Chapter 8 - Finance

1 (2015)

			It will help Amrod Ltd manage its cash flow and live within its means. It acts as a **financial control mechanism** that can be used to measure actual cash flow against planned cash flow encouraging Amrod Ltd to plan its finances sensibly and live within its means and not to overtrade/Avoids cash flow problems as costs are considered in advance/ to ensure it has sufficient funds.	
			It will help Amrod Ltd identify periods of time in the future when the business will have an excess of expenditure over income i.e. a deficit and then take corrective action/assess the best methods to deal with the cash shortfall/ Enable Amrod Ltd to use its **scarce resources** more effectively. It will help Amrod Ltd identify periods of time in the future when the business will have a surplus of income over expenditure. Amrod Ltd can then make plans to place these **surplus funds** on deposit with a financial institution or make expansion decisions. It will help Amrod Ltd **gain access to finance** from financial institutions as the cash flow forecast is an integral part of the business plan given to banks and other potential investors/ Supports applications for loans and grants etc.	
			A = (€10,000) =2m **B** = (€30,000)= 2m (90,000 -120,000)= 1m **C** = €20,000 =2m	
6	**C**	**iii**	Financial Problem: The deficits months are October and December. How to address: Avail of a short-term source of finance: Amrod Ltd could arrange a bank overdraft facility with its bank to finance problem months where the business is running a deficit. The overdraft facility provides extra flexibility for Amrod Ltd when it needs it most. However, care should be taken because the rate of interest charged on a bank overdraft is high. Other short term sources could be considered such as trade credit (delaying payment to creditors/ seeking an extension period of credit from creditors).	
			Adjust receipts: Its receipts in October and December could be increased by changing its marketing mix, e.g. lowering price to sell more, increasing the price depending on elasticities, designing new products or more effective promotion campaigns/reducing period of credit given to debtors/cash sales only. Adjust payments: The business could decrease its cash payments by sourcing cheaper suppliers, restructuring loan repayments or asking employees to take a wage decrease. By moving €10,000 of payments from October to November, the company would break even at the end of October etc.	

(i) Explain the benefits to Buttercup Garden Centre of preparing a Cash Flow Forecast.

- Identifying the timing and sources of cash inflows
- Identifying the timing and sources of cash outflows
- Establishing Net Inflows/Outflows – business can then plan effectively to meet cash shortages/or alternatively consider their options in relation to a large cash surplus
- Provides a benchmark against which actual performance can be compared, aiding financial control
- Access to finance from financial institutions

(ii) Based on the information provided above, outline how Buttercup Garden Centre could improve the Cash Flow position of its business.

A. <u>Purchase of Equipment – Capital Expenditure</u>

Buttercup Garden Centre plans to purchase and pay for equipment out of Cash Flow in October 2008. Equipment is an item of capital expenditure and will most probably be used in the business over a period of a number of years. Buttercup should consider taking out a medium term loan to pay for the equipment – this would ease their Cash Flow position considerably, and provide access to badly needed cash.

B. Access to Credit/Bank Overdraft

Buttercup Garden Centre will need to negotiate a bank overdraft with its local bank. If trade continues as per the month of December, and there are no changes in overheads or other unforeseen expenses it will take at least another five months to clear the forecasted deficit of €5000.

C. Credit Control

Information provided in the Cash Flow forecast for Buttercup Garden Centre shows that:

- Cash Sales are expected to decrease, while the level of Credit Sales is expected to increase over the three-month budgeted period.
- Cash purchases are expected to increase, while Credit Purchases are expected to decrease over the three-month period.

Both sales and purchases forecasts are putting pressure on Cash Flow, and the availability of cash. Buttercup needs to review its credit policy – decrease cash purchases if possible and increase Cash Sales.

D. Control of Overheads

Wages increase from €6000 to €7500 (a 25% increase) from October to December, yet sales fall in the same period. Buttercup Garden Centre needs to review and control the amount of money spent on wages.

3 (2007)

(B) Cash Flow Forecast

(i) Cash flow forecast prepared by Balden Ltd (why?):

- Measure the expected liquidity for July to September
- Identify problem areas/periods
- Plan for sources of finance
- Compare with previous forecasts
- Good cash management.

(ii) Financial issue in forecast

- July: Net Cash deficit of €10,000
  How? – Increase Receipts, quicker collection of outstanding money from Debtors
  – Arrange a short-term source of finance, e.g. bank overdraft.

(C) Liquidity Ratios

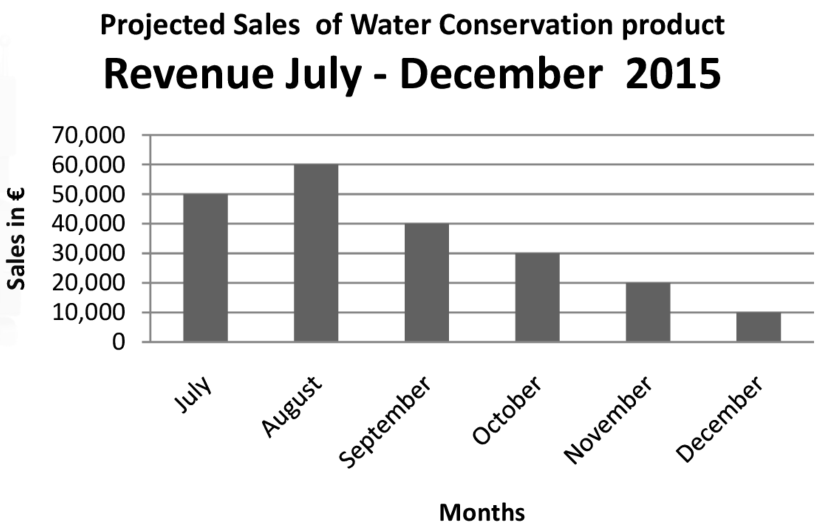
Two liquidity ratios (name):
(i) Working Capital ratio
(ii) Acid Test ratio.

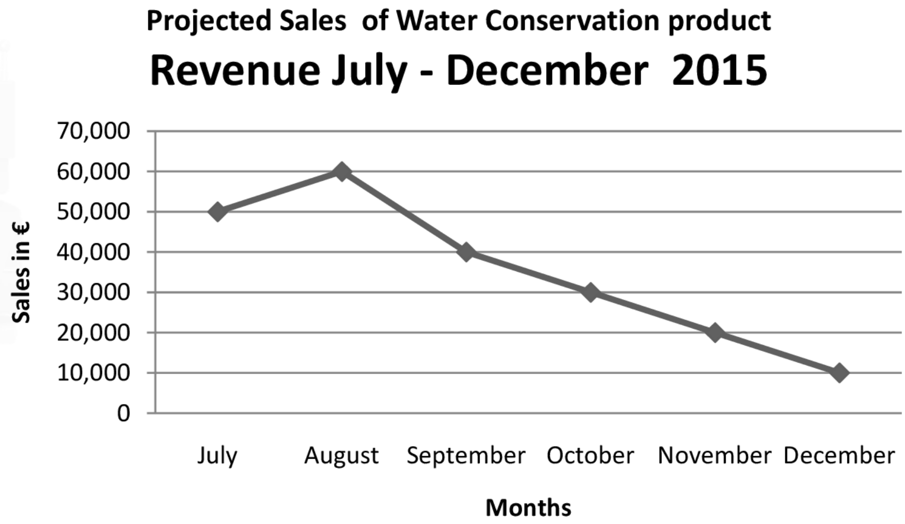
(i) Working Capital ratio: Current Assets : Current Liabilities (2:1)
(ii) Acid Test ratio: Current Assets – Closing Stock : Current Liabilities (1:1)
Description of their respective benefits required

4 (2005)

10	2 (1 + 1) + 2 + 2 + 2 + labels 2 marks

5 (2015)



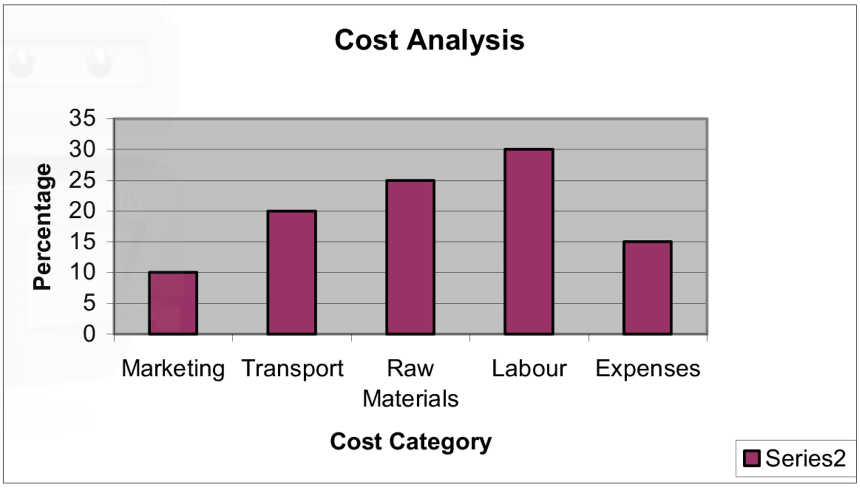


4	**A**	**ii**	**Outline the principles Paul should consider to ensure he communicates his message effectively to the board of directors.**	
			Audience knowledge/Preparation: Know your audience as it will influence the tone, voice and quality of the message/Your message must reflect the education level, aims and objectives of your audience. Paul should know the strengths and weaknesses of the board/Target the message to his specific audience, the board of directors (BOD) and see things from their perspective.	
			Accuracy: Have a thorough knowledge of the topic to be discussed/ All factual information must be accurate/ Have an introduction, plan of action and expected outcomes. Paul should anticipate the concerns of the BOD and have considered possible responses.	
			Clarity/appropriate language/conciseness: If the language is too technical or too difficult for the board of directors to understand then the message may be misinterpreted. Paul needs to choose language appropriate to his audience and he may use short clear sentences/avoid jargon/give the bottom line.	
			Visuals: “A picture is worth a thousand words” and visual supports such as bar charts and line graphs communicate financial data very effectively. By presenting the financial information in a chart Paul is making it easier for the BOD to process the information quicker. A power point presentation could have a strong impact.	
			Confidentiality/safety: The medium chosen must be appropriate to the message been given. If the message is sensitive (projected sales data for a new product) meetings are more appropriate and effective. Face-to face may be more effective for sensitive information. Competitors would be very interested in Paul’s projects sales figures.	
			Feedback: The board of directors may be looking for /or giving feedback in order to take further action in relation to the product. This may be a reason for organising a meeting as it allows for immediate feedback and clarification and provides an opportunity for Paul to eliminate any misunderstandings. Other acceptable points: Timing/appropriate method/need for record etc.	

6 (2003)

10	2 + 2 + 2 + 2 + 2 marks. No Title and Labels (-2 marks)

10. Bar Chart



7 (2002)

(C) (i)Why prepare a Cash Flow Forecast

- Cash is money that can be readily exchanged for goods or services. It is said to be 'liquid' in that it can be spent at a moment's notice. Without an adequate level of cash (or near cash) to allow purchases to be made, the ability of an enterprise to conduct business is limited. The flow of cash into and out of a business (Cash Flow) is an excellent way of measuring whether the business is performing well or not.

- To check the ability of a business to pay its bills or to meet its liabilities as they fall due to be paid. Liquidity or cash flow problems are related to a shortage of cash. The enterprise may have to 'lean on the trade', i.e. take trade credit but be slow in making payment, running the risk of a loss in reputation, credibility and loss of discounts.

- To locate problem areas. A business may not collecting cash from its debtors and therefore must fund its operation from its own money or from borrowing. Costs go up.

- To ensure that income from sales of stock, sale of assets, grants from government agencies and investments which generate interest income are adequate to cover out-goings. A business enterprise would have to spend its money on buying stock, paying wages, etc., i.e. current expenditure and also on buying replacement or new assets for the business, e.g. machinery, i.e. capital expenditure.

- To plan for sources of Finance eg. bank overdrafts, accrued expenses, creditors and invoice discounting. Medium term finance, hire purchase, leasing or the longer term sources, debentures, commercial mortgages, equity capital, venture capital and the reinvestment of the profits back into the business.

- Good cash management. All business enterprises will keep a certain amount of cash, usually quite small, on the premises or in a bank account, readily available for emergency spending. The enterprise will attempt to manage the amount of cash held so that there will not be too much or too little cash at any one time.

- **July:** Net cash (€12,000) is negative and receipts are low compared to payments.
- **August:** Net cash is positive €2,750 and payments (out-goings) are decreasing in Aug.
- **September:** Overdraft increased and payments increased (perhaps purchase of machinery?).
- **July, August and Sept**. Receipts decreasing steadily.

(ii) Reduce or control expenses.

Increase receipts eg sales/decrease payments. Reduce purchases. Arrange overdraft facilities. Improve Credit Control and credit collection procedures.