question Type: MultipleChoice

The selection of the denominator in the return on investment (ROI) formula is critical to the measure's effectiveness. Which denominator is criticized because it combines the effects of operating decisions made at one level of the organization with financing decisions made at another organization level?

Options:

- A- Total assets available.
- B- Total assets employed.
- C- Working capital plus other assets.
- D- Shareholder's equity.

Answer:

D

Explanation:

Choice 'd' is correct. Shareholders' equity is the ROI denominator that has been criticized because it combines the effects of operating decisions made at another organization level.

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

Question 2

Question Type: MultipleChoice

Of the following items, the one item that would not be considered in evaluating the adequacy of the budgeted annual operating income for a company is:

Options:

- A- Return on assets.
- B- Long-range profit objectives.
- C- Industry average for earnings on sales.
- D- Internal rate of return.

Answer:

D

Explanation:

Choice 'd' is correct. In evaluating the adequacy of the budgeted annual operating income, you would not use the internal rate of return calculation. The internal rate of return is used for capital budgeting.

Choices 'a', 'b', and 'c' are incorrect. Return on assets, long range profit objectives, industry average for earnings on sales, and earnings per share [not mentioned as an option] are all measures for evaluating the adequacy of the budgeted annual operating income.

Question 3

Question Type: MultipleChoice

Limitations of the information provided by total asset turnover include:

Options:

A- A good measure for trend analysis of a particular company, but variable ways of calculating cost of goods sold limit its usefulness for

comparative analysis.

B- The calculation can be affected by varying accounting assumptions, which affect the calculation of net income.

C- Because of differing costs of capital, the measure cannot be effectively used for comparative analysis.

D- When making the calculation, total assets may need to be refined by the elimination of assets that do not relate to sales as the inclusion of these items could distort the measure.

Answer:

D

Explanation:

Choice 'd' is correct. When calculating the turnover, total assets may need to be refined by the elimination of assets that do not relate to sales as the inclusion of these items could distort the measure.

Choice 'a' is incorrect. This option pertains to gross profit margin.

Choice 'b' is incorrect. This option pertains to return on the investment in assets.

Choice 'c' is incorrect. This option pertains to residual income.

Question 4

Question Type: MultipleChoice

Return on assets:

Options:

- A-** Is a measure of profitability and indicates how much is left of each sales dollar to cover operating expenses and profit.
- B-** Is a profitability measure and can be used to evaluate the efficiency of asset usage and management, and the effectiveness of business strategies to create profits.
- C-** Measures the amount of operating income earned above the imputed cost of capital for the operating unit. If the measure is positive, returns exceed the cost of financing the operating unit.
- D-** Measures asset activity and the ability of the firm to generate sales through the use of assets. Generally, the more sales dollars generated per dollar of assets used, the better the net income of an entity.

Answer:

B

Explanation:

Choice 'b' is correct. Return on assets is a profitability measure and can be used to evaluate the efficiency of asset usage and management, and the effectiveness of business strategies to create profits.

Choice 'a' is incorrect. This option defines gross profit margin.

Choice 'c' is incorrect. This option defines residual income.

Choice 'd' is incorrect. This option defines total asset turnover.

Question 5

Question Type: MultipleChoice

In planning and controlling capital expenditures, the most logical sequence is to begin with:

Options:

- A- Analyzing capital addition proposals.
- B- Analyzing and evaluating all promising alternatives.
- C- Identifying capital addition projects and other capital needs.
- D- Developing capital budgets.

Answer:

C

Explanation:

Choice 'c' is correct. The most logical sequence in planning and controlling capital expenditures is to begin with identifying capital addition projects and other capital needs.

Choice 'a' is incorrect. Analyzing capital addition proposals omits other capital needs.

Choice 'b' is incorrect. Analyzing and evaluating all promising alternatives is beyond the scope of planning and controlling capital expenditures.

Choice 'd' is incorrect. Developing capital budgets is the same as planning and controlling capital expenditures.

Question 6

Question Type: MultipleChoice

A company has total costs of \$100,000, of which 40% is variable costs. What is the operating leverage?

Options:

A- .40

B- .60

C- 1.5

D- 2.5

Answer:

C

Explanation:

Choice 'c' is correct. A shortcut computation for operating leverage is the ratio of fixed costs to variable costs. If total cost is \$100,000 and variable cost is 40% of total costs (or \$40,000), then fixed costs must be 60% (or \$60,000). Operating leverage is then calculated as follows:

$$\$60,000/\$40,000 = 1.5$$

Choice 'a' is incorrect. .4 is obtained by dividing \$100,000 into the variable cost of \$40,000.

Choice 'b' is incorrect. .6 is obtained by dividing total costs into fixed costs.

Choice 'd' is incorrect. 2.5 is obtained by dividing total costs by variable costs.

Question 7

Question Type: MultipleChoice

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:

Options:

A- 10.0 percent.

B- 20.0 percent.

C- 25.0 percent.

D- 40.0 percent.

Answer:

C

Explanation:

Choice 'c' is correct.

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

Question 8

Question Type: MultipleChoice

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 B is:

Options:

A- 10.5 percent.

B- 12.0 percent.

C- 13.2 percent.

D- 21.0 percent.

Answer:

C

Explanation:

Choice 'c' is correct.

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

Question 9

Question Type: MultipleChoice

CyberAge outlet, a relatively new store, is a cafe that offers customers the opportunity to browse the Internet or play computer games at their tables while they drink coffee. The customer pays a fee based on the amount of time spent signed on to the computer. The store also sells books, tee shirts, and computer accessories. CyberAge has been paying all of its bills on the last day of the payment period, thus forfeiting all supplier discounts. Shown below are data on CyberAge's two major vendors, including average monthly purchases and credit terms.

<u>Vendor</u>	<u>Average Monthly Purchases</u>	<u>Credit Terms</u>
Web Master	\$25,000	2/10, net 30
Softidee	50,000	5/10, net 90

Should CyberAge use trade credit and continue paying at the end of the credit period?

Options:

- A-** No, if the cost of alternative short-term financing is more.
- B-** Yes, if the firm's weighted average cost of capital is equal to its weighted average trade credit.
- C-** No, if the cost of alternative long-term financing is more.
- D-** Yes, if the cost of alternative short-term financing is more.

Answer:

D

Explanation:

Choice 'd' is correct. Yes, CyberAge should use trade credit and continue paying at the end of the credit period, if the cost of alternative short-term financing is more.

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

Question 10

Question Type: MultipleChoice

CyberAge outlet, a relatively new store, is a cafe that offers customers the opportunity to browse the Internet or play computer games at their tables while they drink coffee. The customer pays a fee based on the amount of time spent signed on to the computer. The store also sells books, tee shirts, and computer accessories. CyberAge has been paying all of its bills on the last day of the payment period, thus forfeiting all supplier discounts. Shown below are data on CyberAge's two major vendors, including average monthly purchases and credit terms.

<u>Vendor</u>	<u>Average Monthly Purchases</u>	<u>Credit Terms</u>
Web Master	\$25,000	2/10, net 30
Softidee	50,000	5/10, net 90

Assuming a 360-day year and that CyberAge continues paying on the last day of the credit period, the company's weighted annual interest rate for trade credit (ignoring the effects of compounding) for these two vendors is:

Options:

- A- 27.0 percent.
- B- 28.0 percent.
- C- 29.3 percent.
- D- 30.2 percent.

Answer:

B

Explanation:

Choice 'b' is correct. 28% weighted annual interest rate.

This question pertains to a complex computation of effective rates on lost discounts for multiple terms and multiple balances. The computation of the annual percentage cost of the lost discount is equal to the effective rate of interest for the period (for example 2/10, net 30 is 2% interest charge/ 98% proceeds) times the number of times this period occurs in a year (for example 2/10, net 20 is 360 days per year divided by 20 day period during which the lost discount is used or 18 times). Extension of this logic to the referenced question involves allocating the computed annual rates to the relative balances of the outstanding payables as follows:

Question 11

Question Type: MultipleChoice

Which one of the following statements about trade credit is correct? Trade credit is:

Options:

- A- Not an important source of financing for small firms.
- B- A source of long-term financing to the seller.
- C- Subject to risk of buyer default.
- D- Usually an inexpensive source of external financing.

Answer:

C

Explanation:

Choice 'c' is correct. Trade credit is subject to risk of buyer default.

Choice 'a' is incorrect. Trade credit is an important source of financing for small firms.

Choice 'b' is incorrect. Trade credit is not a source of long-term financing to the seller.

Choice 'd' is incorrect. Trade credit is usually an expensive source of external financing.

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