

SESSION 10: CASH BUDGETS & PROJECTED INCOME STATEMENTS

KEY CONCEPTS:

In this session we will look at:

- Users of Budgets
- Purpose of Analysing the Monthly Cash Budgets
- How to do a Monthly Cash Budget
- Analysis of Cash Budget
- Difference between Cash Budgets and Income Statements.

X-PLANATION:

INTRODUCTION:

The success of a business is largely dependent on how well it is managed.

Management plays a pivotal role in determining the way in which a business is run and the direction it is moving in.

People in management are those people who are not only able to think of current issues, but are also able to anticipate and find solutions to problems and situations of the future. The main elements of management are: Planning, Organising, Leading and Control (POLC).

Budgets form an important part of planning and control. They can be used as a tool for future planning as well as a tool for exercising control over cash receipts and payments.

For the scope of our curriculum in grade 12, our emphasis will be on the analysis of the Monthly Cash Budget.

USERS OF BUDGETS:

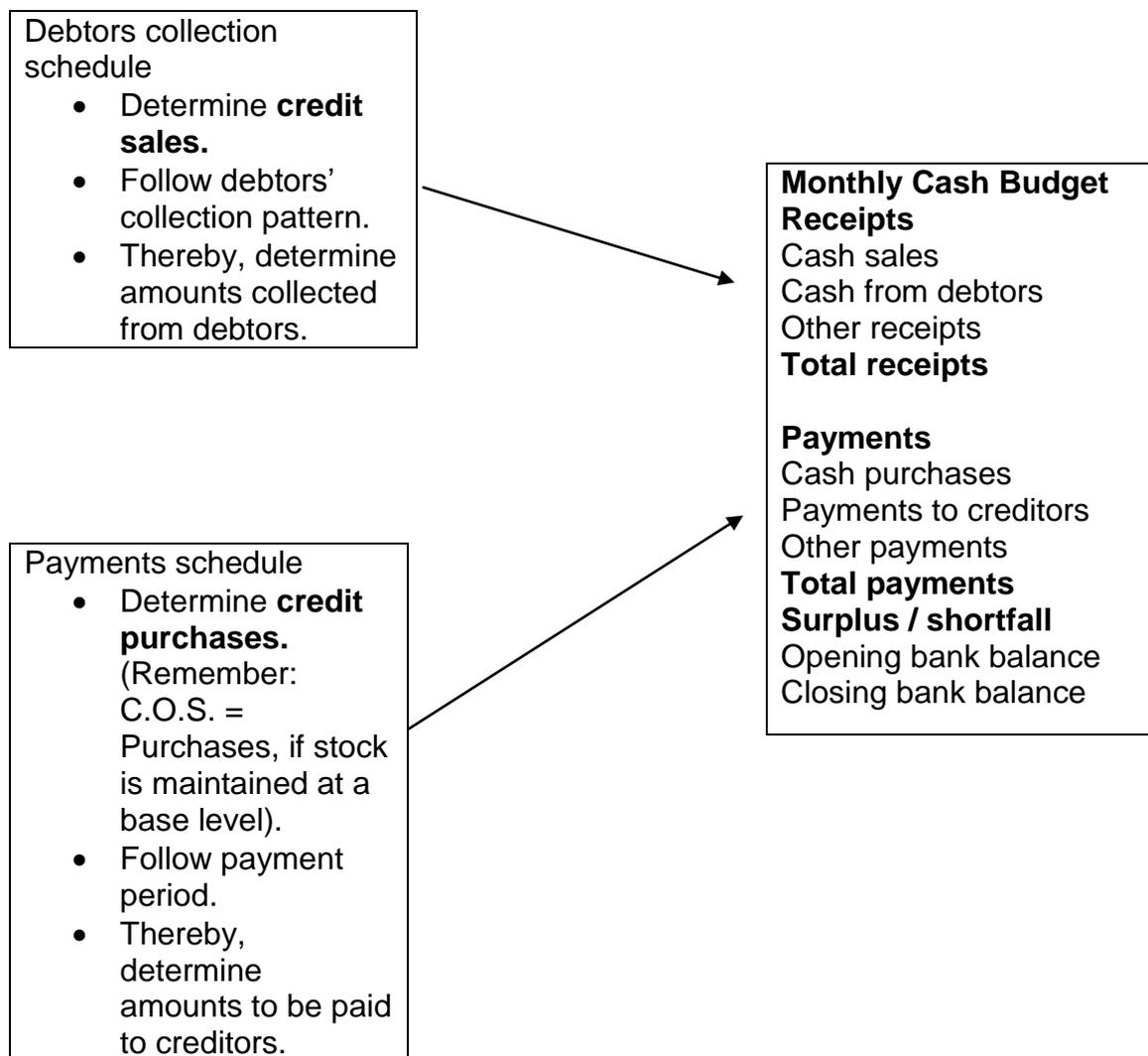
- Business people
- Government
- Salary and wage earners
- Administrators of non profit organisations
- Informal traders and a host of other parties

Therefore, it would be very realistic to assume that each one of us, some time in our lives, might be preparing and analysing budgets.

PURPOSE OF ANALYSING THE MONTHLY CASH BUDGET:

- Observations can assist with future planning.
- Assist in exercising control over business operations.
- Assist management with decision making.
- Allow for redistribution of resources where necessary.
- Assist with setting of targets for the business.
- Help to determine effective utilisation of cash resources.
- Help to maintain control over expenditure.
- Determine availability or shortage of cash.

HOW TO DO A MONTHLY CASH BUDGET:



ANALYSIS OF CASH BUDGETS:

An analysis of the monthly cash budget can reveal, amongst others, the following:

- Availability of excess cash lying idle.
- Shortage of cash / bank overdraft.
- Period of collection from debtors and sales policy.

DIFFERENCE BETWEEN CASH BUDGETS AND INCOME STATEMENTS:

CASH BUDGET	INCOME STATEMENT
Cash sales only	Both cash and credit sales
Collections from debtors	No debtors' collections
Cash purchases of trading stock	No purchases of trading stock
Payments to creditors	No payments to creditors
Cash purchases of fixed assets	No purchases of fixed assets
Cash receipts from sale of assets	Only profit / loss on sale of assets
Cash raised from issue of shares	No issues of shares
Cash paid to shareholders for dividends	No dividends
Cash drawings by the owner	No drawings
No depreciation	Depreciation
No bad debts	Bad debts
No trading stock deficit	Trading stock deficit
Donations of cash only	Donations of cash and trading stock
Prepaid expenses but no accrued expenses	Accrued expenses but no prepaid expenses
Income received in advance but no accrued income	Accrued income but no income received in advance
Cash raised from taking out a loan	No loans
Loan repayments plus interest	Interest on loan repayments only
Maturity of fixed deposit plus interest	Interest on fixed deposit only

X-AMPLE QUESTIONS:

QUESTION 1:

CASH BUDGET OF A SOLE TRADER:

You are provided with an incomplete Cash Budget and additional information relating to “The Smart Store”, a popular retail clothing store situated in a busy shopping centre in Wattsville.

The owner, Mrs N. Reddy, is very concerned about the drop in sales over the past months.

REQUIRED

- 1.1 Refer to the proposed Cash Budget, Debtors & Creditors Schedules as well as the additional information provided to calculate the figures labelled to (e).
(18)

ADDITIONAL INFORMATION

1. **Actual and Budgeted Sales Figures:**

	Actual		Budgeted	
	Aug	Sept	Oct	Nov
Total Sales	220 000	200 000	180 000	220 000
Cost Of Sales	176 000	160 000	144 000	176 000

- 20% of total sales are sold on credit each month.
 - 65% of all stock is bought on credit.
 - A fixed level of trading stock on hand is maintained throughout the year through replacement on a monthly basis.
2. **Debtors are expected to pay their accounts as follows:**
70 % in the month following the month of sale.
28 % in two months following the month of sale.
2 % to be written off in the 3rd month following the month of sale.
3. **Creditors are paid in full** in the month following the month of purchase to qualify for a 5% discount.
- 1.2
- 1.2.1 Refer to the item, “Fixed Deposit (1 November)”, as shown under the Receipts section of the Cash Budget. Explain what is expected to happen with regards to the Fixed Deposit on 1 November 2008 (2)
- 1.2.2 The Smart Store plans to purchase equipment during the budget period.
Study the Cash Budget in order to calculate the total expected cost price of this equipment. (3)

- 1.2.3 The sales assistant has complained to Mrs Reddy about her proposed salary increase in November 2008.
- Give one point to support her opinion.
 - Give one point against her opinion. (4)
- 1.2.4 At the end of October 2008, you compare the Actual figures against the Cash Budget figures and you notice differences on certain items. Provide ONE point of advice to Mrs Reddy in respect of **Advertising**:

	October Budget	October Actual	Difference
Advertising	R 2 000	R 600	– R1 400

(3)

Cash Budget of “The Smart Store” for October & November 2008

	October	November
RECEIPTS:		
Cash sales	144 000	(a)
Debtors collections	40 320	(c)
Fixed deposit (1 November)	-	20 000
Interest on fixed deposit (12% p.a.)	500	300
Other cash Income	?	?
PAYMENTS:		
Cash purchase of Trading stock	(b)	61 600
Payments to creditors	(d)	88 920
Deposit – purchase of equipment	3 000	-
Instalment payment – equipment (4 equal instalments)	-	4 700
Rent expense	16 000	17 440
Salary – shop manager	12 000	13 680
Salary – sales assistant	5 000	5 125
Consumable stores	11 000	12 080
Advertising	2 000	2 000
Interest on overdraft	315	-
Other cash operating expenses	?	?
Surplus / (Shortfall) for the month	(21 995)	18 855
Bank balance at beginning of the month	14 200	(e)
Bank balance at the end of the month	(7 795)	?

[30]

X-ERCISE QUESTIONS:

QUESTION 1:

PROJECTED INCOME STATEMENT

You are provided with a Projected Income Statement for Riverside Traders for January and February 2009. The actual figures are also provided. The business is owned by Cheryl Rivers.

She uses a fixed mark-up percentage at all times and credit sales comprise 60% of all sales.

RIVERSIDE TRADERS

PROJECTED INCOME STATEMENT FOR JANUARY AND FEBRUARY 2009

	JANUARY BUDGET	JANUARY ACTUAL	FEBRUARY BUDGET	FEBRUARY ACTUAL
Sales	540 000	396 000	594 000	360 000
Cost of sales	300 000	220 000	330 000	200 000
Gross profit	240 000	176 000	264 000	160 000
Other income	47 000	34 000	53 000	44 000
Commission received	11 000	16 000	11 000	23 000
Rent income	36 000	18 000	42 000	21 000
Gross operating income	287 000	210 000	317 000	204 000
Operating expenses	(154 480)	(147 580)	(136 128)	(143 300)
Salary of the store manager	40 000	40 000	50 000	50 000
Wages of shop assistants	24 000	24 000	24 000	16 800
Sundry operating expenses	13 000	9 000	14 000	9 000
Motor vehicle expenses	12 000	13 200	12 000	13 200
Telephone	1 000	3 000	1 000	5 000
Security expenses	7 000	3 500	7 000	3 500
Trading stock deficit	0	18 000	0	12 000
Training of employees	30 000	10 000	0	0
Advertising	5 000	1 000	5 000	1 000
Discount allowed	2 000	0	2 000	0
Bad debts	6 480	11 880	7 128	10 800
Stationery	4 000	4 000	4 000	7 000
Depreciation	10 000	10 000	10 000	15 000
Operating profit	132 520	62 420	180 872	60 700
Interest income (6% p.a.)	12 000	12 000	12 000	9 000
Profit before interest expense	144 520	74 420	192 872	69 700
Interest expense (15% p.a.)	(37 500)	(37 500)	(37 500)	(37 500)
Net profit for the year	107 020	36 920	155 372	32 200

REQUIRED

- 1.1 Calculate the mark-up % that Cheryl uses for her business. (4)
- 1.2 Refer to the actual figures for February for Interest income and (4)

- Depreciation.
In each case, give a probable reason why the actual figure is different from the budget for February.
- 1.3 Cheryl is always worried about the internal control over three expenses in particular: stationery, telephone and motor vehicle expenses (especially as the petrol price increased unexpectedly by 25% at the beginning of January).
Comment on whether or not these expenses have been well controlled. Quote figures to support your answer. (7)
- 1.4 Cheryl is concerned that she has to keep contributing more capital each month so that the business can settle its debts. Explain why the Projected Income Statement will not help her in identifying the reasons for this problem. (3)
- 1.5 Cheryl has also borrowed money to set up this business. She is not sure if she can afford the loan repayments which start in March.
- Calculate the amount of the loan. (4)
 - What advice would you give her regarding accessing funds in order to repay the loan? Name TWO points. (4)
- 1.6 Cheryl is concerned about the support she is getting from her customers. She is concerned about losing 'goodwill'.
- Quote figures from the questions, which indicate that she appears to be losing customers. (2)
 - Identify THREE points, with appropriate figures from the Projected Income Statement, which indicate that she has made mistakes in dealing with her customers. (6)
- 1.7 The shop assistants earn equal wages. Two of the six shop assistants resigned at the beginning of February. They have not been replaced.
- Calculate the monthly salary earned by each shop assistant in January. (3)
 - Calculate the % salary increase that Cheryl granted the shop assistants in February. (4)
 - Give TWO reasons why they would not be happy with this increase. Quote evidence to support your answer. (4)
- [45]**

SOLUTIONS TO X-ERCISE QUESTIONS

QUESTION 1:

- 1.1 **Calculate the mark-up % that Cheryl uses for her business.**
 $\checkmark \quad \checkmark \quad \checkmark \checkmark$
 $240\ 000 / 300\ 000 \times 100 = 80\%$
Or: use figures from any of the other columns (4)
- 1.2 **Probable reason for interest income:**
 The investment was decreased. $\checkmark \checkmark$
Probable reason for depreciation:
 More fixed/tangible assets were bought. $\checkmark \checkmark$ (4)
- 1.3 **Comment on Stationery:**
Responses may be expressed differently
Part-marks can be awarded
 Well controlled in January, but R3 000 over budget in February. This is possibly due to wastage/theft. $\checkmark \checkmark$
Comment on Telephone:
 Abuse is apparent. R2 000 over budget in January and R4 000 over budget in February. Not well controlled. $\checkmark \checkmark$
Comment on Motor vehicle expenses:
 Well controlled. The variance is only 10% (1 200/ 12 000) whilst the price of petrol increased by 25%. $\checkmark \checkmark \checkmark$ (7)
- 1.4 *Responses may be expressed differently* $\checkmark \checkmark \checkmark$
 Excellent = 3; Good = 2; Poor = 1; Incorrect = 0
 Cash problems will be identified in the Cash Budget. The projected Income Statement reflects profit. Certain income items might not have been collected, while payments for debts are not reflected in the Projected Income Statement. $\checkmark \checkmark \checkmark$ (3)
- 1.5 **Calculate the amount of the loan.**
 $\checkmark \quad \checkmark \quad \checkmark \quad \checkmark$
 $37\ 500 / 0.15 \times 12 = R3\ m$
What advice would you give her regarding accessing funds in order to repay the loan? Name TWO points.
Any TWO valid points, e.g. $\checkmark \checkmark \quad \checkmark \checkmark$
 - Liquidate the investment as the interest is only 6%
 - Admit a partner/member
 - Sell off unused property
 - Any other valid point (8)

1.6 Each point named: 1 mark; Figure provided: 1 mark

Jan. actual sales R396 000 Budgeted R540 000 ✓✓

OR Feb. actual sales R360 000 Budgeted R594 000

OR Feb. actual sales R360 000 are less than Jan R396 000

Identify THREE points, with appropriate figures from the Projected Income Statement, which indicate that she has made mistakes in dealing with her customers.

Any **THREE** valid points, e.g. ✓✓ ✓✓ ✓✓

- Advertising only R1 000 per month compared to R5 000 budget
- Discount allowed is nil, despite R2 000 monthly budget – not granting discount, or debtors are paying too slowly to gain the benefit
- The 80% mark-up at all times might be a problem in relation to prices of competitors – offer trade discounts
- Security spent is 50% of the budget of R7 000 – this is causing shop-lifting as evidenced by trading stock deficits which were not budgeted.
- Bad debts R11 880/R10 800 exceed the budget R6 480/R7 128 – indicates poor screening or poor collection. (8)

1.7 **Calculate the monthly salary earned by each shop assistant in January.**

✓ ✓ ✓

$$R24\ 000 / 6 = R4\ 000$$

Calculate the % salary increase that Cheryl granted the shop assistants in February.

$$R16\ 800 / 4 = R4\ 200 \checkmark$$

$$R4\ 000 \times 4 = R16\ 000$$

$$\text{Increase} = R4\ 200 - R4\ 000 \checkmark = R200 \quad R16\ 800 - R16\ 000 = R800$$

$$\% \text{ increase} = 200 / 4000 \times 100 = 5\% \checkmark \checkmark \quad R800 / R16\ 000 = 5\%$$

Give TWO reasons why they would not be happy with this increase. Quote evidence to support your answer.

Any **TWO** valid points, e.g. ✓✓ ✓✓

- The manager received a 25% increase while the assistants received 5%
- The 5% increase is significantly less than the inflation rate of approximately 11%.
- The assistants who resigned were not replaced. The remaining assistants probably have to work harder for a small increase. (11)

TOTAL MARKS: 45