

7. Tullis Tours has a credit policy where full payment is required after 60 days. If the customers pay by the 20th day, they are entitled to a 2 percent discount. Which of the following correctly identifies its credit policy?

- a. 2/20, net 60
- b. 2/60, net 20
- c. 20/2 net 60
- d. 20/60, net 2
- e. 60/20, net 2

8. Small, undercapitalized firms

- a. Are generally issuers of net trade credit.
- b. Are major users of banker's acceptances.
- c. Generally, issue commercial paper.
- d. Usually do not use any debt finance.
- e. Typically, use accounts payable as an important source of funds.

9. The conservative and aggressive working capital financing strategies discussed in the text, differ primarily in the

- a. Relative amount of equity capital used.
- b. Use of short-term debt.
- c. Average level of permanent current assets.
- d. Amount of trade credit used.
- e. Relative amount invested in marketable securities.

10.. Net working capital may be defined as current assets minus current liabilities. This also defines the current ratio.

- a. True
- b. False

11. Which of the following actions are likely to reduce the length of a company's cash conversion cycle?

- a. Adopting a just-in-time inventory system which reduces the inventory conversion period.
- b. Reducing the average days sales outstanding (DSO) on its accounts receivable.
- c. Reducing the amount of time the company takes to pay its suppliers.
- d. All of the answers above are correct.
- e. Answers a and b are correct.

12. Other things held constant, which of the following will cause an increase in working capital?

- a. Cash is used to buy marketable securities.
- b. A cash dividend is declared and paid.
- c. Merchandise is sold at a profit, but the sale is on credit.
- d. Long-term bonds are retired with the proceeds of a preferred stock issue.
- e. Missing inventory is written off against retained earnings.

13. Permanent current assets reflect the fact that current assets do not shrink to zero even when business is at a seasonal or cyclical low. Thus, permanent current assets represent a minimum level of current assets the firm must finance.

- a. True
- b. False

14. If a firm fails to take trade credit discounts it may cost the firm money, but generally such a policy has a negligible effect on the firm's income statement and no effect on the firm's balance sheet.

- a. True
- b. False

15. An unusually high turnover of accounts receivable, which implies a very short days sales outstanding (DSO), 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.
- e. Only answers a and c above.

Exam 3 Spring 2003 FINC 4532 Your Name _____
YOU HAVE 120 MINUTES TO COMPLETE BOTH PARTS OF THIS EXAM

Instructions:

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. (20 points) Cash Budget for Bundle of Joy Corp. (in millions)

	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter
New Data				
Sales forecast	85.0	75.0	100.0	150.0
Cost of Goods Sold = 60% of sales				
Labor expenses	42.0	48.0	42.0	51.0
Capital expenditures	15.0	0.0	5.0	0.0
Taxes and dividends	25.0	19.0	25.0	19.0

In addition, the following assumptions are made:

87 percent of sales are realized as cash in the quarter in which they are made.

The remaining 13 percent of sales is collected as cash the following quarter.

Sales prior to the first quarter of this forecasting period were \$130 million.

Cost of Goods sold are paid for in the in the quarter after they are purchased (net 90).

All labor and administrative expenses are paid when due.

The current checking account balance is 50. The required c hecking account balance is 30.

Construct an annual cash budget segmented by quarters.

2. (14 points) Your company has \$0 in its checking account. Your company needs to borrow money, such that it has a \$150,000 remaining balance at the end of one year. You are offered the following loans, all with a quoted 9% annual interest rate. Two question for each loan. 1) What amount must you borrow today in order to have \$150,000 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
 Effective Interest Rate = _____

3. (4 points) Every 15 days you receive \$10,000 worth of raw materials from your suppliers. The credit terms for these purchases are 2/10, net 30, and thus far, you have been paying on the 30th day after each delivery because you are short of cash. You have been contemplating taking out a one-year bank loan for \$9,800 (98 percent of the invoice amount). If the effective annual interest rate on this loan is 14 percent, what will be your net dollar savings over the year by borrowing and then taking the discount? That is, what is the difference between the dollars saved if you take the discount and the dollars spent on interest expense for the loan?

- a. \$3,428 b. \$1,372 c. \$4,800 d. \$200 e. -\$1,372

4. (4 points) Roa Computers, Inc. trade policy is 3/10, net 30. Roa's annual cost of goods sold is \$9,785,000. Roa uses a 360-day accounting year. What is Roa's nominal annual cost of trade credit?

- a. 38.93% b. 47.48% c. 55.67% d. 64.78% e. 73.02%

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