

Solution:

(1)

Since the bank had asked for a compensating balance of \$25,000, the usable cash provided to Morneau Corporation is given by $\$200,000 - \$25,000 = \$175,000$.

(2)

The amount of interest Morneau needs to pay on \$200,000 is given by $0.08 \times \$200,000 = \$16,000$. This is done, effectively on the \$175,000 that Morneau possess.

Thus, the effective interest rate is $\frac{16,000}{175,000} \times 100\% = 9.14\%$ on the loan.

(3)

“The company has \$45,000 cash in a compensating balance arrangement.”