

# Working Capital

## Question 1

The following are the January 1 and June 30 balance sheets of a company:

	Assets (in millions)	
	January 1	June 30
Cash	3	4
Accounts receivable	5	4
Inventories	8	10
Fixed assets	<u>10</u>	<u>11</u>
<b>Total assets</b>	<b>26</b>	<b>29</b>
Accounts payable	2	3
Notes payable	4	3
Accrued wages	1	2
Long-term debt	9	11
Stockholder's equity	<u>10</u>	<u>10</u>
<b>Total liabilities and stockholders' equity</b>	<b>26</b>	<b>29</b>

From January 1 to June 30, the net working capital:

- |                            |                           |
|----------------------------|---------------------------|
| A. Increased by 2 million  | C. Increased by 1 million |
| B. Decreased by 1 million. | D. Stayed the same.       |

## Question 14

ABC Corporation is considering a plant expansion that will increase its sales and net income. The following data represent management's estimate of the impact the proposal will have on the company:

	Current	Proposal
Cash	\$100,000	\$120,000
Accounts payable	350,000	430,000
Accounts receivable	400,000	500,000
Inventory	380,000	460,000
Marketable securities	200,000	200,000
Mortgage payable (current)	175,000	325,000
Fixed assets	2,500,000	3,500,000
Net income	500,000	650,000

The effect of the plant expansion on ABC's working capital will be a(n)

- |                           |                           |
|---------------------------|---------------------------|
| A. Increase of \$30,000.  | C. Decrease of \$30,000.  |
| B. Decrease of \$150,000. | D. Increase of \$120,000. |

## Question 19

All of the following statements in regard to working capital are correct except:

- A. Profitability varies inversely with liquidity.
- B. The hedging approach to financing involves matching maturities of debt with specific financing needs.
- C. Current liabilities are an important source of financing for many small firms.
- D. Financing permanent inventory buildup with long-term debt is an example of an aggressive working capital policy.

### Question 22

Which one of the following would increase the working capital of a firm?

- A. Cash collection of accounts receivable.
- B. Purchase of a new plant financed by a 20-year mortgage.
- C. Refinancing a short-term note payable with a two-year note payable.
- D. Cash payment of payroll taxes payable.

### Question 23

XYZ Corporation has 100,000 shares of stock outstanding. Below is part of XYZ's Statement of Financial Position for the last fiscal year.

<b>XYZ Corporation</b>	
<b>Statement of Financial Position - Selected Items</b>	
	<b>December 31</b>
Cash	\$455,000
Accounts receivable	900,000
Inventory	650,000
Prepaid assets	45,000
Accrued liabilities	285,000
Accounts payable	550,000
Current portion, long-term notes payable	65,000

What is the maximum amount XYZ can pay in cash dividends per share and maintain a minimum current ratio of 2 to 1 ? Assume that all accounts other than cash remain unchanged

- A. \$3.35
- B. \$2.05
- C. \$3.80
- D. \$2.50

### Question 24

When a firm finances each asset with a financial instrument of the same approximate maturity as the life of the asset, it is applying

- A, Return maximization.
- B, A hedging approach.
- C. Financial leverage.
- D. Working capital management.

### Question 83

Net working capital is the difference between

- A, Total assets and total liabilities.
- B. Fixed assets and fixed liabilities.
- C, Current assets and current liabilities.
- D. Shareholders' investment and cash.

### Question 87

During the year, Company's current assets increased by \$120, current liabilities decreased by \$50, and net working capital

- A. Decreased by \$170.
- B. Did not change.
- C. Increased by \$170.
- D. Increased by \$70.

### Question 89

Of the following, the working capital financing policy that would subject a firm to the greatest level of risk is the one where the firm finances

- A. permanent current assets with long-term debt.

- B. permanent current assets with short-term debt.
- C. fluctuating current assets with long-term debt.
- D. fluctuating current assets with short-term debt.

### Question 102

Which one of the following transactions would increase the current ratio and decrease net profit?

- A. A stock dividend is declared.
- B. Uncollectible accounts receivable are written off against the allowance account.
- C. Vacant land is sold for less than the net book value,
- D. A federal income tax payment due from the previous year is paid.

### Question 110

Which group of ratios would be useful in evaluating the effectiveness of working capital management?

- A. Profit margin, acid-test ratio, and return on assets.
- B. Acid-test ratio, inventory turnover ratio, and average collection period ratio.
- C. Inventory turnover ratio, times interest earned, and debt-to-equity ratio.
- D. Acid-test ratio, current ratio, and return on equity

### Question 116

AEC Products currently has a conservative credit policy and is in the process of reviewing three other credit policies. The current credit policy (Policy A) results in sales of \$12 million per year. Policies B and C involve higher sales, accounts receivable and inventory balances, as well as higher bad debt and collection costs. Policy D grants longer payment terms than Policy C but charges customers interest if they take advantage of the lengthy payment terms. The policies are outlined below.

	Policy (000)			
	A	B	C	D
Sales	\$12,000	\$13,000	\$14,000	\$14,000
Average accounts receivable	1,500	2,000	3,500	5,000
Average inventory	2,000	2,300	2,500	2,500
Interest income	0	0	0	500
Bad debt expense	100	125	300	400
Collection cost	100	125	250	350

If the direct cost of products is 80% of sales and the cost of short-term funds is 10%, what is the optimal policy for AEC?

- A. Policy C.
- B. Policy A.
- C. Policy B.
- D. Policy D.

### Question 118

Determining the appropriate level of working capital for a firm requires:

- A. Maintaining a high proportion of liquid assets to total assets in order to maximize the return on total investments.
- B. Changing the capital structure and dividend policy of the firm.
- C. Maintaining short-term debt at the lowest possible level because it is generally more expensive than long-term debt.
- D. Offsetting the benefit of current assets and current liabilities against the probability of technical insolvency.

### Question 122

'X Inc' has current assets of \$300,000 and current liabilities of \$200,000. 'X' could increase its working capital by the

- A. Purchase of \$50,000 of temporary investments for cash
- B. Refinancing of \$50,000 of short-term debt with long-term debt.
- C. Prepayment of \$50,000 of next year's rent.
- D. Collection of \$50,000 of accounts receivable.

### Question 140

As a company becomes more conservative in its working capital policy, it would tend to have a(n):

- A. Increase in the ratio of current assets to units of output,
- B. Increase in funds invested in common stock and a decrease in funds invested in marketable securities.
- C. Decrease in its acid-test ratio.
- D. Increase in the ratio of current liabilities to non-current liabilities

### Question 123

TED Corporation's management is considering a plant expansion that will increase its sales and have commensurate impact on its net working capital position. The following information presents management's estimate of the impact the proposal will have on TED.

	<b>Current</b>	<b>Proposal</b>
Cash	\$100,000	\$110,000
Accounts payable	400,000	470,000
Accounts receivable	560,000	690,000
Inventory	350,000	380,000
Marketable securities	200,000	200,000
Fixed assets	2,500,000	3,500,000
Net income	500,000	650,000

The impact of the plant expansion on TED's working capital would be

- A, A decrease of \$950,000.
- B, An increase of \$950,000.
- C, An increase of \$100,000.
- D, A decrease of \$100,000.

### Question 147

All decisions by financial managers should be driven by the primary goal to

- A. Minimize fixed costs and variable costs,
- B. Stabilize growth.
- C. Maximize stockholder wealth.
- D. Maximize revenues.