

Exam 3 Fall 2002 FINC 4532 Your Name _____
YOU HAVE 120 MINUTES TO COMPLETE BOTH PARTS OF THIS EXAM

Instructions:

- 1) The part of the exam is closed book and closed notes. No scrap paper is allowed; use the back of the exam if necessary.
- 2) Partial points are based on readily observable evidence that you know at least part of the solution concept. The more evidence presented (and the clearer the evidence), the better the chance for partial points. In other words, SHOW ALL WORK!
- 3) True/False questions are worth 2 ½ points. Multiple choice questions are worth 4 points. Short answer questions usually take less than three sentences and are worth 5 points.

1. Define Net Working Capital.

2. Offering trade credit discounts is costly to a firm and as a result, firms that offer trade discounts are usually those that are performing poorly and need cash quickly.

- a. True b. False

3. A firm changes its credit policy from 2/10, net 30, to 3/10, net 30. The change is meant to meet competition, so no increase in sales is expected. Average accounts receivable will probably decline as a result of this change.

- a. True b. False

4. Which of the following statements is most correct?

- a. Shorter-term cash budgets, in general, are used primarily for planning purposes while longer-term budgets are used for actual cash control.
- b. The cash budget and the capital budget are planned separately and although they are both important to the firm, they are independent of each other.
- c. Since depreciation is a non-cash charge, it does not appear on nor have an effect on the cash budget.
- d. The target cash balance is set optimally such that it need not be adjusted for seasonal patterns and unanticipated fluctuations in receipts, although it is changed to reflect long-term changes in the firm's operations.
- e. The typical actual cash budget will reflect interest on loans and income from investment of surplus cash. These numbers are expected values and actual results might turn out different.

5. Define Temporary Current Assets.

6. Accruals represent a source of "free" financing in the sense that no explicit interest is paid on these funds.

- a. True b. False

7. A line of credit can be either a formal or informal agreement between borrower and bank regarding the maximum amount of credit the bank will extend to the borrower subject to certain conditions.

- a. True b. False

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The part of the exam is open book and open notes.

Point values are listed with the question.

3) Look over the entire exam before starting. The best strategy is generally to “cherry pick”. In other words, solve the easiest (and/or most familiar) problems first. This will save time (and energy) that can be expended on the more difficult problems.

4) Partial points are based on readily observable evidence that you know at least part of the solution concept. The more evidence presented (and the clearer the evidence), the better the chance for partial points. In other words, SHOW ALL WORK!

5) If you have additional time remaining, give your work one last check.

1. (25 points) Prepare a cash budget for January -March for the ABC Company using the following data. All sales are on credit. Sales are; December=\$95,000, January = \$55,000, February = \$65,000, and March= \$65,000. December 31 receivables were \$135,000. The average accounts receivable period is 30 days, thus $\frac{1}{2}$ of sales are collected the month the sale is made and $\frac{1}{2}$ is collected one month after the sale is made. Wages and other expenses are 30% of sales and are paid in the month the expense is incurred. Raw materials are ordered two months in advance of sales. Raw materials are 50% of sales. All purchases on trade credit with terms of net 90. An annual dividend of \$100,000 is expected to be paid in March. A tax payment of \$40,000 will be made on January 15. No capital expenditures are planned for the first quarter. The January beginning cash balance is \$41,000. The minimum cash balance allowed by our bank is \$25,000.

2. (24 points) Your company has \$0 in its checking account. Your company needs to borrow money, such that it has a \$60,000 remaining balance at the end of one year. You are offered the following loans, all with a quoted 6% annual interest rate. Two question for each loan. 1) What amount must you borrow today in order to have \$60,000 at the end of one year? What is the effective annual interest rate for each loan?

Simple Interest

Initial Loan Amount = _____ Effective Interest Rate = _____

Discount Interest

Initial Loan Amount = _____ Effective Interest Rate = _____

Discount Interest with a 10% compensating balance

Initial Loan Amount = _____ Effective Interest Rate = _____

Add-on Interest

Initial Loan Amount = _____ Effective Interest Rate = _____

3. (5 points) 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 c. \$350,000 d. \$410,000 e. \$320,000