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# Question 1

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## Question Type: MultipleChoice

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The treasury analyst for Garth Manufacturing has estimated the cash flows for the first half of next year (ignoring any short-term borrowings) as follows:

	Cash (millions)	
	Inflows	Outflows
January	\$2	\$1
February	2	4
March	2	5
April	2	3
May	4	2
June	5	3

Garth has a line of credit of up to \$4 million on which it pays interest monthly at a rate of 1 percent of the amount utilized. Garth is expected to have a cash balance of \$2 million on January 1 and no amount utilized on its line of credit. Assuming all cash flows occur at the end of the month, approximately how much will Garth pay in interest during the first half of the year?

### Options:

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A- \$61,000

B- \$80,000

C- \$132,000

D- \$240,000

**Answer:**

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A

**Explanation:**

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Choice 'a' is correct. First, determine the amount and timing of cash needs:

	<u>Borrow</u>	<u>Inflows</u>	<u>Cash</u> <u>Outflows</u>	<u>Balance</u>	
Beg. bal				\$2,000,000	1
January		2,000,000	(1,000,000)	\$3,000,000	2
February		2,000,000	(4,000,000)	\$1,000,000	2
March		2,000,000	(5,000,000)	(\$2,000,000)	3
Borrow	2,000,000			-	4
April		2,000,000	(3,000,000)	(\$1,000,000)	3
Interest paid on \$2 mil			(20,000)	(\$1,020,000)	5
Borrow	<u>1,020,000</u>			-	4
Total debt	<b>3,020,000</b>				6
May		4,000,000	(2,000,000)	\$2,000,000	7
Interest paid on \$3.02 mil			(30,200.00)	\$1,969,800	8
Pay LOC	<u>(1,969,800)</u>		(1,969,800)	-	9
Total debt	<u>1,050,200</u>				6
June		5,000,000	(3,000,000)	\$2,000,000	7
Interest on \$1,050,200			(10,502)	\$1,989,498	8

Total interest paid is sum of three interest payments  
(20,000)

#### Comments

1 Given

2 Computed balance, positive cash flows

3 Computed balance, negative cash flows

4 Borrow from LOC

5 Computed balance, negative cash flows + interest

6 Cumulative LOC Balance

7 Computed positive cash flows

8 Computed balance, positive cash flows - interest

9 Immediate pay down of LOC

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

## Question 2

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**Question Type:** MultipleChoice

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Newman Products has received proposals from several banks to establish a lockbox system to speed up receipts. Newman receives an average of 700 checks per day averaging \$1,800 each, and its cost of short-term funds is 7 percent per year. Assuming that all proposals will produce equivalent processing results and using a 360-day year, which one of the following proposals is optimal for Newman?

**Options:**

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- A-** A flat fee of \$125,000 per year.
- B-** A fee of 0.03 percent of the amount collected.
- C-** A compensating balance of \$1,750,000.
- D-** A fee of \$0.35 per check plus 0.01 percent of the amount collected.

**Answer:**

---

C

**Explanation:**

---

Choice 'c' is correct. The optimal proposal is that which has the lowest cost for Newman.

(A) Costs		\$125,000
(B) Costs $0.03 (1,800) (700) (360) =$		\$136,080
(C) Costs $0.07 (\$1,750,000) =$		\$122,500
(D) Costs $0.35 (700) (360) =$	\$ 88,200	
$+0.01(1,800)(700)(360) =$	<u>45,360</u>	
		\$133,560

Thus, the lowest cost is 'c' at \$122,500.

Choices 'a', 'b', and 'd' are incorrect, per the above calculations/Explanation:.

## Question 3

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**Question Type:** MultipleChoice

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The following information applies to Brandon Company.

	<u>Purchases</u>	<u>Sales</u>
January	\$160,000	\$100,000
February	160,000	200,000
March	160,000	240,000
April	140,000	300,000
May	140,000	260,000
June	120,000	240,000

Forty percent of purchases are paid for in cash at the time of purchase, and 30 percent is paid for in each of the next two months. Purchases for the previous November and December were \$150,000 per month.

Payroll is 10 percent of sales in the month it occurs, and operating expenses are 20 percent of the following months sales (July sales were \$220,000). Interest payments were \$20,000 paid quarterly in January and April. Brandon's cash disbursements for the month of April were:

**Options:**

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**A-** \$152,000

**B-** \$200,000

**C-** \$248,000

**D-** \$254,000

**Answer:**

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D

**Explanation:**

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Choice 'd' is correct. Cash disbursements in April would include paying for purchases made in February and March. It would also include payroll expense and operating expenses. The calculation would be:

Purchases:		
February	$160,000 \times 30\% =$	\$ 48,000
March	$160,000 \times 30\% =$	\$ 48,000
April	$140,000 \times 40\% =$	\$ 56,000
Payroll:		
April Sales	$= 300,000 \times 10\% =$	\$ 30,000
Operating Expenses:		
May Sales	$= 260,000 \times 20\% =$	\$ 52,000
Interest Expenses		<u>\$ 20,000</u>
April Cash Disbursements		<u>\$254,000</u>

Choices 'a', 'b', and 'c' are incorrect, per above calculations.



## Question 4

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**Question Type:** MultipleChoice

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A firm can best delay disbursements through the use of:

### Options:

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- A- A centralized disbursement function.
- B- Drafts.
- C- Factoring.
- D- Trade discounts.

### Answer:

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B

### Explanation:

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Choice 'b' is correct. Paying by means of a draft (or check) allows the firm to take advantage of the float period. This delays cash disbursements.

Choice 'a' is incorrect. A centralized disbursement function will not necessarily delay cash disbursements.

Choice 'c' is incorrect. Factoring is the sale of accounts receivable to a factor. This has no effect on cash disbursements.

Choice 'd' is incorrect. Trade discounts are discounts on account receivable and do not impact cash disbursements.

## Question 5

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**Question Type:** MultipleChoice

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Wyley Inc. purchases an item on credit with terms of 3/10, net 45. Based on a 360-day year, Wyley's annual interest cost of foregoing the cash discount and making payment on the last day of the credit period is:

### Options:

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**A-** 24.00%

**B-** 30.86%

**C-** 31.81%

**D-** 37.11%

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. The formula for computing the cost of credit discounts is:

$$\frac{360}{(\text{Total pay period} - \text{Discount period})} \times \frac{\text{Discount \%}}{(100\% - \text{Discount \%})} =$$
$$\frac{360}{(45 - 10)} \times \frac{3\%}{100\% - 3\%} =$$
$$10.28 \times .0309 = 31.8\%$$

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

## Question 6

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**Question Type:** MultipleChoice

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An increase in sales collections resulting from an increased cash discount for prompt payment would be expected to cause a (n):

**Options:**

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- A- Increase in the operating cycle.
- B- Increase in the average collection period.
- C- Decrease in the cash conversion cycle.
- D- Increase in bad debt losses.

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. An increase in sales collections would decrease the cash conversion cycle.

Choice 'a' is incorrect because the operating cycle (as well as the cash conversion cycle) would decrease.

Choice 'b' is incorrect, as the average collection period would decrease.

Choice 'd' is incorrect. Bad debt losses would decrease from an increase in sales collections.

## Question 7

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**Question Type:** MultipleChoice

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

### Options:

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- A- Maximizing rate of return.
- B- Minimizing taxes.
- C- Investing in common stock due to the dividend exclusion for federal income tax purposes.
- D- Liquidity and safety.

### Answer:

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D

### Explanation:

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Choice 'd' is correct. When managing cash and short-term investments, a corporate treasurer is primarily concerned with liquidity and safety.

Choice 'a' is incorrect. The board of directors and general management would be interested in maximizing rate of return on company operations.

Choices 'b' and 'c' are incorrect. The tax manager would be interested in minimizing taxes, and investing in common stock due to the dividend exclusion for federal income tax purposes.

## Question 8

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**Question Type:** MultipleChoice

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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:

### Options:

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- 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.

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. The working capital financing policy that finances permanent current assets with short-term debt subjects the firm to the greatest risk of being unable to meet the firm's maturing obligations.

Choices 'a' and 'b' are incorrect because the use of long-term debt financing produces the smallest risk of being unable to meet maturing obligations.

Choice 'd' is incorrect because, although financing fluctuating current assets with short-term debt exposes the firm to some risk, it is not the greatest or the smallest.

## Question 9

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**Question Type:** MultipleChoice

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Which of the following transactions does not change the current ratio and does not change the total current assets?

### Options:

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- A- A cash advance is made to a divisional office.
- B- A cash dividend is declared.
- C- Short-term notes payable are retired with cash.
- D- Equipment is purchased with a three-year note and a 10 percent cash down payment.

### Answer:

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A

### Explanation:

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Choice 'a' is correct. This does not change the current ratio because the reduction of cash is offset by an increase in accounts receivable.

Choice 'b' is incorrect. A cash dividend increases current liabilities without increasing current assets. Although current assets remain unchanged (until the payment happens), the current ratio will change.

Choice 'c' is incorrect. Cash is reduced and current liabilities are reduced. Total current assets will change (they will be reduced).

Choice 'd' is incorrect. The payment of cash reduces current assets. Long-term assets are increased, as well as long-term and short-term liabilities. The current ratio is reduced.



## Question 10

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**Question Type:** MultipleChoice

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As a company becomes more conservative in its working capital policy, it would tend to have a (n):

### Options:

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- A- Decrease in its acid-test ratio.
- B- Increase in the ratio of current assets to units of output.
- C- Increase in funds invested in common stock and a decrease in funds invested in marketable securities.
- D- Decrease in its level of permanent working capital.

### Answer:

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B

### Explanation:

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Choice 'b' is correct. As a company becomes more conservative in its working capital policy, it would tend to have an increase in the ratio of current assets to units of output.

Choice 'a' is incorrect. Acid-test ratio would tend to increase with conservatism.

Choice 'c' is incorrect. Marketable securities investments would tend to increase while common stock investments would tend to decrease.

Choice 'd' is incorrect. Permanent working capital would tend to increase.

## Question 11

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**Question Type: MultipleChoice**

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Determining the appropriate level of working capital for a firm requires:

### Options:

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- A-** Changing the capital structure and dividend policy of the firm.
- B-** Maintaining short-term debt at the lowest possible level because it is generally more expensive than long-term debt.
- C-** Offsetting the benefit of current assets and current liabilities against the probability of technical insolvency.
- D-** Maintaining a high proportion of liquid assets to total assets in order to maximize the return on total investments.

**Answer:**

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C

**Explanation:**

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Choice 'c' is correct. Determining the appropriate level of working capital for a firm requires offsetting the benefit of current assets and current liabilities against the probability of technical insolvency.

Choice 'a' is incorrect. Changing the capital structure (common stock vs. preferred stock vs. long-term debt) and dividend policy has nothing to do with the level of working capital required for day-to-day operations of the business.

Choice 'b' is incorrect. The relative interest cost of short-term vs. long-term debt does not determine the appropriate level of working capital.

Choice 'd' is incorrect. Because profitability varies inversely with liquidity, maximizing the return on total investments would require a low (not high) level of liquid assets and a high level of liquid assets does nothing to determine the required level of working capital.

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