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# Question 1

**Question Type:** **MultipleChoice**

Which one of the following provides a spontaneous source of financing for a firm?

## Options:

**A-** Accounts payable.

**B-** Accounts receivable.

**C-** Debentures.

**D-** Preferred stock.

## Answer:

A

## Explanation:

Choice 'a' is correct. Accounts payable provide a spontaneous source of financing for a firm.

Choice 'b' is incorrect. Accounts receivable take time to factor.

Choices 'c' and 'd' are incorrect.

Each of the following take time to issue:

C Debentures.

D Preferred stock.

# Question 2

**Question Type:** **MultipleChoice**

Which one of the following financial instruments generally provides the largest source of short-term credit for small firms?

## Options:

**A-** Installment loans.

**B-** Commercial paper.

**C-** Trade credit.

**D-** Bankers' acceptances.

## Answer:

C

## Explanation:

Choice 'c' is correct. Trade credit generally provides the largest source of short-term credit for small firms.

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

# Question 3

**Question Type:** **MultipleChoice**

A company obtained a short-term bank loan of $500,000 at an annual interest rate of eight percent. As a condition of the loan, the company is required to maintain a compensating balance of $100,000 in its checking account. The checking account earns interest at an annual rate of three percent. Ordinarily, the company maintains a balance of $50,000 in its account for transaction purposes. What is the effective interest rate of the loan?

## Options:

**A-** 7.77 percent.

**B-** 8.50 percent.

**C-** 9.44 percent.

**D-** 8.56 percent.

## Answer:

D

## Explanation:

Choice 'd' is correct. 8.56%. To calculate the effective annualized percentage cost of financing:

Step 1 Calculate the actual finance charge:
Actual interest = (P × Rate × Time)

$$\$500{,}000 \times 8\% = \$40{,}000$$

Step 2 Subtract any interest earned (if any) on additional required compensating balance:

Additional interest earned: $50,000 × .03 = **$1,500**

Net interest cost = $40,000 [from Step 1] – $1,500 = **$38,500**

Step 3 Divide the difference (net interest) by the loan proceeds the company has use of:

Loan proceeds company has use of: $500,000 - $50,000 (additional balance) = **$450,000**

$$\frac{\$38{,}500}{\$450{,}000} = 8.555\% = \mathbf{8.56\%} \text{ (PeriodicRates)}$$

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

# Question 4

**Question Type:** MultipleChoice

A company obtained a short-term bank loan of $250,000 at an annual interest rate of 6 percent. As a condition of the loan, the company is required to maintain a compensating balance of $50,000 in its checking account. The company's checking account earns interest at an annual rate of 2 percent.

Ordinarily, the company maintains a balance of $25,000 in its checking account for transaction purposes. What is the effective interest rate of the loan?

## Options:

**A-** 6.44 percent.

**B-** 7.11 percent.

**C-** 5.80 percent.

**D-** 6.66 percent.

## Answer:

A

## Explanation:

Choice 'a' is correct. 6.44%. To calculate the effective interest rate:

| | Useable Loan | | Rate | | Interest |
|---|---|---|---|---|---|
| Step 1 - Calculate the Actual Finance Charge: Actual Interest (Principal × Rate × Time) | 250,000 | × | 6% | = | $15,000 |
| Step 2 - Subtract any Interest Earned (if any) on **Additional** Required Compensating Balance $50,000 – 25,000 = | (25,000) | × | 2% | = | (500) |
| Net Interest Cost | 225,000 | | | | 14,500 |

$$\text{Step 3 - } \frac{\text{Divide net interest cost}}{\text{By net loan proceeds useable}} = \frac{14,500}{(225,000)} = 6.44\%$$

# Question 5

**Question Type:** **MultipleChoice**

Edwards Manufacturing Corporation uses the standard Economic Order Quantity (EOQ) model. If the EOQ for Product A is 200 units and Edwards maintains a 50-unit safety stock for the item, what is the average inventory of Product A?

## Options:

**A-** 250 units.

**B-** 150 units.

**C-** 125 units.

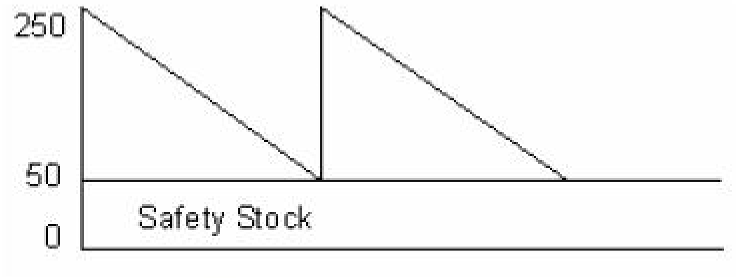
**D-** 100 units.

## Answer:

B

## Explanation:

Choice 'b' is correct. 150 units is the average inventory including a 50-unit safety stock.




| | |
|---|---|
| Reorder Quantity | 200 |
| Divide By 2 to Calculate Avg Inventory | ÷ 2 |
| Average Inventory **Excluding** Safety Stock | 100 |
| Add Safety Stock | 50 |
| Average Inventory **Including** Safety Stock | 150 |

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

# Question 6

**Question Type: MultipleChoice**

All of the following are inventory carrying costs, except:

## Options:

**A-** Insurance.

**B-** Opportunity cost on inventory investment.

**C-** Obsolescence and spoilage.

**D-** Inspections.

## Answer:

D

## Explanation:

Choice 'd' is correct. Inspections. Inspections are part of order costs, not carrying costs.

Choices 'a' and 'c' are incorrect. Inventory carrying costs include all costs associated with warehousing (storing) inventory (e.g., storage, insurance, obsolescence, and spoilage associated with holding inventory).

Choice 'b' is incorrect. The economic cost of holding inventory includes the implicit (opportunity) cost of foregoing a return on the money invested in inventory.

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