

Formal assessment

Presentation Cash budgets (50 marks)

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Background Information

You are provided with information relating to Party Dress Shop. Kash Chand is the owner. She believes that she established a reputable name for her business. To date she has been more than satisfied with the financial results of the business. However, the budget for the next three months has not provided her with much confidence.

She has appointed you to provide her with advice and strategies to improve the cash flow of her business. Use the information provided to prepare a presentation taking into account the following:

- 1 Definition of a budget and an explanation of budgeting periods.
- 2 Advantages of budgeting.
- 3 Complete the Debtors Collection Schedule and the Cash budget
- 4 Comment on the collection from debtors and payments to creditors. What strategies should the business adopt?
- 5 Use the prepared Cash budget to discuss.
 - Whether the business will experience a liquidity problem within the next three months. Explain the main reasons for your answer.
 - What strategies can be implemented to improve the liquidity situation?
- 6 Discuss the following factors to ensure effective and reliable forecasting:
 - past transactions
 - external factors
 - management
 - contractual obligations
 - internal control and ethical business practices

Information:

KASH PARTY DRESS SHOP
DEBTORS COLLECTION SCHEDULE FOR 1 JULY 20.9 TO 30 SEPTEMBER 20.9

	Credit Sales R	July R	August R	September R	Debtors control R	Bad debts R
October	48 000	32 640				960
November						
December						
January						
Total						

KASH PARTY DRESS SHOP

CASH BUDGET FOR PERIOD 1 JULY 20.9 TO 30 SEPTEMBER 20.9

Cash receipts

Collections from debtors

Cash sales

Interest on current account

Proceeds of fixed deposit

Total receipts

Cash payments

Cash purchases of stock

Payments to creditors (for stock)

Wages to bookkeeper

Rent paid

Salaries to employees

Other operating expenses

Cash drawings by owner

Deposit on new vehicle

Instalment on vehicle

Interest on overdraft

Total payments

Cash surplus (deficit)

Bank balance at beginning of month

Bank balance at end of month

	July R	August R	September R
Collections from debtors	?	?	?
Cash sales	?	?	?
Interest on current account	100		
Proceeds of fixed deposit		12 360	
Total receipts	?	?	?
Cash payments			
Cash purchases of stock	?	?	?
Payments to creditors (for stock)	?	?	?
Wages to bookkeeper	5 200	5 200	5 200
Rent paid	8 500	8 500	9 350
Salaries to employees	44 000	40 500	43 740
Other operating expenses	8 300	8 900	9 500
Cash drawings by owner	15 000	15 000	15 000
Deposit on new vehicle		35 000	
Instalment on vehicle			?
Interest on overdraft		334	23
Total payments	(?)	(?)	(?)
Cash surplus (deficit)	?	?	?
Bank balance at beginning of month	24 000	?	?
Bank balance at end of month	?	?	?

Additional Information

1. Sales and Cost of sales:

	Actual sales (?)	Budgeted sales (?)	Cost of sales (?)
June 20.9	120 000	—	80 000
July 20.9	—	105 000	70 000
August 20.9	—	270 000	180 000
September 20.9	—	105 000	70 000

40% of the total sales are sold on credit

Debtors are expected to pay their accounts as follows:

- 30% settle their accounts in the same month as the credit sale.
- 68% settle in the month following the transaction month.
- 2% is to be written off.

A fixed level of trading stock on hand is maintained throughout the year through replacement on a monthly basis.

Purchases of stock:

- 70% of stock is bought on credit.
- Creditors are paid in full in the month following the month of purchase to qualify for a 5% settlement discount.

2. Six full time and one part-time employee earned total salaries of R44 000 for July 20.9. The part-time employee, who earns R3 500 per month, will leave the business at the end of July 20.9. Salaries of the remaining employees will increase effective 1 September 20.9.

3. A vehicle with a carrying value of R48 000 will be traded in at book value on 1 August 20.9 for a new vehicle costing R350 000. A deposit of R35 000 will be paid on 1 August 20.9 and the balance of the outstanding amount will be paid in 10 equal instalments commencing 1 September 20.9.
4. The business has an overdraft of R22 860 on 30 November 20.8. Interest is calculated by the bank (on the previous month-end balances) at the beginning of each month. Provide for interest at the following rates (calculate your answers to the nearest rand):
 - Unfavourable balance 18% p.a.
 - Favourable balance 5% p.a.

Task assessment rubric: Presentation					
Criteria	1 marks	2-4 marks			
Definition and budgeting period	Defines cash budget	Defines cash budget and explains budgeting periods			
Criteria	1-2 marks	3-6 marks			
Advantages of budgeting	Provides a reason	Provides detailed reasons			
Criteria	1-2 marks	3-4 marks	5-6 marks	7-8 marks	9-10 marks
Preparation of Debtors Collection Schedule and Cash Budget	Debtors Collection and Budget has some correct amounts	Debtors and Collection Schedule and Budget is complete with at least 25% correct amounts	Debtors and Collection Schedule and Budget is complete with at least 50% correct amounts	Debtors and Collection Schedule and Budget is complete with at least 75% with correct amounts	Debtors and Collection Schedule and Budget is correctly completed with correct amounts
Comments on debtors and creditors collection	Brief comments	Comment and mentioning of acceptable ratio	Comments and brief strategies mentioned	Comments with good strategies mentioned	Comments and excellent strategies mentioned
Criteria	1-2 marks	3-4 marks	5-6 marks	7-8 marks	9-10 marks
Comments from Cash Budget On Liquidity	List liquidity problems and its causes in detail.	List liquidity problems and its cause in detail. Able to provide a solution	List liquidity problems and its causes in detail. Able to provide a few solutions	List liquidity problems and its causes in detail. Able to provide a few good solutions	List liquidity problems and its causes in detail. Able to provide a few excellent solutions
Criteria	1-2 marks	3-4 marks	5-6 marks	7-8 marks	9-10 marks
Effective and reliable forecasting	At least one comment made	Comments shows that the learners has some understanding	Comments shows understanding	Good comments showing understanding Evident that research was done	Excellent comments showing understanding Evident that extensive research was done
Total (out of 50)					

Suggested answers

1 Budgets

- A budget is a formal written plan which a business draws up to indicate future financial planning.
- It is based on the objectives/goals of a business and is intended to show how policies are to be pursued in order to achieve the objectives/goals.
- It plans for expected revenues and expenses.
- It allocates resources.
- It controls income and expenditure.

The budgeting period

- The budget period will depend on the nature and the size of the business.
- The following is considered:

Long term budgeting: prepared by top management for a period of a number of years. The planning will include capital, financing and staffing needs.

Short-term budgeting: prepared for a period of one year or few months or one month. This gives a more detailed lay out of the budgeting process. It includes expected sales, cost of sales, other income and expenses, the cash float, acquisition of assets, financing of current assets and repayment of non-current and current liabilities.

Medium-term budgeting: forms a link between the long term and short term budgeting process. Budgeting is a continuous process and changes take place depending on the economic situation of markets and the profits of the business.

2 Advantages of budgeting

- Enable businesses to plan for the future.
- Monitor and detect early warning signs of potential problems.
- Provide corrective measures.

3

KASH PARTY DRESS SHOP

DEBTORS COLLECTION SCHEDULE FOR 1 JULY 20.9 TO 30 SEPTEMBER 20.9

	Credit Sales R	July R	August R	September R	Debtors control R	Bad debts R
October	48 000	32 640	—	—	—	960
November	42 000	12 600	28 560	—	—	840
December	108 000	—	32 400	73 440	2 160	—
January	42 000	—	—	12 600	29 400	—
Total	240 000	45 240	60 960	86 040	31 560	1 800

KASH PARTY DRESS SHOP

CASH BUDGET FOR PERIOD 1 JULY 20.9 TO 30 SEPTEMBER 20.9

	July 20.9 R	August 20.9 R	September 20.9 R
Cash receipts			
Collections from debtors	45 240	60 960	86 040
Cash sales	63 000	162 000	63 000
Interest on current account	100	—	—
Proceeds of fixed deposit	—	12 360	—
Total receipts	108 340	235 320	149 040
Cash payments			
Cash purchases of stock	21 000	54 000	21 000
Payments to creditors (for stock)	53 200	46 550	119 700
Wages to bookkeeper	5 200	5 200	5 200
Rent paid	8 500	8 500	9 350
Salaries to employees	44 000	40 500	43 740
Other operating expenses	8 300	8 900	9 500
Cash drawings by owner	15 000	15 000	15 000
Deposit on new vehicle	—	35 000	—
Instalment on vehicle	—	—	30 000
Interest on overdraft	—	334	23
Total payments	(155 200)	(213 984)	(253 513)
Cash surplus (deficit)	46 860	21 336	(104 473)
Bank balance at beginning of month	24 000	(22 860)	(1 524)
Bank balance at end of month	(22 860)	(1 524)	(105 997)

- 4 At the end of the 3 months a collection of R192 240 were collected from debtors R31 560 was still outstanding and an amount of R1 800 for bad debts was recorded.

Concern that only 30% paid with the first month of sale.

Should encourage debtors to pay a greater amount in the first month and offer them a discount.

Should charge debtors interest on overdue debtors account

Creditors are paid the following month and 5% discount is offered.

Should negotiate to pay debtors within 90 months since a greater portion of purchases are on a credit basis

Any other reasonable answer

5 Problems

- Cash flow problems. Overdraft of bank. The amount R105 997 deficit is recorded for September from R1 525 in August.
- Expenses increased and Sales decreased.
- Purchasing a new vehicle for R350 000 was the main contributing factor to the cash flow problems
- $6 \text{ workers} \times R40\,500 \div 6 = R6\,750$ per month. Might be that there are too many staff employed.
- The bookkeeper, who earns R5 200, contributes to the cash flow problems.
- Strategies
- Get Debtors to pay 50% up front
- Kash could make an additional capital contribution
- A loan or overdraft facility can be negotiated with the bank

- Need to look at strategies to improve sales
 - » This can be done through effective advertising or approaching schools (matric dances) and companies (year-end functions)
 - » The mark-up percentage on cost can be increased as the festive season is approaching.
- Kash should hold on in the purchasing of the new vehicle or consider a higher purchase agreement so the monthly payments can be lower.
- Decrease the drawings from the business until the business shows a more positive cash flow.

6 Reliable and representative records of past transactions.

Use of comparative figures.

Results are regularly measured and compared with predetermined objectives.

Consider external factors e.g. deteriorating economic conditions, inflation, etc.

Take into account internal logical assumptions and contractual obligations (e.g. loans, paying your workers etc.) relating to the future.

Internal factors considered for:

- the purchase of fixed assets
- the purchase of stock
- Sales and Debtors collection period
- Purchases and Creditors payment period
- financing methods and sources.

Ethical consideration – King III Report regarding

- discipline
- independence
- responsibility
- fairness
- social responsibility
- transparency
- accountability.