



## **Free Questions for CPA-Business by certscare**

**Shared by Walsh on 24-05-2024**

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# Question 1

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**Question Type:** MultipleChoice

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A firm has daily cash receipts of \$100,000. A bank has offered to reduce the collection time on the firm's deposits by two days for a monthly fee of \$500. If money market rates are expected to average 6 percent during the year, the net annual benefit (loss) from having this service is:

**Options:**

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**A-** \$3,000

**B-** \$12,000

**C-** \$6,000

**D-** \$(6,000)

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. \$6,000 net annual benefit from using a lockbox system.

Daily Cash Receipts	\$100,000/Day
Days Accelerated	× <u>2</u> Days
Increased Cash Receipts	\$200,000
Annual Interest Rate	× <u>6%</u>
Marginal Revenue	12,000
Monthly Lockbox Fee \$500 × 12 =	<u>(6,000)</u>
Net Annual Benefit From Using Lockbox System	<u>\$ 6,000</u>

## Question 2

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**Question Type:** MultipleChoice

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If a firm increases its cash balance by issuing additional shares of common stock, working capital:

**Options:**

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- A- Remains unchanged and the current ratio remains unchanged.
- B- Increases and the current ratio remains unchanged.
- C- Increases and the current ratio decreases.
- D- Increases and the current ratio increases.

**Answer:**

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D

**Explanation:**

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Choice 'd' is correct. If a firm increases its cash balance by issuing additional shares of common stock, working capital increases and the current ratio increases.

Illustration	Before		Stock Sale	=	After
Current Assets	300	+	100	=	400
Current Liabilities	<u>100</u>		<u>    </u>		<u>100</u>
Working Capital	<u>200</u>	+	<u>100</u>	=	<u>300</u>
Current Ratio	3 To 1				4 To 1
Equity	<u>100</u>	+	<u>100</u>	=	<u>200</u>

## Question 3

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**Question Type:** MultipleChoice

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Which one of the following would increase the working capital of a firm?

### Options:

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- A- Purchase of a new plant financed by a 20-year mortgage.
- B- Cash collection of accounts receivable.
- C- Payment of a 20-year mortgage payable with cash.
- D- Refinancing a short-term note payable with a two-year note payable.

### Answer:

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D

### Explanation:

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Choice 'd' is correct. Refinancing a short-term note payable with a two-year note payable would increase the working capital of a firm.

<u>Journal Entry</u>	<u>Dr</u>	<u>Cr</u>
Short-term N/P (working capital)	xx	
Long-term note payable		xx

Choice 'a' is incorrect. The purchase of a new plant (fixed asset) financed by a 20-year mortgage (longterm debt with a one-year current portion) would reduce working capital because current liabilities would be increased.

Choice 'b' is incorrect. The cash collection of accounts receivable has no effect on working capital-cash increases by the amount that A/R decreases.

Choice 'c' is incorrect. The payment of a 20-year mortgage payable (long-term debt) would reduce cash and have no effect on current liabilities, thereby reducing working capital.

## Question 4

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**Question Type:** MultipleChoice

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Net working capital is the difference between:

**Options:**

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- A- Current assets and current liabilities.
- B- Fixed assets and fixed liabilities.
- C- Total assets and total liabilities.
- D- Total assets and current liabilities.

**Answer:**

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A

**Explanation:**

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Choice 'a' is correct. Current assets minus current liabilities equals net working capital.

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

## Question 5

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**Question Type:** MultipleChoice

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When a firm finances each asset with a financial instrument of the same approximate maturity as the life of the asset, it is applying:

### Options:

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- A- Working capital management.
- B- Return maximization.
- C- Financial leverage.
- D- Operating leverage.

### Answer:

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A

### Explanation:

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Choice 'a' is correct. Appropriate working capital management matches the maturity life of each asset with the length of the financial instrument used to finance that asset.

Choice 'b' is incorrect. Return maximization seeks to obtain the optimal return rate by asset utilization. It is not necessarily related to the maturity of the asset.

Choice 'c' is incorrect. Financial leverage is the amount of debt used to finance an asset. Higher leverage equals more debt. It is unrelated to the maturity life of an asset.

Choice 'd' is incorrect. Operating leverage is the degree that fixed costs are used in the production process. Operating leverage is unrelated to the methods used to finance assets.



## Question 6

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**Question Type:** MultipleChoice

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Assume the following facts about Martin Corporation:

- \* The long-term debt was originally issued at par (\$1,000/bond) and is currently trading at \$1,250 per bond.
- \* Martin Corporation can now issue debt at 150 basis points over U.S. treasury bonds.
- \* The current risk-free rate (U.S. treasury bonds) is 7 percent.
- \* Martin's common stock is currently selling at \$32 per share.
- \* The expected market return is currently 15 percent.
- \* The beta value for Martin is 1.25.
- \* Martin's effective corporate income tax rate is 40 percent.

Based on these assumptions, what is the current net after-tax cost of debt for Martin Corporation?

**Options:**

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A- 5.5 percent.

B- 7.0 percent.

C- 5.1 percent.

D- 8.5 percent.

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. 5.1 percent current net cost of debt.

The fact pattern states that debt can be currently secured at 150 basis points above the Treasury bond rate. A basis point is equal to 1/100 of 1% (1% of 1%).

Applying the decimals it's:

150 basis points x 1/100 of 1% (or .0001)

this yields .015 or 1.5%

Add the additional basis points converted to percentage (1.5%) to the Treasury bond rate of 7% to arrive at the pre-tax debt cost of 8.5%. Apply 1 - tax rate to arrive at the current net cost of debt as follows:

	<u>Decimal</u>	<u>%</u>
Basis points over U.S. Treasury bond rate	150	150
One basis point = 1/100 of 1%	x <u>.0001</u>	<u>.01%</u>
	.015	1.5%
Current risk-free rate (U.S. Treasury bonds = baseline)	<u>.070</u>	<u>7.0</u>
Pretax cost	.085	8.5
Income tax at 40%	<u>.034</u>	<u>3.4</u>
Net (after-tax) cost of debt (60%)	<u>.051</u>	<u>5.1%</u>

## Question 7

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### Question Type: MultipleChoice

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DQZ Telecom is considering a project for the coming year, which will cost \$50 million. DQZ plans to use the following combination of debt and equity to finance the investment.

\* Issue \$15 million of 20-year bonds at a price of 101, with a coupon rate of 8 percent, and flotation costs of 2 percent of par.

\* Use \$35 million of funds generated from earnings.

The equity market is expected to earn 12 percent. U.S. treasury bonds are currently yielding 5 percent.

The beta coefficient for DQZ is estimated to be .60. DQZ is subject to an effective corporate income tax rate of 40 percent.

The before-tax cost of DQZ's planned debt financing, net of flotation costs, in the first year is:

**Options:**

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A- 11.80 percent.

B- 8.08 percent.

C- 10.00 percent.

D- 7.92 percent.

**Answer:**

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B

**Explanation:**

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Choice 'b' is correct. 8.08 percent before-tax cost of debt financing, net of flotation costs.

$$k_{dt} = \frac{1 + (PV - Nd)/n}{(Nd + PV)/2}$$

$$k_{dt} = \frac{\$1,200,000 + [(\$15,000,000 - \$14,850,000)/20]}{(\$14,850,000 + \$15,000,000)/2}$$

$$k_{dt} = \frac{\$1,200,000 + \$7,500}{\$14,925,000}$$

$$k_{dt} = 8.09\% \text{ (and with rounding, is 8.08\%)}$$

#### Alternate Computation

$$\frac{8\% \text{ Interest rate}}{101\% \text{ Sales price} - 2\% \text{ Flotation costs}} = \frac{8}{99} = 8.08\% \text{ Before-tax cost}$$

## Question 8

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### Question Type: MultipleChoice

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#### Additional Data

- \* The long-term debt was originally issued at par (\$1,000/bond) and is currently trading at \$1,250 per bond.
- \* Martin Corporation can now issue debt at 150 basis points over U.S. treasury bonds.

- \* The current risk-free rate (U.S. treasury bonds) is 7 percent.
- \* Martin's common stock is currently selling at \$32 per share.
- \* The expected market return is currently 15 percent.
- \* The beta value for Martin is 1.25.
- \* Martin's effective corporate income tax rate is 40 percent.

Using the Capital Asset Pricing Model (CAPM), Corporation's current cost of common equity is:

**Options:**

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- A- 10.00 percent.
- B- 15.00 percent.
- C- 17.00 percent.
- D- 18.75 percent.

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. 17.00 percent. Using the CAPM model, Martin's current cost of common equity would be:

Cost of equity = Capital risk free rate + Beta (market rate risk free rate)

Cost of equity = 7% + 1.25 (15% 7%)

Cost of equity = 7% + 1.25 (8%)

Cost of equity = 7% + 10%

Cost of equity = 17%

## Question 9

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**Question Type:** MultipleChoice

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A preferred stock is sold for \$101 per share, has a face value of \$100 per share, underwriting fees of \$5 per share, and annual dividends of \$10 per share. If the tax rate is 40 percent, the cost of funds (capital) for the preferred stock is:

**Options:**

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- A- 4.2 percent.
- B- 6.2 percent.
- C- 10.0 percent.
- D- 10.4 percent.

**Answer:**

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D

**Explanation:**

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Choice 'd' is correct. The stock is issued for a net of \$96 per share (\$101 less \$5 underwriting fee). Because preferred stock dividends are not tax deductible, the cost to the company is \$10/share (the tax rate is a distractor). Therefore, the cost of the preferred stock is:

$$\frac{\$10}{\$96} = 10.4\% \text{ D}$$

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



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