

Reading 38: Working Capital Management

Question #1 of 44

Question ID: 460670

Robel Company, which pays no dividends, carries out a 3-for-5 reverse split of its common shares. How will this transaction affect Robel's forecasts of its net cash position?

- A) More net cash in both the short-term forecast and the long-term forecast.
 - B) No effect on the short-term forecast but less net cash in the longterm forecast.
 - C) No effect because this transaction does not affect future cash flows.
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Question #2 of 44

Question ID: 460668

Pierce Motor Company has an operating cycle of 150 days and a cash conversion cycle of 120 days, while Dunhill Motor, Inc. has an operating cycle of 140 days and a cash conversion cycle of 125 days. Based on these figures it is *most likely* that:

- A) average days of receivables for Dunhill is less than for Pierce.
 - B) average days of payables for Dunhill is less than for Pierce.
 - C) average days of inventory for Dunhill is less than for Pierce.
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Question #3 of 44

Question ID: 414874

The condition that occurs when a company disburses cash too quickly, stretching the company's cash reserves, is *best* described as a:

- A) liquidity premium.
 - B) pull on liquidity.
 - C) drag on liquidity.
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Question #4 of 44

Question ID: 414891

Which yield measure is the *most* appropriate for comparing a company's investments in short-term securities?

- A) Discount basis yield.
 - B) Bond equivalent yield.
 - C) Money market yield.
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Question #5 of 44

Question ID: 414892

A 30-day bank certificate of deposit has a holding period yield of 1%. What is the annual yield of this CD on a bond-equivalent basis?

- A) 12.17%.
 - B) 11.83%.
 - C) 12.00%.
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Question #6 of 44

Question ID: 414897

A firm is choosing among three short-term investment securities:

Security 1: A 30-day U.S. Treasury bill with a discount yield of 3.6%.

Security 2: A 30-day banker's acceptance selling at 99.65% of face value.

Security 3: A 30-day time deposit with a bond equivalent yield of 3.65%.

Based only on these securities' yields, the firm would:

- A) prefer the banker's acceptance.
 - B) prefer the U.S. Treasury bill.
 - C) prefer the time deposit.
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Question #7 of 44

Question ID: 414889

Which of the following factors is *most likely* to cause a firm to need short-term financing?

- A) Operating cash inflows that fluctuate seasonally.
 - B) Shorter cash conversion cycle than the industry average.
 - C) Return of principal from maturing investments.
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Question #8 of 44

Question ID: 460672

An analyst is reviewing the working capital portfolio investment policy of a publicly traded firm. Which of the following components of the policy is the analyst *least likely* to find acceptable?

- A) Investments must have an A-1 rating from S&P or an equivalent rating from another agency.
 - B) Investments in U.S. T-bills, commercial paper, and bank CDs are acceptable unless issued by Stratford Bank.
 - C) Authority for selecting and managing short-term investments rests with the firm's treasurer and any designees selected by the treasurer.
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Question ID: 414882

In a recent staff meeting, David Hurley, stated that analysts should understand that financial ratios mean little by themselves. He advised his colleagues to evaluate financial ratios carefully. During the discussion he made the following statements:

Statement 1: A company can be compared with others in its industry by relating its financial ratios to industry norms. However, care must be taken because many ratios are industry-specific, but not all ratios are important to all industries.

Statement 2: Comparing a company to the overall economy is useless because overall business conditions are constantly changing. Specifically, it is not the case that financial ratios tend to improve when the economy is strong and weaken during recessionary times.

Are statements 1 and 2 as made by Hurley regarding financial ratio analysis CORRECT?

Statement 1 Statement 2

- | | |
|--------------|-----------|
| A) Incorrect | Correct |
| B) Correct | Incorrect |
| C) Correct | Correct |

Question #10 of 44

Question ID: 414884

Compared to the prior period, a firm has greater days of receivables. The effect on the firm's cash conversion cycle and operating cycle are *most likely* a(n):

Cash conversion cycle Operating cycle

- | | |
|-------------|----------|
| A) Increase | Decrease |
| B) Increase | Increase |
| C) Decrease | Increase |

Question #11 of 44

Question ID: 414888

An appropriate cash management strategy for a company that has a seasonally high need for cash prior to the holiday shopping season would *least likely* include:

- A) investing in U.S. Treasury notes at other times of the year because they are highly liquid.
- B) borrowing funds through a bank line of credit.
- C) allowing short-term securities to mature without reinvestment.

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Question ID: 434354

Which of the following *most* accurately represents the cash conversion cycle?

- A) average days of receivables + average days of inventory - average days of payables.
 - B) average days of receivables + average days of inventory + average days of payables.
 - C) average days of payables + average days of inventory - average days of receivables.
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Question #13 of 44

Question ID: 414873

An example of a secondary source of liquidity is:

- A) cash flow management.
 - B) trade credit and bank lines of credit.
 - C) negotiating debt contracts.
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Question #14 of 44

Question ID: 434357

Yields on firms' investments in short-term securities for comparison purposes are *best* stated as:

- A) $\frac{\text{discount}}{\text{face}} \left(\frac{360}{\text{days to maturity}} \right)$.
 - B) holding period return $\left(\frac{360}{\text{days to maturity}} \right)$.
 - C) holding period return $\left(\frac{365}{\text{days to maturity}} \right)$.
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Question #15 of 44

Question ID: 414906

Which of the following sources of liquidity is the *most* reliable?

- A) Revolving line of credit.
 - B) Uncommitted line of credit.
 - C) Committed line of credit.
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Question #16 of 44

Question ID: 414900

With respect to inventory management,:

- A) a decrease in a firm's days of inventory on hand indicates better inventory management and can lead to increased profits.
- B) an increase in days of inventory on hand can be the result of either good or poor inventory management.

- C) a firm with inventory turnover higher than the industry average can be expected to have better profitability as a result.
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Question ID: 460671

Randex Industries has the following investment policy statement: "In order to achieve the safety and liquidity necessary in the investment of excess cash balances, the CFO or his designee may invest excess cash balances in 30-day U.S. Treasury bills, or in banker's acceptances with maturities of less than 31 days or 30-day certificates of deposit, where the credit rating of the issuing bank is A+ or higher." This policy statement is:

- A) inappropriate because it is too restrictive.
 - B) appropriate because these are all safe, liquid securities.
 - C) inappropriate because both banker's acceptances and certificates of deposit are illiquid.
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Question #18 of 44

Question ID: 414905

Which of the following sources of short-term liquidity is considered reliable enough that it can be listed in the footnotes to a firm's financial statements as a source of liquidity?

- A) Uncommitted line of credit.
 - B) Revolving line of credit.
 - C) Factoring agreement.
-

Question #19 of 44

Question ID: 485792

A company has just received a \$5 million shipment from a supplier. Its terms of trade credit are 2/15 net 30. It has access to a line of credit with an annualized cost of 9%. The *best* short-term financing strategy is to pay the invoice:

- A) on day 30.
 - B) immediately.
 - C) on day 15.
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Question ID: 434358

Pfluger Company's accounts payable department receives an invoice from a vendor with terms of 2/10 net 30. If Pfluger pays the invoice on its due date, the cost of trade credit is *closest* to:

- A) 27.9%.
- B) 43.5%.
- C) 44.6%.

Question #21 of 44

Question ID: 414877

Which of the following is NOT a limitation to financial ratio analysis?

- A) The need to use judgment.
- B) Differences in international accounting practices.
- C) A firm that operates in only one industry.

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Question ID: 414890

A firm records the following cash flows on the same day: \$250 million from debt proceeds; \$100 million funds transferred to a subsidiary; \$125 million in interest payments; and \$30 million in tax payments. The net daily cash position:

- A) worsened.
- B) improved.
- C) remained the same.

Question #23 of 44

Question ID: 434359

Which of the following forms of short-term financing is typically used to facilitate international trade?

- A) Overdraft line of credit.
- B) Commercial paper.
- C) Banker's acceptances.

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Question ID: 414887

The *least* appropriate security for investing short-term excess cash balances would be:

- A) bank certificates of deposit.
- B) preferred stock.
- C) time deposits.

Question #25 of 44

Question ID: 414903

A large, creditworthy manufacturing firm would *most likely* get short-term financing by:

- A) issuing commercial paper.
- B) factoring its receivables.

C) entering into an agreement for a committed line of credit.

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Question ID: 434352

Liquidating short-term assets and renegotiating debt agreements are *best* described as a firm's:

- A) pulls and drags on liquidity.
 - B) secondary sources of liquidity.
 - C) primary sources of liquidity.
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Question #27 of 44

Question ID: 414881

Which of the following is *least likely* an indicator of a firm's liquidity?

- A) Inventory turnover.
 - B) Amount of credit sales.
 - C) Cash as a percentage of sales.
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Question #28 of 44

Question ID: 414875

An example of a primary source of liquidity is:

- A) using trade credit from vendors.
 - B) renegotiating debt agreements.
 - C) filing for bankruptcy.
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Question #29 of 44

Question ID: 414886

An analyst who is evaluating a firm's working capital management would be *least likely* to be concerned if the firm's:

- A) total asset turnover is lower than its industry average.
 - B) operating cycle is shorter than that of its peers.
 - C) number of days of inventory is higher than that of its peers.
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Question ID: 414895

Assume that a 30-day commercial paper security has a holding period yield of 0.80%. The bond equivalent yield of this security is:

- A) 10.12%.
- B) 9.73%.
- C) 9.60%.

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Question ID: 414876

An analyst computes the following ratios for Iridescent Carpeting Inc. and compares the results to the industry averages:

Financial Ratio	Iridescent Carpeting	Industry Average
Current Ratio	2.3x	1.8x
Net Profit Margin	22%	24%
Return on Equity	17%	20%
Total Debt / Total Capital	35%	56%
Times Interest Earned	4.7x	4.1x

Based on the above data, which of the following can the analyst conclude? Iridescent Carpeting:

- A) is most likely a younger company than its competitors.
- B) has stronger profitability than its competitors.
- C) has better short-term liquidity than its competitors.

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Question ID: 414894

An investment policy statement for a firm's short-term cash management function would *least* appropriately include:

- A) procedures to follow if the investment guidelines are violated.
- B) a list of permissible securities.
- C) information on who is allowed to invest corporate cash.

Question #33 of 44

Question ID: 434356

A high cash conversion cycle suggests that a company's investment in working capital is:

- A) too high.
- B) appropriate.
- C) too low.

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Question ID: 434355

The average number of days that it takes to turn raw materials into cash proceeds is a firm's:

- A) operating cycle.
 - B) inventory turnover cycle.
 - C) receivables cycle.
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Question #35 of 44

Question ID: 414878

Alton Industries will have better liquidity than its peer group of companies if its:

- A) quick ratio is lower.
 - B) receivables turnover is higher.
 - C) average trade payables are lower.
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Question ID: 434353

Compared to the prior year, Chart Industries has reported that its operating cycle has remained relatively stable while its cash conversion cycle has decreased. The *most likely* explanation for this is that the firm:

- A) is relying more on its suppliers for short-term liquidity.
 - B) is paying its bills for raw materials more rapidly.
 - C) has improved its inventory turnover.
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Question #37 of 44

Question ID: 414893

A 91-day Treasury bill has a holding period yield of 1.5%. What is the annual yield of this T-bill on a bond-equivalent basis?

- A) 6.65%.
 - B) 6.24%.
 - C) 6.02%.
-

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Question ID: 414901

A result that is *most likely* to give a financial manager concern that his firm's credit policy may have become too lenient is:

- A) weighted average collection period has increased.
 - B) receivables turnover has increased significantly.
 - C) inventory turnover has decreased considerably.
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Question #39 of 44

Question ID: 414904

Which of the following sources of credit would an analyst *most likely* associate with a borrower of the lowest credit quality?

- A) Committed line of credit.
- B) Revolving line of credit.
- C) Uncommitted line of credit.

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Question ID: 414896

A banker's acceptance that is priced at \$99,145 and matures in 72 days at \$100,000 has a(n):

- A) money market yield greater than its discount yield.
- B) bond equivalent yield greater than its effective annual yield.
- C) discount yield greater than its bond equivalent yield.

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Question ID: 460669

In reviewing the effectiveness of a company's working capital management, an analyst has calculated operating cycle and cash conversion cycle measures for the past three years.

	<u>20X6</u>	<u>20X7</u>	<u>20X8</u>
Operating cycle (number of days)	55	60	62
Cash conversion cycle (number of days)	27	30	32

The trends in the operating cycle and cash conversion cycle *most likely* indicate:

- A) improving liquidity.
- B) slower collections of receivables.
- C) stretching of payables.

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Question ID: 414880

The quick ratio is considered a more conservative measure of liquidity than the current ratio because the quick ratio excludes:

- A) accounts receivable, which may not be collectible in the short term.
- B) inventories, which are not necessarily liquid.
- C) short-term marketable securities, which may need to be sold at a significant loss.

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Question ID: 414879

A firm has average days of receivables outstanding of 22 compared to an industry average of 29 days. An analyst would *most likely* conclude that the firm:

- A) has a lower cash conversion cycle than its peer companies.
 - B) may have credit policies that are too strict.
 - C) has better credit controls than its peer companies.
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Question #44 of 44

Question ID: 414899

Which of the following strategies is *most likely* to be considered good payables management?

- A) Taking trade discounts only if the firm's annual return on short-term investments is less than the discount percentage.
- B) Paying invoices on the last possible day to still get the supplier's discount for early payment.
- C) Paying trade invoices on the day they arrive.