BUSINESS-ENVIRONMENT-AND-CONCEPTS[Q&As]

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QUESTION 1

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.

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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.

Present	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 overall discounted cash flow impact of Gunning Industries\\' working capital investment for the new production machine would be:

A. $(7,959)

B. $(10,680)

C. $(13,265)

D. $(35,000)

Correct Answer: C

Choice "c" is correct. $(13,265) overall discounted cash flow impact of working capital investment.

Period	Cash Flow		PV Interest Factor		PV of Cash Flow	
0	35,000	×	1,000	=	(35,000)	PV of cash outflow (increase in working capital) in year 1
5	35,000	×	(.621)	=	21,735	PV of cash inflow release of working capital) in year 5
					(13,265)	Overall discounted cash flow impact of working capital investment

QUESTION 2

If a retailer\\'s terms of trade are 3/10, net 45 with a particular supplier, what is the cost on an annual basis of not taking the discount? Assume a 360-day year.

A. 37.11 percent.

B. 36.00 percent.

C. 24.74 percent.

D. 31.81 percent.

Correct Answer: D

$$\frac{360}{(\text{Total pay period} - \text{Discount period})} \times \frac{\text{Discount }\%}{(100\% - \text{Discount }\%)} =$$

$$\frac{360}{(45-10)} \times \frac{3\%}{100\% - 3\%} = 31.81\%$$

Choice "d" is correct. 31.81% annual cost of not taking the discount. Choices "a", "b", and "c" are incorrect, per the above calculation.

QUESTION 3

Noll Corp. and Orr Corp. are contemplating entering into an unincorporated joint venture. Such a joint venture:

A. Will be treated as a partnership in most important legal respects.

B. Must be dissolved upon the completion of a single undertaking.

C. Will be treated as an association for federal income tax purposes and taxed at the prevailing corporate rates.

D. Must file a certificate of limited partnership with the appropriate state agency.

Correct Answer: A

Choice "a" is correct. The legal requirements, the consequences, the advantages, and disadvantages of

forming a joint venture generally are identical to those of a general partnership. Joint ventures are treated

as a partnership in most important legal aspects.

Choice "b" is incorrect. A joint venture need not be dissolved upon the completion of a single undertaking.

Joint ventures may be formed for a single transaction or for a related series of transactions.

Choice "c" is incorrect because a joint venture would be taxed like a partnership, not a corporation.

Choice "d" is incorrect because a joint venture, like a partnership, may be formed without filing with the

state.

QUESTION 4

Generally, a corporation\\'s articles of incorporation must include all of the following, except the:

A. Name of the corporation\\'s registered agent.

B. Name of each incorporator.

C. Number of authorized shares.

D. Quorum requirements.

Correct Answer: D

Choice "d" is correct. A corporation\\'s articles of incorporation need not contain any information regarding quorum requirements. Choices "a", "b", and "c" are incorrect because under the Revised Model Business Corporations Act a corporation\\'s articles of incorporation must include:

(1)

The name of the corporation,

(2)

The name and address of the corporation\\'s registered agent,

(3)

The names and addresses of each of the incorporators, and

(4)

The number of shares authorized to be issued.

QUESTION 5

The benefits of debt financing over equity financing are likely to be highest in which of the following situations?

A. High marginal tax rates and few noninterest tax benefits.

B. Low marginal tax rates and few noninterest tax benefits.

C. High marginal tax rates and many noninterest tax benefits.

D. Low marginal tax rates and many noninterest tax benefits.

Correct Answer: A

Choice "a" is correct. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high (because interest on debt is deductible for tax purposes) and if there are few noninterest tax benefits (because there is little or no reason to depart from debt financing). Choice "b" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high, not low (because interest on debt is deductible for tax purposes), and if there are few noninterest tax benefits. Choice "c" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high (because interest on debt is deductible for tax purposes) and if there are few, not many, noninterest tax benefits. Choice "d" is incorrect. The benefits of debt financing over equity financing are likely to be highest if marginal tax rates are high, not low (because interest on debt is deductible for tax purposes), and if there are few, not many, noninterest tax benefits.