Mobilization and Management of Finance Course
Quiz 2 Solution Date: 28/01/2017

1. The total asset turnover ratio is measured as:
   a. Sales minus total assets.
   b. Sales divided by total assets.
   c. Sales times total assets.
   d. Total assets divided by sales.
   e. Total assets plus sales.

2. One of the reasons why cash flow analysis is popular is because:

   a. Cash flows are more subjective than net income.
   b. Cash flows are hard to understand.
   c. It is easy to manipulate, or spin the cash flows.
   d. It is difficult to manipulate, or spin the cash flows.
   e. None of these.

3. A conflict of interest between the stockholders and management of a firm is called:

   a) Stockholders' liability.
   b) Corporate breakdown.
   c) The agency problem.
   d) Corporate activism.
   e) Legal liability.

4. _____ refers to the changes in net capital assets.

   a. Operating cash flow
   b. Cash flow from investing
   c. Net working capital
   d. Cash flow from assets
   e. Cash flow to creditors

5. Which one of the following statements is correct concerning the organizational structure of a corporation?

   a) The vice president of finance reports to the chairman of the board.
   b) The chief executive officer reports to the board of directors.
   c) The controller reports to the president.

d) The treasurer reports to the chief executive officer.
e) The chief operations officer reports to the vice president of production.

6. An increase in which one of the following will cause the operating cash flow to increase?

   a. Depreciation
   b. Changes in the amount of net fixed capital
   c. Net working capital
   d. Taxes
   e. Costs

7. Working capital management includes decisions concerning which of the following?

   (i) Accounts payable
   (ii) Long-term debt
   (iii) Accounts receivable
   (iv) Inventory

   a) I and II only
   b) I and III only
   c) II and IV only
   d) I, II, and III only
   e) I, III, and IV only

8. The cash ratio is measured as:

   a. Current assets divided by current liabilities.
   b. Current assets minus cash on hand, divided by current liabilities.
   c. Current liabilities plus current assets, divided by cash on hand.
   d. Cash on hand plus inventory, divided by current liabilities.
   e. Cash on hand divided by current liabilities.

9. Total assets are Rs.1000, fixed assets are Rs.700, long-term debt is Rs.250, and short-term debt is Rs.300. What is the amount of net working capital?

   a. Rs.0
   b. Rs.50
   c. Rs.300
   d. Rs.650
   e. Rs.700

Net working capital = Rs.1000 - Rs.700 - Rs.300 = Rs.0

10. Ratios that measure a firm's financial leverage are known as ________ ratios.

    a. Asset Management
    b. Long-Term Solvency
    c. Short-Term Solvency
    d. Profitability

e. Market Value

11. You have deposited $1,500 in an account that promises to pay 8% compounded quarterly for the next five years. How much will you have in the account at the end?

    a. $1,598.33
    b. $2,203.99
    c. $2,228.92
    d. $6,991.44
    e. None of these.

$1,500(1.02)20 = $2,228.92

12. The long-term debts of a firm are liabilities:

    a. that come due within the next 12 months.

    b. that do not come due for at least 12 months.

    c. owed to the firm's suppliers.

    d. owed to the firm's shareholders.

    e. the firm expects to incur within the next 12 months.

1. Agency Problems and Corporate Ownership:

   The agency issues would change due to the role and responsibility of the new players unlike the state-owned (largely) dormant financial institutions. Previously, some of these domestic financial institutions could even be managed with gifts etc. However, with the rising trend of institutional ownership (including foreign funds), there would be greater demand for transparency in the organizations this could reduce the agency problems within these organizations and increase the level of corporate ownership for these investors. This in itself does not mean that private rent seeking acts would become zero (but they could go down).

2. The EBITD/Assets ratio shows the company’s operating performance before interest, taxes, and depreciation. This ratio would show how a company has controlled costs. While taxes are a cost, and depreciation and amortization can be considered costs, they are not as easily controlled by company management. Conversely, depreciation and amortization can be altered by accounting choices. This ratio only uses costs directly related to operations in the numerator. As such, it gives a better metric to measure management performance over a period than does ROA.

3. The better deal is the one with equal installments.

4. The income statement for the company is:

Income Statement

Sales	$387,000
Costs	175,000
Depreciation	40,000
EBIT	$172,000
Interest	21,000
EBT	$151,000
Taxes	52,850
Net income	$ 98,150

One equation for net income is:

Net income = Dividends + Addition to retained earnings

Rearranging, we get:

Addition to retained earnings = Net income – Dividends

Addition to retained earnings = $98,150 – 30,000

Addition to retained earnings = $68,150

5. Cash flow to creditors = Interest paid – Net new borrowing

   Cash flow to creditors = $127,000 – ($LTD_{end}$ – LTD_{beg})

   Cash flow to creditors = $127,000 – ($1,520,000 – 1,450,000)

   Cash flow to creditors = $127,000 – 70,000

   Cash flow to creditors = $57,000

6. ROE is a better measure of the company's performance. ROE shows the percentage return for the year earned on shareholder investment. Since the goal of a company is to maximize shareholder wealth, this ratio shows the company's performance in achieving this goal over the period.

7. With the information provided, the cash flows from the firm are the capital spending and the change in net working capital, so:

Cash flows from the firm

Capital spending	$(21,000)
Additions to NWC	(1,900)

Cash flows from the firm	$(22,900)

And the cash flows to the investors of the firm are:

Cash flows to investors of the firm	
Sale of long-term debt	(17,000)
Sale of common stock	(4,000)
Dividends paid	14,500
Cash flows to investors of the firm	$(6,500)