

PoA

Case study: Budgets

50 marks

Required

- You have audited the books, analysed and interpreted the Cash Budgets. You do not share Zodwa’s confidence about her liquidity situation. Calculate the liquidity ratios showing whether there is a good or bad liquidity position on 28 February 2.11. Analyse the answers and give a detailed account with reasons. Include the following ratios:
  - Current ratio
  - Acid-test ratio
  - Period of inventory on hand (in days)
  - Average payment period by debtors (in days)
  - Average creditors payment period (in days).

Information

CASH BUDGET FOR THE PERIOD 1 MARCH TO 31 MAY 2.11

	March 2.11 R	April 2.11 R	May 2.11 R
Cash receipts			
Cash sales *	52 800	24 000	24 000
Cash from debtors **	15 000	45 096	32 688
Total receipts	67 800	69 096	56 688
Cash payments			
Payments to creditors ***	29 091	70 400	32 000
Drawings	6 000	6 000	6 000
Interest on loan	1 400	1 400	733
Repayment: Loan	-	-	50 000
Move to premises	-	15 000	-
Other overhead expenses	7 500	7 500	7 500
Total payments	43 991	100 300	96 233
Cash surplus/(deficit)	23 809	(31 204)	(39 545)
Bank balance beginning of year	28 000	51 809	20 605
Bank balance at the end of year	51 809	20 605	(18 940)

Calculations

* Sales (01/03/10 – 28/02/11) 576 000 · $\frac{110}{100}$	R	633 600
March 2011: $\frac{R633\ 600}{6}$		105 600
Cash = credit		52 800
Other months: $(\frac{R633\ 600 - R105\ 600}{Sales})$		48 000
Cash = credit		24 000
**Debtors		
March: $(\frac{1}{2} \cdot R30\ 000)$		15 000
April: $(\frac{1}{2} \cdot R30\ 000) + (\frac{60}{100} \cdot 52\ 800 \cdot \frac{95}{100}) = R15\ 000 + R30\ 096$		45 096
May: $(\frac{36}{100} \cdot R52\ 800 + (\frac{60}{100} \cdot 24\ 000 \cdot \frac{95}{100})) = R19\ 008 + R13\ 680$		32 688
***Creditors		
March (Balance 28/02/05)		29 091
April: $R105\ 000 \cdot \frac{100}{150}$		70 400
May: $R48\ 000 \cdot \frac{100}{150}$		32 000

- Zodwa indicates that the full-page colour advertisement in the local Community paper will bring her new customers. She states that when she opens her new shop at the Menlyn Mall, she will manage to acquire

- customers of all ages. In your opinion, should she continue to pursue these plans? What advice do you offer to solve her cash flow problems?
- 3 You must advise Zodwa why budgeting is important and how it assists in planning for the future. Refer to
- the benefits
  - the importance of using variances
  - how budgets assist management.

### Background information

Zodwa owns Bukeka Fashions, which is situated close to the Menlyn Mall, Pretoria. She thinks the business performs well. As part of her financial planning she has envisaged the following future business decisions.

- 1 Within the next three months she intends opening another branch at the Menlyn Mall.
- 2 In order to expand, she plans to take out a loan of R50 000. Zodwa states that when she calculated the variances there are not many differences between the actual and budgeted amounts for her previous year's budget. Therefore she is confident that she will have no problem in meeting all her plans and commitments. Her short reports indicate the following:
  - There is R56 000 in the Bank at the moment and profits over the next three months will improve this cash balance.
  - Her creditors allowed her 60 days to settle her accounts, but she has made a point of settling them within 30 days in order to develop a good reputation for her company. All purchases are on credit.
  - She granted her debtors terms of 30 days but some of them have been slow in paying. She is confident that she can rectify this minor problem.
  - She aims to keep between two to three months' inventory on hand at all times in order to attend to the needs of all her customers.

### Additional information

- 1 The 50% mark-up will be maintained. Suppliers agreed to keep prices the same for the next three months.
- 2 One sixth of Zodwa's sales take place in March when most of the schools in the surrounding areas have their Matric Ball. The rest of the sales occur evenly throughout the year.
- 3 Figures extracted from the Financial Statements at the year-end, 28 February, are reflected on the next page.

	2.11 R	2.10 R
Sales (half are on credit)	576 000	
Cost of sales	384 000	
Interest on loan (16% per year)	18 600	
Bad debts	10 000	
Other overhead expenses	90 000	
Inventories (all trading inventory)	85 000	75 000
Trade debtors	30 000	38 000
Cash	31 000	15 000
Trade creditors	29 091	39 091
Loan from Fund Bank: Current position	50 000	45 000
Long-term portion	55 000	105 000

Rubric

Criteria	2 marks	4 marks	5-6 marks	7-8 marks
Liquidity position – Current ratio and acid-test ratio	At least one ratio calculated correctly.	The calculations of both ratios are accurately calculated.	The calculations of both ratios are accurately calculated.	The calculations of both ratios are accurately calculated. Comparisons are made.
Criteria	4 marks	8 marks	12 marks	
Calculation and comments	One calculated correctly: Period of inventory on hand Average payment period by debtors Average creditors period	Two calculated correctly: Period of inventory on hand Average payment period by debtors Average creditors period	Three calculated correctly: Period of inventory on hand Average payment period by debtors Average creditors period	
	<b>3 marks</b>	<b>6 marks</b>		
	Comments A brief comment made on each ratio.	Comments A brief comment made on each and reasons given for its appropriateness to Bukeka.		
Criteria	0-2 marks	3-4 marks		
Solving cash flow problems	Stating whether liquidity problems will be experienced.	Explaining in detail the reasons for the answer.		
	<b>0-2 marks</b>	<b>3-4 marks</b>	<b>5-8 marks</b>	
	Giving a reason for not opening a second shop.	Briefly gives reasons on solving cash flow problems.	Explains in detail the reasons on solving the cash flow problems.	
Criteria	0-2 marks	3-4 marks	5-8 marks	9-12 marks
Importance of budgeting	Explains only why budgeting is important.	Briefly explains budgeting and benefits.	Explains budgeting, benefits and variances.	Explains budgeting, benefits and variances in detail with examples using the given budget. Explains how managers benefit from budgeting.
<b>TOTAL</b>				<b>50 MARKS</b>