
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
8. The maturity matching or "self-liquidating" approach involves the financing of permanent current assets with combinations of long-term capital and short-term capital depending on the level of interest rates. When short-term rates are high, short-term assets will be financed with long-term debt to reduce cost and risk.
   a. True   b. False

9. Which of the following statements is incorrect?
   a. Commercial paper can be issued by virtually any firm so long as it is willing to pay the going interest rate.
   b. Accruals represent a source of “free” financing in the sense that no explicit interest is paid on these funds.
   c. A conservative approach to working capital will result in all permanent assets being financed using long-term securities.
   d. The risk to the firm of borrowing using short-term credit is usually greater than with long-term debt. Added risk can stem from greater variability of interest costs on short-term debt.
   e. Trade credit is often the largest source of short-term credit.

10. The optimal safety stock increases with the uncertainty of demand forecasts and decreases with the costs (in terms of lost sales and lost goodwill) that result from inventory shortages.
    a. True                                   b. False

11. Other things held constant, which of the following will cause an increase in working capital?
    a. Long-term bonds are retired with the proceeds of a preferred stock issue.
    b. Missing inventory is written off against retained earnings.
    c. Cash is used to buy marketable securities.
    d. A cash dividend is declared and paid.
    e. Merchandise is sold at a profit, but the sale is on credit.

12. Which of the following is typically part of the cash budget?
    a. Payments lag.    b. Payment for plant construction.
    c. Cumulative cash.    d. All of the above.
    e. Only answers a and c above.

13. 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.

14. The calculated cost of trade credit is reduced by paying late.
    a. True   b. False

15. Which of the following statements is most correct?
    a. If a company receives trade credit under the terms 2/10 net 30, this implies the company has 10 days of free trade credit.
    b. Accruals are an expensive way to finance working capital.
    c. If the lender who has financed the purchase of a company's inventory has a blanket lien against the inventory, this prevents the company from freely selling its inventory.
    d. Answers a and b are correct.
    e. None of the answers above is correct.
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 1/2 of sales are collected the month the sale is made and 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