

## Finance 534 week 10 quiz 9

### Question 1

Which of the following statements is NOT CORRECT?

Answer

**Commercial paper can be issued by virtually any firm so long as it is willing to pay the going interest rate.**

Accruals are "free" in the sense that no explicit interest is paid on these funds.

A conservative approach to working capital management will result in most if not all permanent current operating assets being financed with long-term capital.

The risk to a firm that borrows with short-term credit is usually greater than if it borrowed using long-term debt. This added risk stems from the greater variability of interest costs on short-term debt and possible difficulties with rolling over short-term debt.

Bank loans generally carry a higher interest rate than commercial paper.

2 points

### Question 2

Which of the following statements is CORRECT?

Answer

Accruals are an expensive but commonly used way to finance working capital.

A conservative financing policy is one where the firm finances part of its fixed assets with short-term capital and all of its net working capital with short-term funds.

**If a company receives trade credit under terms of 2/10 net 30, this implies that the company has 10 days of free trade credit.**

One cannot tell if a firm has a conservative, aggressive, or moderate current asset financing policy without an examination of its cash budget.

If a firm has a relatively aggressive current asset financing policy vis-à-vis other firms in its industry, then its current ratio will probably be relatively high.

2 points

### Question 3

Which of the following statements is CORRECT?

Answer

Shorter-term cash budgets, in general, are used primarily for planning purposes, while longer-term budgets are used for actual cash control.

The cash budget and the capital budget are developed separately, and although they are both important to the firm, one does not affect the other.

Since depreciation is a non-cash charge, it neither appears on nor has any effect on the cash budget.

The target cash balance should be set such that it need not be adjusted for seasonal patterns and unanticipated fluctuations in receipts, although it should be changed to reflect long-term changes in the firm's operations.

**The typical cash budget reflects interest paid on loans as well as income from the investment of surplus cash. These numbers, as well as other items on the cash budget, are expected values; hence, actual results might vary from the budgeted amounts.**

2 points

Question 4

Helena Furnishings wants to reduce its cash conversion cycle. Which of the following actions should it take?

Answer

Increase average inventory without increasing sales.

**Take steps to reduce the DSO.**

Start paying its bills sooner, which would reduce the average accounts payable but not affect sales.

Sell common stock to retire long-term bonds.

Sell an issue of long-term bonds and use the proceeds to buy back some of its common stock.

2 points

Question 5

Which of the following actions would be likely to shorten the cash conversion cycle?

Answer

**Adopt a new manufacturing process that speeds up the conversion of raw materials to finished goods from 20 days to 10 days.**

Change the credit terms offered to customers from 3/10 net 30 to 1/10 net 50.

Begin to take discounts on inventory purchases; we buy on terms of 2/10 net 30.

Adopt a new manufacturing process that saves some labor costs but slows down the conversion of

raw materials to finished goods from 10 days to 20 days.

Change the credit terms offered to customers from 2/10 net 30 to 1/10 net 60.

2 points

Question 6

Which of the following statements is CORRECT?

Answer

Trade credit is provided only to relatively large, strong firms.

**Commercial paper is a form of short-term financing that is primarily used by large, strong, financially stable companies.**

Short-term debt is favored by firms because, while it is generally more expensive than long-term debt, it exposes the borrowing firm to less risk than long-term debt.

Commercial paper can be issued by virtually any firm so long as it is willing to pay the going interest rate.

Commercial paper is typically offered at a long-term maturity of at least five years.

2 points

Question 7

Which of the following is NOT a situation that might lead a firm to increase its holdings of short-term marketable securities?

Answer

The firm must make a known future payment, such as paying for a new plant that is under construction.

The firm is going from its peak sales season to its slack season, so its receivables and inventories will experience a seasonal decline.

**The firm is going from its slack season to its peak sales season, so its receivables and inventories will experience seasonal increases.**

The firm has just sold long-term securities and has not yet invested the proceeds in operating assets.

The firm just won a product liability suit one of its customers had brought against it.

2 points

Question 8