MANAGEMENT ADVISORY SERVICES

WORKING CAPITAL FINANCE

THEORY

1. Compared to other firms in the industry, a company that maintains a conservative working capital policy will tend to have a

    a. Greater percentage of short-term financing.
    b. Greater risk of needing to sell current assets to repay debt.
    c. Higher ratio of current assets to fixed assets.
    d. Higher total asset turnover.

2. A firm following an aggressive working capital strategy would

    a. Hold substantial amount of fixed assets.
    b. Minimize the amount of short-term borrowing.
    c. Finance fluctuating assets with long-term financing.
    d. Minimize the amount of funds held in very liquid assets.

3. The working capital financing policy that subjects the firm to the greatest risk of being unable to meet the firm's maturing obligations is the policy that finances

    a. Fluctuating current assets with long-term debt.
    b. Permanent current assets with long-term debt.
    c. Permanent current assets with short-term debt.
    d. Fluctuating current assets with short-term debt.

4. Determining the appropriate level of working capital for a firm requires

    a. Evaluating the risks associated with various levels of fixed assets and the types of debt used to finance these assets.
    b. Changing the capital structure and dividend policy for the firm.
    c. Maintaining short-term debt at the lowest possible level because it is ordinarily more expensive than long term debt.
    d. Offsetting the profitability of current assets and current liabilities against the probability of technical insolvency.
    e. Maintaining a high proportion of liquid assets to total assets in order to maximize the return on total investments.

5. Starrs Company has current assets of $300,000 and current liabilities of $200,000. Starrs could increase its working capital by the

    a. Prepayment of $50,000 of next year's rent.

- **b. Refinancing of $50,000 of short-term debt with long-term debt.**
- c. Purchase of $50,000 of temporary investments for cash.
- d. Collection of $50,000 of accounts receivable.

6. A lock-box system

- a. Reduces the need for compensating balances.
- b. Provides security for late night deposits.
- c. Reduces the risk of having checks lost in the mail.
- **d. Accelerates the inflow of funds.**

7. Ignoring cost and other effects on the firm, which of the following measures would tend to reduce the cash conversion cycle?

- a. Maintain the level of receivables as sales decrease.
- b. Buy more raw materials to take advantage of price breaks.
- c. Take discounts when offered.
- **d. Forgo discounts that are currently being taken.**

8. Which of the following is not a major function in cash management?

a. Cash flow control	c. **Maximizing sales**
b. Cash surplus investment	d. Obtaining financing services

9. A precautionary motive for holding excess cash is

- a. To enable a company to meet the cash demands from the normal flow of business activity.
- b. To enable a company to avail itself of a special inventory purchase before prices rise to higher levels.
- **c. To enable a company to have cash to meet emergencies that may arise periodically.**
- d. To avoid having to use the various types of lending arrangements available to cover projected cash deficits.

10. The amount of cash that a firm keeps on hand in order to take advantage of any bargain purchases that may arise is referred to as its

a. Transactions balance.	c. Precautionary balance.
b. Compensating balance.	d. **Speculative balance.**

11. All of the following are valid reasons for a business to hold cash and marketable securities except to

- a. Satisfy compensating balance requirements.

b. Maintain adequate cash needed for transactions.
c. Meet future needs.
d. Earn maximum returns on investment assets.

12. Which of the following actions would not be consistent with good management?

a. Increased synchronization of cash flows.
b. Minimize the use of float.

c. Maintaining an average cash balance equal to that required as a compensating balance or that which minimizes total cost.
d. Use of checks and drafts in disbursing funds.

13. When managing cash and short-term investments, a corporate treasurer is primarily concerned with

a. Maximizing rate of return.
b. Minimizing taxes.
c. Investing in Treasury bonds since they have no default risk.
d. Liquidity and safety.

14. The economic order quantity (EOQ) formula can be adapted in order for a firm to determine the optimal mix between cash and marketable securities. The EOQ model assumes all of the following except

a. The cost of a transaction is independent of the dollar amount of the transaction and interest rates are constant over the short run.
b. An opportunity cost is associated with holding cash, beginning with the first dollar.
c. The total demand for cash is known with certainty.
d. Cash flow requirements are random.

15. The following are desirable in cash management except:

a. Cash is collected at the earliest time possible.
b. Most sales are on cash basis and receivables are aged “current”
c. Post-dated checks are not deposited on time upon maturity.

d. All sales are properly receipted and promptly deposited intact.

16. The one item listed below that would warrant the least amount of consideration in credit and collection policy decisions is the

a. Quality of accounts accepted.
b. **Quantity discount given.**
c. Cash discount given.
d. Level of collection expenditures.

17. Which of the following investments is not likely to be a proper investment for temporary idle cash?

    a. Initial public offering of an established profitable conglomerate.
    b. Commercial paper.
    c. Treasury bills.
    d. Treasury bonds due within one year.

18. The goal of credit policy is to

    a. Extend credit to the point where marginal profits equal marginal costs.
    b. Minimize bad debt losses.
    c. Minimize collection expenses.
    d. Maximize sales.

19. It is held that the level of accounts receivable that the firm has or holds reflects both the volume of a firm's sales on account and a firm's credit policies. Which one of the following items is not considered as part of the firm's credit policies?

    a. The minimum risk group to which credit should be extended.
    b. The extent (in terms of money) to which a firm will go to collect an account.
    c. The length of time for which credit is extended.
    d. The size of the discount that will be offered.

20. In assessing the loan value of inventory, a banker will normally be concerned about the portion of inventory that is work-in-process because

    a. WIP inventory is relatively easy to sell because it does not represent a raw material or a finished product.
    b. WIP inventory usually has the highest loan value of the different inventory types.
    c. WIP generally has the lowest marketability of the various types of inventories.
    d. WIP represents a lower investment by a corporation as opposed to other types of inventories.

21. When a company analyzes credit applicants and increases the quality of the accounts rejected, the company is attempting to

    a. Maximize sales.
    b. Increase bad-debt losses.
    c. Increase the average collection period.
    d. Maximize profits.

22. A high turnover of accounts receivable, which implies a very short days-sales outstanding, could indicate that the firm

a. Has a relaxed (lenient) credit policy.
b. Offers small discounts.
c. Uses a lockbox system, synchronizes cash flows, and has short credit terms.
d. Has an inefficient credit and collection department.

23. Accounts receivable turnover will normally decrease as a result of

a. The write-off of an uncollectible account (assume the use of the allowance for doubtful accounts method).
b. A significant sales volume decrease near the end of the accounting period.
c. An increase in cash sales in proportion to credit sales.
d. A change in credit policy to lengthen the period for cash discounts.

24. The credit and collection policy of Amargo Co. provides for the imposition of credit block when the credit line is exceeded and/or the account is past due. During the month, because of the campaign to achieve volume targets, the general manager has waived the credit block policy in a number of instances involving big volume accounts. The likely effect of this move is

a. Deterioration of aging of receivables only.
b. Increase in the level of receivables only.
c. Deterioration of aging and increase in the level of receivables.
d. Decrease in collections during the month the move was done.

25. An increase in sales resulting from an increased cash discount for prompt payment would be expected to cause

a. An increase in the operating cycle.
b. An increase in the average collection period.
c. A decrease in the cash conversion cycle.
d. A decrease in purchase discounts taken.

26. If a firm had been extending trade credit on a 2/10, net/30 basis, what change would be expected on the balance sheet of its customer if the firm went to a net cash 30 policy?

a. Increased payables and increased bank loan.
b. Increased receivables.
c. Decreased receivables.
d. Decrease in cash.

27. The level of accounts receivable will most likely increase as

    a. Cash sales increase and number of says sales.
    b. Credit limits are expanded, credit sales increase, and credit terms remain the same.
    c. Credit limits are expanded, cash sales increase, and aging of the receivables is improving.
    d. Cash sales increase, current receivables ratio to past due increases, credit limits remain the same.

28. A change in credit policy has caused an increase in sales, an increase in discounts taken, a reduction of the investment in accounts receivable, and a reduction in the number of doubtful accounts. Based on this information, we know that:

    a. Net profit has increased.
    b. The average collection period has decreased.
    c. Gross profit has declined.
    d. The size of the discount offered has decreased.

29. A strict credit and collection policy is in place in Star Co. As Finance Director you are asked to advise on the propriety of relaxing the credit standards in view of stiff competition in the market. Your advise will be favorable if

    a. The competitor will do the same thing to prevent lost sales.
    b. There is a decrease in the distribution level of your product, and a more aggressive stance in necessary to retain market share.
    c. The projected margin from increased sales will exceed the cost of carrying the incremental receivables.
    d. The account receivable level is improving, so the company can afford the carrying cost of receivables.

30. Merkle, Inc. has a temporary need for funds. Management is trying to decide between not taking discounts from one of their three biggest suppliers, or a 14.75% per annum renewable discount loan from its bank for 3 months. The suppliers' terms are as follows:

Fort Co.	1/10, net 30
Riley Manufacturing Co.	2/15, net 60
Shad, Inc. 3/15,	net 90

Using a 360-day year, the cheapest source of short-term financing in this situation is

    a. The bank.
    b. Fort Co.
    c. Riley Manufacturing Co.
    d. Shad, Inc.

31. A company obtaining short-term financing with trade credit will pay a higher percentage financing cost, everything else being equal, when

   a. The discount percentage is lower.
   b. The items purchased have a higher price.
   c. The items purchased have a lower price.
   d. The supplier offers a longer discount period.

32. Enert, Inc.'s current capital structure is shown below. This structure is optimal, and the company wishes to maintain it.

Debt	25%
Preferred equity	5%
Common equity	70%

Enert's management is planning to build a $75 million facility that will be financed according to this desired capital structure. Currently, $15 million of cash is available for capital expansion. The percentage of the $75 million that will come from a new issue of common shares is

a. 50.00%. b. 56.25%. c. 70.00%. **d. 56.00%.**

33. Bobo LLC's has an asset base of $1 million. After a dividend payment of $40,000, Bobo added $50,000 to retained earnings. What is Bobo's internal growth rate?

a. 1% b. 4% **c. 5%** d. 9%

34. It is the policy of Franz Corp. that the current ratio cannot fall below 1.5 to 1.0. Its current liabilities are P400,000 and the present current ratio is 2 to 1. How much is the maximum level of new short-term loans it can secure without violating the policy?

a. P400,000 b. P300,000 c. P266,667 d. P800,000

35. Wildthing Amusement Company's total assets fluctuate between $320,000 and $410,000, while its fixed assets remain constant at $260,000. If the firm follows a maturity matching or moderate working capital financing policy, what is the likely level of its long-term financing?

a. $ 90,000 b. $260,000 d. $410,000 **e. $320,000**

36. Jarrett Enterprises is considering whether to pursue a restricted or relaxed current asset investment policy. The firm's annual sales are $400,000; its fixed

assets are $100,000; debt and equity are each 50 percent of total assets. EBIT is $36,000, the interest rate on the firm's debt is 10 percent, and the firm's tax rate is 40 percent. With a restricted policy, current assets will be 15 percent of sales. Under a relaxed policy, current assets will be 25 percent of sales. What is the *difference* in the projected ROEs between the restricted and relaxed policies?

a. 1.6% b. 6.2% c. 3.8% **d. 5.4%**

37. Bully Corporation purchases raw materials on July 1. It converts the raw materials into inventory by September 30. However, Bully pays for the materials on July 20. On October 31, it sells the finished goods inventory. Then, the firm collects cash from the sale 1 month later on November 30. If this sequence accurately represents the average working capital cycle, what is the firm's cash conversion cycle in days?

a. 92 days. **b. 133 days.** c. 123 days. d. 153 days.

38. Jumpdisk Company writes checks averaging $15,000 a day, and it takes five days for these checks to clear. The firm also receives checks in the amount of $17,000 per day, but the firm loses three days while its receipts are being deposited and cleared. What is the firm's net float in dollars?

a. $126,000 b. $ 75,000 c. $ 32,000 **d. $ 24,000**

39. What is the opportunity cost of keeping a cash balance of $2 million, if the daily interest rate is 0.02% and the average transaction cost of investing money overnight is $50?

A. $50 **B. $350** C. $400 D. $40,000

40. Hakuna Inc. sells on terms of 3/10, net 30 days. Gross sales for the year are P2,400,000 and the collections department estimates that 30% of the customers pay on the 10th day and take discounts; 40% pay on the 30th day; and the remaining 30% pay, on the average, 40 days after the purchase. Assuming 360 days per year, what is the average collection period.

a. 40 days. b. 15 days. c. 20 days **d. 27 days.**

Questions 41 and 42 are based on the following information.

A company has a 10% cost of borrowing and incurs fixed costs of $500 for obtaining a loan. It has stable, predictable cash flows, and the estimated total amount of net new cash needed for transactions for the year is $175,000. The company does not hold safety stocks of cash.

41. When the average cash balance of the company is higher, the <List A> the cash balance is <List B>.

	List A	List B
a.	**Opportunity cost of holding**	**Higher**
b.	Total transactions costs associated with obtaining	Higher
c.	Opportunity cost of holding	Lower
d.	Total costs of holding	Lower

42. If the average cash balance for the company during the year is $20,916.50, the opportunity cost of holding cash for the year will be

a. **$2,091.65** b. $4,183.30 c. $8,750.00 d. $17,500.00

43. CMR is a retail mail order firm that currently uses a central collection system that requires all checks to be sent to its Boston headquarters. An average of 5 days is required for mailed checks to be received, 4 days for CMR to process them and 1½ days for the checks to clear through its bank. A proposed lockbox system would reduce the mail and process time to 3 days and the check clearing time to 1 day. CMR has an average daily collection of $100,000. If CMR should adopt the lockbox system, its average cash balance would increase by

a. $250,000. b. $400,000. **c. $650,000.** d. $800,000.

44. What are the expected annual savings from a lockbox system that collects 200 checks per day averaging $500 each, and reduces mailing and processing times by 2.0 and 0.5 days, respectively, if the annual interest rate is 6%?

a. $250,000 b. $12,000 c. $6,000 **d. $15,000**

45. A company has daily cash receipts of $150,000. The treasurer of the company has investigated a lock box service whereby the bank that offers this service will reduce the company’s collection time by four days at a monthly fee of $2,500. If money market rates average 4% during the year, the additional annual income (loss) from using the lock box service would be

a. $6,000. **b. $(6,000).** c. $12,000. d. $(12,000).

46. A banker has offered to set up and operate a lock box system for your company. Details are given below.

Average number of daily payments	325
Average size of payments	$1,250
Daily interest rate	0.021%
Saving in mailing time	1.3 days
Saving in processing time	0.9 days
Bank charges	$0.30

Estimate the annual savings. Assume 250 processing days per year.

a. $3,273 **b. $22,675** c. $23,500 d. $47,000

47. QRS makes large cash payments averaging P17,000 daily. The company changed from using checks to sight drafts which will permit it to hold unto its cash for one extra day. If QRS can use the extra cash to earn 14% annually, what annual peso return will it earn?

a. P652.10 b. P6,521.00 c. P6.52 **d. P2,380**

48. Sixty percent of Baco's annual sales of $900,000 is on credit. If its year-end receivables turnover is 4.5, what is the average collection period and the year-end receivables, respectively (assume a 365-day year)?

a. **81 days and $120,000.**
c. 73 days and $108,000.
b. 73 days and $120,000.
d. 81 days and $200,000.

49. Best Computers believes that its collection costs could be reduced through modification of collection procedures. This action is expected to result in a lengthening of the average collection period from 30 to 35 days; however, there will be no change in uncollectible accounts, or in total credit sales. Furthermore, the variable cost ratio is 60%, the opportunity cost of a longer collection period is assumed to be negligible, the company's budgeted credit sales for the coming year are $45,000,000, and the required rate of return is 6%. To justify changes in collection procedures, the minimum annual reduction of costs (using a 360-day year and ignoring taxes) must be

a. $375,000 b. $37,500 c. $125,000 **d. $22,500**

Questions 50 and 51 are based on the following information.

Snobiz, Inc. has $2 million invested in Treasury bills yielding 8% per annum; this investment will satisfy the firm's need for funds during the coming year.

50. If it costs $50 to sell these bills, regardless of the amount, how much should be withdrawn at a time?

    A. $50,000 B. $100,000 C. $250,000 D. $500,000

51. If Snobiz, Inc. needs $167,000 a month, how frequently should the CFO sell off Treasury bills?

    a. About every 3 days.
    b. **About every 9 days.**
    c. About every 15 days.
    d. About every 18 days.

52. Ten Q's Inc. has an inventory conversion period of 60 days, a receivable conversion period of 35 days, and a payment cycle of 26 days. If its sales for the period just ended amounted to P972,000, what is the investment in accounts receivable? (Assume 360 days a year.)

    a. P85,200 b. P72,450 **c. P94,500** d. P79,600

53. Simba Corp., whose gross sales amounted to P1,200,000 sold on terms of 3/10, net 30. The collections manager estimated that 30% of the customers pay on the 10th day and take discounts; 40% on the 30th day; and the remaining 30% pay, on the average, 40 days after the purchase. If management would toughen on its collection policy and require that all non-discount customers pay on the 30th day, how much would be the receivables balance?

    a. P60,000 **b. P80,000** c. P70,000 d. Zero

54. Prest Corp. plans to tighten its credit policy. Below is the summary of changes:

	Old	New
Average number of days collection	75	50
Ratio of credit sales to total sales	70%	60%

Projected sales for the coming year is P100 million and it is estimated that the new policy will result in a 5% loss if the new policy is implemented. Assuming a 360-day year, what is the effect of the new policy on accounts receivable?

a. Decrease of P13 million.
b. No change.
c. Decrease of P5 million.
d. Decrease of P 6.67 million.

55. Numero 1 Co.'s budgeted sales for the coming year are P96 million, of which 80% are expected to be credit sales at terms of n/30. The company estimates that a proposed relaxation of credit standards would increase credit sales by 30% and increase the average collection period form 30 days to 45 days. Based on a 360-day year, the proposed relaxation of credit standards would result to an increase in accounts receivable balance of

a. P6,880,000 b. P1,920,000 c. P2,880,000 **d. P6,080,000**

56. Phillips Glass Company buys on terms of 2/15, net 30. It does not take discounts, and it typically pays 30 days after the invoice date. Net purchases amount to $720,000 per year. On average, how much "free" trade credit does Phillips receive during the year? (Assume a 360-day year.)

a. $30,000 b. $40,000 c. $50,000 d. $60,000

57. Slippers Mart has sales of P3 million. Its credit period and average collection period are both 30 days and 1% of its sales end as bad debts. The general manager intends to extend the credit period to 45 days which will increase sales by P300,000. However, bad debts losses on the incremental sales would be 3%. Costs of products and related expenses amount to 40% exclusive of the cost of carrying receivables of 15% and bad debts expenses. Assuming 360 days a year, the change in policy would result to incremental investment in receivables of

a. P24,704. **b. P65,000.** c. P701,573 d. P9,750.

58. The Liberal Sales Co. budgeted sales for the coming year are P30 million of which 80% are expected to be on credit. The company wants to change its credit terms from n/30 to 2/10, n/30. If the new credit terms are adopted, the company estimates that cash discounts would be taken on 40% of the credit sales and the new uncollectible amount would be unchanged. The adoption of the new credit terms would result in expected discount availed of in the coming year of

a. P600,000 b. P288,000 c. P480,000 **d. P192,000**

59. Mr. S. Mart assumed the presidency of Riches Corp. He instituted new policies and with respect to credit policy, below is a summary of relevant information:

	Old Credit Policy	New Credit Policy
Sales	P1,800,000	P1,980,000
Average collection period	30 days	36 days

The company requires a rate of return of 10% and a variable cost ratio of 60%. Using a 360-day year, the pre-tax cost of carrying the additional investment in receivables under the new policy would be

a. P4,800 **b. P2,880** c. P3,000 d. P4,080

60. The Sales Director of Can Can Co. suggests that certain credit terms be modified. He estimates the following effects:

- Sales will increase by at least 20%.
- Accounts receivable turnover will be reduced to 8 times from the present turnover of 10 times.
- Bad debts, now at 1% of sales will increase to 1.5%. Sales before the proposed changes is at P900,000. Variable cost ratio is 55% and desired rate of return is 20%. Fixed expenses amount to P150,000.

Should the company allow the revision of its credit terms?

a. Yes, because income will increase by P68,850.
b. Yes, because losses will be reduced by P78,800.
c. No, because income will be reduced by P13,000.

d. No, because losses will increase by P28,000.

61. Wasting Resource Co. has annual credit sales of P4 million. Its average collection period is 40 days and bad debts are 5% of sales. The credit and collection manager is considering instituting a stricter collection policy, whereby bad debts would be reduced to 2% of total sales, and the average collection period would fall to 30 days. However, sales would also fall by an estimated P500,000 annually. Variable costs are 60% of sales and the cost of carrying receivables is 12%. Assuming a tax rate of 35% and 360 days a year, the incremental change in the profitability of the company if stricter policy would be implemented would be

a. Zero as the positive and negative effects offset each other.
b. A reduction in net income by P70,000.
c. A reduction in net income by P38,350.

d. A reduction in net income by P35,400.

62. Phranklin Pharms Inc. purchases merchandise from a company that gives sales terms of 2/15, net 40. Phranklin Pharms has gross purchases of $800,000 per year. What is the *maximum* amount of costly trade credit Phranklin could get, assuming they abide by the suppliers credit terms? (Assume a 360-day year.)

a. $87,111.20 b. $32,666.70 c. $54,444.50 d. $52,266.67

63. Crest Co. has the opportunity to increase annual sales by P1 million by selling to new riskier customers. It has been estimated that uncollectible expenses would be 15% and collection costs 5%. The manufacturing and selling costs are 70% of sales and corporate tax is 35%. If it pursues this opportunity, the after tax profit will

a. Increase by P35,000.
b. Increase by P97,500.
c. Increase by P65,000.
d. Remain the same.

64. A firm currently sells $500,000 annually with 3% bad debt losses. Two alternative policies are available. Policy A would increase sales by $500,000, but bad debt losses on additional sales would be 8%. Policy B would increase sales by an additional $120,000 over Policy A and bad debt losses on the additional $120,000 of sales would be 15%. The average collection period will remain at 60 days (6 turns per year) no matter the decision made. The profit margin will be 20% of sales and no other expenses will increase. Assume an opportunity cost of 20%. What should the firm do?

a. Make no policy change.
b. Change to only Policy A.
c. Change to Policy B (means also taking Policy A first).
d. All policies lead to the same total firm profit, thus all policies are equal.

65. A firm that often factors its accounts receivable has an agreement with its finance company that requires the firm to maintain a 6% reserve and charges 1% commission on the amount of receivables. The net proceeds would be further reduced by an annual interest charge of 10% on the monies advanced. Assuming a 360-day year, what amount of cash (rounded to the nearest dollar) will the firm receive from the finance company at the time a $100,000 account that is due in 90 days is turned over to the finance company?

a. $93,000
b. $90,000
c. $83,700
d. $90,675

Questions 66 through 67 are based on the following information.

Flesher, Inc.'s credit manager studied the bill-paying habits of its customers and found that 90% of them were prompt. She also discovered that 22% of the slow payers and 5% of the prompt ones subsequently defaulted. The company has 3,000 accounts on its books, none of which has yet defaulted.

66. Calculate the total number of expected defaults, assuming no repeat business is on the horizon.

a. 795
b. 201
c. 135
d. 66

67. Given average revenues from sales of $1,200 and the cost of sales of $1,100, what is the average expected profit or loss from extending credit to slow payers?

a. $100 profit. **b. $164 loss**. c. $220 loss. d. $264 loss.

68. Given revenues from sales of $1,200 and the cost of sales of $1,100, what would the average level of revenues that makes it worthwhile to extend credit to slow payers?

a. $1,364.00 b. $1,389.74 **c. $1,410.26** d. $1,510.26

69. On cash discounts, all of the following statements do not apply except

a. If a firm buys P10,000 of goods on terms of 1/10, net 30 and pays within the discount period, the amount paid would be P9,000.
b. The cost of not taking a cash discount is always higher than the cost of a bank loan.
c. **With trade terms of 2/15, net 60, if the discount is taken the buyer receive 45 days of credit**.
d. The cost of not taking the discount is higher for terms of 2/10, net 60 than for 2/10, net 30.

70. Your firm buys on credit terms of 2/10, net 45, and it always pays on Day 45. If you calculate that this policy effectively costs your firm $157,500 each year, what is the firm's average accounts payable balance?

a. $1,234,000 b. $625,000 **c. $750,000** d. $157,500

71. Suppose the credit terms offered to your firm by your suppliers are 2/10, net 30 days. Out of convenience, your firm is not taking discounts, but is paying after 20 days, instead of waiting until Day 30. You point out that the nominal cost of not taking the discount and paying on Day 30 is around 37 percent. But since your firm is not taking discounts and is paying on Day 20, what is the *effective* annual cost of your firm's current practice, using a 360-day year?

a. 36.7% b. 43.6% **c. 106.9%** d. 73.4%

72. What is the effective annual interest rate on a 9% annual percentage rate automobile loan that has monthly payments?

a. 9% **b. 9.38%** c. 9.81% d. 10.94%

73. Corbin, Inc. can issue 3-month commercial paper with a face value of $1,000,000 for $980,000. Transaction costs will be $1,200. The effective annualized percentage cost of the financing, based on a 360-day year, will be

a. 8.48%. **b. 8.66%.** c. 8.00%. d. 2.00%.

74. ABC Company finances all of its seasonal inventory needs from the local bank at an effective interest cost of 9%. The firm's supplier promises to extend trade credit on terms that will match the 9% bank credit rate. What terms would the supplier have to offer (approximately)?
   a. 2/10, n/60. b. 2/10, n/100. **c. 2/10, n/90.** d. 3/10, n/60.

75. A company has accounts payable of $5 million with terms of 2% discount within 15 days, net 30 days (2/15 net 30). It can borrow funds from a bank at an annual rate of 12%, or it can wait until the 30th day when it will receive revenues to cover the payment. If it borrows funds on the last day of the discount period in order to obtain the discount, its total cost will be
   A. $51,000 less. **B. $75,500 less.** C. $100,000 less. D. $24,500 more.

76. Every 15 days a company receives $10,000 worth of raw materials from its suppliers. The credit terms for these purchases are 2/10, net 30, and payment is made on the 30th day after each delivery. Thus, the company is considering a 1-year bank loan for $9,800 (98% of the invoice amount). If the effective annual interest rate on this loan is 12%, what will be the net dollar savings over the year by borrowing and then taking the discount on the materials?

   a. $3,624 b. $1,176 c. $4,800 d. $1,224

77. Which of the following statements is true?

   a. Cash is decreased when new debt is issued to purchase holiday merchandise.
   b. Accepting the credit offered by a supplier is a source of cash.
   c. Increasing the use of trade credit offered by a supplier is a use of cash.
   d. Collecting an accounts receivable is a use of cash.

78. Which one of the following will increase the operating cycle?

   a. increasing the inventory period
   b. decreasing the cash cycle
   c. decreasing the accounts payable period
   d. increasing the accounts payable period

79. Which one of the following actions should a manager take if he or she wants to decrease the operating cycle?

   a. decrease the period of time for which credit is granted to customers
   a. b.. decrease the rate at which the average inventory is sold
   b. delay payments to suppliers to decrease the cash cycle
   c. increase the inventory level while maintaining constant sales

80. All else equal, which one of the following will decrease the cash cycle?

a. increasing the operating cycle
b. decreasing the accounts receivable turnover rate
c. decreasing the accounts payable period
d. increasing the inventory turnover rate

81. Which one of the following credit terms is most apt to produce the shortest accounts receivable period?

a. net 10
b. 2/10, net 30
c. net 45
d. 2/20, net 45
e. 3/5, net 10

82. Baker Industries offers credit terms of 2/20, net 60 to Charlie Co. Charlie Co. has an inventory period of 15 days and an operating cycle of 45 days. Given this, which of the following statements are correct? (I. The credit terms of Baker Industries are too restrictive; II. If Charlie Co. forgoes the discount on its purchases, it will have a negative cash cycle; III. Baker Industries is financing the accounts receivable of Charlie Co; IV. If Charlie Co. is delinquent in its payment, Baker Industries should be concerned)

a. III and IV only
b. I and II only
c. I, III, and IV only
d. II, III, and IV only

83. Which one of the following statements is correct concerning the accounts payable period?

a. Managers generally prefer a shorter accounts payable period than a longer one.
b. The accounts payable period is equal to the cost of goods sold divided by the average accounts payable.
c. Extending the accounts payable period effectively decreases the cash needs of a firm.
d. Increasing the accounts payable turnover rate increases the accounts payable period.

84. Which of the following would not be financed from working capital?

a. Cash float.
b. Accounts receivable.
c. Credit sales.
d. A new personal computer for the office.