

# Sweats galore case 6 essay



**ASSIGN  
BUSTER**

SWEATS GALORE 1. Yes, it is important for Michael to stipulate certain criteria during planning for his new business. Michael is wise to set criteria other than simply making a profit. First, Michael wants to do something he enjoys. Because he has prior experience in a related industry and he has envisioned having his own business he will be better prepared to handle the responsibilities of this new business. Michael's positive attitude will be reflected in the way he handles employees and customers.

Michael's business will probably come from customers such as university groups, church groups, civic organizations, youth athletic clubs, and secondary school groups. Because Michael is offering quality shirts at a modest price, he will, in effect, be contributing to the community. In addition, as Michael's company becomes more profitable he will give back to the community through cash donations to some of these groups. Michael's foresight (wanting to grow and be more successful every year) will encourage him to make decisions that will profit the business not just in the short run, but also in the long run. . The difference in the high and low levels of activity is 6, 000 units (8, 000 units in September less 2, 000 units in January). The difference in utility costs is \$300 (\$1, 400 - \$1, 100).

Therefore, estimated variable cost per unit is \$. 05 and total fixed costs are \$1, 000 computed as follows:  $\$300 \div 6,000 = \$.05$   $\$1,400 - (\$.05 \times 8,000) = \$1,000$  The difference in maintenance costs is \$198 (\$1, 914 - \$1, 716). Therefore, estimated variable cost per unit is \$. 033 and total fixed costs are \$1, 650 computed as follows:  $\$198 \div 6,000 = \$.33$   $\$1,914 - (\$.033 \times 8,000) = \$1,650$  If Michael has sales of \$12, 000, the units sold total 750 ( $\$12,000 \div \$16$ ). Therefore his total variable costs relating to utilities

and maintenance for 750 shirts total \$62.25 computed as follows: 750 shirts X \$.05 = \$37.50 750 shirts X \$.033 = \$24.75 If Michael has sales of \$12,000, the total fixed costs would be \$2,650 (\$1,000 + \$1,650). CASE 6 (Continued) 3. SWEATS GALORE Sales Budget For the Year Ending December 31, 2008

Quarter	1	2	3	4	Year
Expected unit sales	8,000	10,000	20,000	12,000	50,000
Unit selling price	\$16	\$16	\$16	\$16	\$16
Budgeted sales revenue	\$128,000	\$160,000	\$320,000	\$192,000	\$800,000

4. SWEATS GALORE Schedule of Expected Collections from Customers For the Year Ending December 31, 2008

Quarter	1	2	3	4	Year
Accounts receivable 1/1/08	0	0	0	0	0
First quarter	(\$128,000)	\$89,600	\$38,400	0	0
Second quarter	0	(\$160,000)	112,000	\$48,000	0
Third quarter	0	0	(\$320,000)	224,000	\$96,000
Fourth quarter	0	0	0	(\$192,000)	134,400
Total collections	\$89,600	\$150,400	\$272,000	\$230,400	\$742,400

5. SWEATS GALORE Shirt Purchases Budget

For the Year Ending December 31, 2008

Quarter	1	2	3	4	Year
Shirts to be silk-screened	8,000	10,000	20,000	12,000	50,000
Plus: Desired ending inventory	2,500	5,000	3,000	4,500	4,500
Total shirts required	10,500	15,000	23,000	16,500	54,500
Less: Beginning inventory	0	2,500	5,000	3,000	0
Total shirts needed	10,500	12,500	18,000	13,500	54,500
Cost per shirt*	\$10	\$10	\$10	\$10	\$10
Total cost of shirt purchases	\$105,000	\$125,000	\$180,000	\$135,000	\$545,000

\*\$1,440 ? 144 (a gross) CASE 6 (Continued) 6. SWEATS GALORE

Schedule of Expected Payments for Purchases For the Year Ending December 31, 2008

Quarter	1	2	3	4	Year
Account payable 1/1/08	0	0	0	0	0
First quarter	(\$105,000)	0	0	0	0

000)\$42, 000\$ 63, 000 Second quarter (\$125, 000)50, 000\$ 75, 000 Third quarter (\$180, 000)72, 000\$108, 000 Fourth quarter (\$135, 000) 54, 000 Total payments\$42, 000\$113, 000\$147, 000\$162, 000

7. SWEATS GALORE Silk-Screen Labor Budget For the Year Ending December 31, 2008

Quarter	1234	Year	Units to be produced	8, 000	10, 000	20, 000	12, 000	50, 000	Silk-screen labor hours per unit*	12 hrs.	12 hrs.	12 hrs.	12 hrs.	2 hrs	Total required silk-screen labor hours	960	1, 200	2, 400	1, 440	6, 000	Silk-screen labor cost per hour**	\$12	\$12	\$12	\$12	\$12	Total silk-screen labor cost	\$11, 520	\$14, 400	\$28, 800	\$17, 280	\$72, 000
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\*(6 workers X 20 hrs. X 50 weeks) ? 50, 000 shirts \*\*\$72, 000 ? (6 X 20 hrs. X 50)

CASE 6 (Continued) 8. SWEATS GALORE Selling and Administrative Expenses Budget For the Year Ending December 31, 2008

Quarter	1234	Year	Variable expenses	Sales commissions	\$12, 800	\$16, 000	\$32, 000	\$19, 200	\$ 80, 000	Total variable expenses	12, 800	16, 000	32, 000	19, 200	80, 000	Fixed expenses
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Advertising [(\$25 + \$75) X 13] \$ 1, 300 \$ 1, 300 \$ 1, 300 \$ 1, 300 \$ 5, 200  
 Rent (\$1, 000 X . 25 X 3)7507507507503, 000 Sales salaries (\$1, 200 X . 50 X 3) 1, 800 1, 800 1, 800 1, 800 7, 200 Office salaries1, 8001, 8001, 8001, 8007, 200 Depreciation\*75757575300 Property taxes and Insurance (\$380 ? 4) 95 95 95 95 380 Total fixed expenses 5, 820 5, 820 5, 820 5, 820 23, 280  
 Total selling and administrative expenses\$18, 620\$21, 820\$37, 820\$25, 020\$103, 280 \*[((\$2, 000 ? 10) + (\$500 ? 5)] ? 4

9. SWEATS GALORE Silk-screen Overhead Expenses Budget For the Year Ending December 31, 2008

Quarter	234	Year	Variable expenses	Ink (\$. 75/unit)	\$ 6, 000	\$ 7, 500	\$15, 000	\$ 9, 000	\$37, 500	Maintenance (\$. 033/unit)	264	330	660	396	1, 650	Utilities (\$. 05/unit)	400	500	1, 000	600	2, 500	Graphics design (\$. 10/unit)	800	1, 000	2,
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000 1, 200 5, 000 Total variable expenses 7, 464 9, 330 18, 660 11, 196 46,  
 650 Fixed expenses Rent (\$1, 000 X . 75 X 3)2, 2502, 2502, 2502, 2509, 000  
 Maintenance (\$1, 650 X 3)4, 9504, 9504, 9504, 95019, 800 Utilities (\$1, 000  
 X 3)3, 0003, 0003, 0003, 00012, 000 Graphics design (\$500 X 3)1, 5001,  
 5001, 5001, 5006, 000 Property taxes and insurance (\$2, 240 ? 4) 560 60  
 560 560 2, 240 Depreciation\* 690 690 690 690 2, 760 Total fixed expenses  
 12, 950 12, 950 12, 950 12, 950 51, 800 Total silk-screen overhead\$20,  
 414\$22, 280\$31, 610\$24, 146\$98, 450 Direct silk-screen hours9601, 2002,  
 4001, 4406, 000 Overhead rate per silk-screen hour\$16. 41 \*(\$7, 500 ? 5) +  
 [(\$1, 350 + \$2, 500) ? 10] + (\$3, 500 ? 4)] = \$2, 760; \$2, 760 ? 4 = \$690

CASE 6 (Continued) 10. SWEATS GALORE Budgeted Income Statement For  
 the Year Ending December 31, 2008 Sales\$800, 000 Cost of goods sold\*670,  
 450 Gross profit 129, 550 Selling and administrative expenses 103, 280  
 Income from operations26, 270 Interest expense (\$20, 000 X . 08) 1, 600  
 Income before income taxes 24, 670 Income tax expense (\$24, 670 X . 20) 4,  
 934 Net income\$ 19, 736 \*Purchase of shirts\$500, 000 (50, 000 @ \$10)

\*Labor 72, 000 \*Overhead 98, 450 \$670, 450 CASE 6 (Continued) 11.

SWEATS GALORE Cash Budget For the Year Ending December 31, 2008

Quarter 1234 Beginning cash balance\$ -0- \$ 9, 136(\$ 19, 874)\$ 7, 661 Add:  
 Receipts Collections from customers 89, 600 150, 400 272, 000 230, 400  
 Total available cash 89, 600 159, 536 252, 126 238, 061 Less:  
 Disbursements

Payments for shirt purchases42, 000113, 000147, 000162, 000 Silk-screen  
 labor11, 52014, 40028, 80017, 280 Silk-screen overhead19, 724\*21, 59030,  
 92023, 456 Selling and administrative expenses 18, 545 \*\* 21, 745 37, 745

24, 945 Payment for equipment purchase 8, 675\*\*\* 8, 675 0 0 Total  
 disbursements 100, 464 179, 410 244, 465 227, 681 Excess (deficiency) of  
 available cash over disbursements(10, 864)(19, 874)7, 661\$10, 380  
 Financing Borrowings 20, 000 ??? 0 0 0 Ending cash balance\$ 9, 136(\$ 19,  
 874)\$ 7, 661\$ 10, 380 \$20, 414 - \$690 depreciation \*\*\$18, 620 - \$75  
 depreciation \*\*\*( $\$7, 500 + \$1, 350 + \$2, 500 + \$3, 500 + \$2, 000 + \$500$ ) X

#### . 50 12. SWEATS GALORE Budgeted Balance Sheet December 31, 2008

Assets Cash\$ 10, 380 Accounts receivable ( $\$192, 000 \times . 30$ )57, 600  
 Sweatshirt inventory ( $4, 500 \times \$10$ )45, 000 Equipment ( $\$7, 500 + \$1, 350 +$   
 $\$2, 500 + \$3, 500 + \$2, 000 + \$500$ )17, 350 Less: Accumulated depreciation  
 ( $\$300 + \$2, 760$ ) (3, 060) Total assets\$127, 270 CASE 6 (Continued)

Liabilities and Owner's Equity Accounts payable ( $\$135, 000 \times . 60$ )\$ 81, 000  
 Notes payable20, 000 Interest payable ( $\$20, 000 \times . 8$ )1, 600 Taxes payable  
 4, 934 Total liabilities107, 534 Michael Woods, Capital 19, 736 Total liabilities  
 and owner's equity\$127, 270 13. (a)Unit Selling Price - Unit Variable Costs =

Contribution Margin  $\$16 - \$10 - (\$80, 000 \div 50, 000) - (\$46, 650 \div 50, 000)$   
 = Contribution Margin  $\$16 - \$12. 533 = \$3. 467$  (b) Estimated fixed costs:

Selling and administrative\$ 23, 280 Overhead51, 800 Salaries72, 000

Interest1, 600 Taxes 4, 934 Total estimated fixed costs\$153, 614 (c)Fixed  
 costs  $\div$  CM = Break-even point in units  $\$153, 614 \div \$3. 467 = 44, 308$  Break-  
 even point in units  $4, 308 \times \$16 = \$708, 928$  Break-even point in dollars 14.

(a)Required Sales = VC + FC + Target Net Income  $\$16X = \$12. 533x +$   
 $\$153, 614 + \$25, 000$   $\$3. 467X = \$178, 614$   $X = 51, 519$  shirts (b)Michael's  
 net income differs from his cash balance because he uses accrual basis  
 accounting to compute his net income. Consequently net income includes  
 revenue that has not been received and expenses that have not been paid.

For example, Michael included revenue of \$57, 600 in the Budgeted Income Statement that was not in the Cash Budget because it was earned but not received.

Likewise items such as accounts payable, notes payable, interest payable, and taxes payable affect the Income Statement in one period and the Cash Budget in another period. CASE 6 (Continued) 15. Answers will vary. Some students will argue that the 10 percent commission is too high and Michael should try to find someone with similar qualifications who is willing to work for a smaller commission. Other students will argue that with Cary Sue's contacts, Michael's sales would be much lower without Cary Sue. In addition, they may argue that if sales are low, Cary Sue's commission will also be low.