A analyzing of cash budgets and hoe its used to make decisions finance essay

Regardless of the type of business, the ability to gauge performance using budgeting is a matter of life and death in the business world. Hence, to make decisions on the organization most managers use the cash budget, which forecast cash inflows and outflows. Moving from organizations budgeting systems, then comes another important element for products, the unit cost. Adding up, unit cost relates resources consumed to outputs produced to help managers to make better management and resource allocation decisions.

Moreover, looking at pricing, it is the most important decision that is made in an organization upon its products and services. Never the less, there are many approaches to pricing, some scientific, some not. Yet, all the methods are been used by organizations managements to become the market leader by taking the righteous pricing decisions. Besides pricing decisions, one of the most important long-term decisions for any business relates to investment. Investment is the purchase or creation of assets with the objective of making gains in the future. This is discussed further in the body of the report.

Last but not the least, records that provide an indication of a company's assets and debts, are well known as financial statements. There are main financial statements, which helps managers to forecast and make better decisions on the organizations issues. Furthermore, these financial statements differ from one business type to another. In addition, these can be justified annually using a number of ratios.

Introduction

Just as there are several organizational models for delivering extension services to the public, there are a number of ways to finance those services and to keep track of the money. Financial management may be fundamental to success. Poor financial management, on the other hand, often accompanies and contributes to failure.

Managing financial resources and making decisions look upon principles related to money matters. Managers apply these concepts as appropriate to situations they face in their own organizations and in accordance with the rules and customs of their own countries. Because people are more readily inclined to apply ideas that deal with practical concerns, this discussion will be organized around practical problems.

Task 1 (P3. 1)

Case Study – Budgets

Analyzing of Cash Budget and how it's used to Make Decisions

Every organization knows the significant of a cash budget and how it can be determine the future directions of its business. In fact, cash budget is one of the key components of a master budget. Never the less, it is the most difficult budget to prepare as compared to the rest. Cash budget in reality is a foretell of cash inflow and cash outflow actions, which are likely to take place in the future. It can be a net cash surplus or net cash shortfall position.

Cash Inflows

Operating Activities

From sales of goods and services

From returns on invesment

Ä°nvesting Activities

From sales of plant, property and equipment

From sales of invesment

From collection of principal on loans to other companies

Financing Activities

From sales of equity securities (issuing company's own stock)

From issuing debt

Cash Outflows

Operating Activities

To suppliers for inventory and expenses

To employees for service

To governmrnt for taxes

To lenders for interest

Ä°nvesting Activities

To purchase property, plant and equipment

To purchase invesments in othr companies (debt or equity)

To make loans to other entities

Financing Activities

To shareholders as dividend

To repay long-term debt

Cash Surplus

A cash surplus is the cash that exceeds the cash necessary for routine operations. Deciding where to use cash surplus requires planning and better judgment. The most common uses are paying down the debt, investing in capital projects, payments to stakeholder or placing the cash surplus in short term investments so that the business has cash for an urgent situation.

Preparing a cash budget helps every organization and its management to make wise decisions. By using a cash budget the organization can make better decisions on effects such as,

Whether the company has sufficient cash to meet its every day needs

How the company can store optional cash

Companies cash expenses ratio

Free cash flow

Nonetheless, by preparing cash budgets the company can come up with decisions to meet problems such as, inflation, supply fluctuation, demand variations, credit shortages and the like. In addition, the cash budget also provides the management to make effective and efficient decisions on performance evaluations, where managers can focus on the activities in the areas where outcome are well ahead of expectation.

Moreover, since cash budgeting is a plan and road map, the managers can make decisions on how to borrow money or to cover cash shortfalls.

Task 2 (P3. 2)

Case Study – Unit Cost

Manufacturing Account

Where a business engages in manufacturing activities a manufacturing account would be prepared with the objectives of establishing the total cost of manufacturing. Having established the total cost of manufacturing, it would then be transferred to the trading account under cost of sales.

Manufacturing Account

Materials

Opening stock xxx

Purchase xx

Carriage inwards xx

Import duties xx

Warehousing charges xx

Any other direct expenses relating materials xx

XX

Returns outwards (x) xxx

xxx

Closing stock (x)

Raw materials consumed XXX Direct wages x

Royalty charges x

Any other direct expenses x xx

Prime cost XXX

Factory overheads

Factory rents & rates xx

Repairs & maintenance xx

Depreciation xx

Insurance xx

Heat & light xx

Factory managers salary xx xxx

Factory cost of production XXX

Work in progress

Opening stock xx

(-)Closing stock (x) xx

Factory cost of goods completed XXX

(Transferred to trading account)

Following are the methods to find one unit of the total cost of manufacturing

Total cost of a unit can be calculated by combining variable cost and fixed cost.

TC= VC+FC

Total cost of a unit can be calculated by in view of the prime cost and the overheads.

Total cost = prime cost + overheads

Costs are classified in three different rudiments, they are,

By nature – this includes material cost, labour cost and expenses

By function – this includes production cost, administration cost, selling and distributing cost and RD cost

By behavior – fixed, variable, semi variable

By Nature

Direct costs – costs that can be easily and conveniently traced out to a unit of product or other cost objectives. Example: direct material and labour

Indirect costs – costs cannot be easily and conveniently traced out to a unit of product or other objectives.

Example: manufacturing overhead

Manufacturing costs

Direct labour – those labour costs can be easily traced to individual units of product.

Example: wages paid to workers

Direct material – those materials that become an integral part of the product and that can be conveniently traced directly to it.

Example: a radio fixed to a car

Direct expenses – those expenses that can be easily charged to individual units of products.

Example: design cost of car

By Function

Classification by function means that when an examination is based on the function of the event (or cost of sales method), this will catalog expenses according to their function as part of cost of sales, distribution or administrative activities. While this arrangement can provide information that is more relevant to users, the allotment of costs to function can often be arbitrary. Organizations who chose to do this should unveil additional information on the nature of expenses, including decline and staff costs. The enterprise should choose the analysis that provides the fairest presentation of the business activities.

By Behavior

Variable cost

Total variable cost changes with activities. Total cost of materials depend on how much materials are been used. Example: raw materials, electricity. Variable costs can also be called direct costs as they are directly associated with production.

Variable cost per unit

Per unit, material cost will remain constant.

Fixed costs

Fixed cost probably does not change when a production is completed. Example: salaries, rent, tax, insurance, heating and lighting. Fixed costs can also be called indirect costs, as they are not directly associated with the final product.

Fixed cost per unit

The average fixed cost per unit decreases as more production is finished.

Semi variable costs

These costs have fixed and variable elements. Example: a person working for the company may have a fixed salary but may also earn commission on sales.

Task 3 (P3. 2)

Case Study – Pricing Decisions

Information Needed to make Pricing Decisions

Pricing is one of the four aspects of marketing. The other three parts of the marketing mix are product management, promotion and distribution. It is also a key variable in microeconomic price allocation theory. Following are the information needed to make pricing decisions.

Demand of Customers

The demands of customers are very important for all business operations, especially when setting prices. For an instance, if a customer wants higher quality equipment, it will enmesh greater production and expensive raw materials. The result will be a higher price. Then again, the management should be vigilant not to price the products out of the market. Hence, the customer demand is gravely important in this process. Therefore, the companies should price their products based on customer survey and market research.

Cost

Firms that combined accurate cost data with internally and externally generated market information appear to be able to follow more flexible and adaptive pricing practice. When analyzing cost, the marketers consider all costs needed to get the product to market. Looking at an example, in the agriculture industry, where grain and meat prices are market driven, farmers must meet the market price. Therefore, to make profit, they must produce at a low cost below the market price. Moreover, looking at a public utility pricing, a request will be made to the public utility commission for a rate increase based on its current and projected production cost. No organization or industry can price its products below their production costs indefinitely. In addition, no companies' management can set prices blindly at cost plus a markup without keeping an eye on the market.

Competitors

Marketers should undoubtedly look to market competitors for indications of how price set. Price analysis can be somewhat more complicated for products sold to the business market since a number of factors including if competitors allow customers to negotiate their final price may affect final price.

Direct Competitor Pricing – pricing will include an evaluation of competitors' offerings. The impact of this information on the actual setting of price will depend on the competitive nature of the market. Marketers must not only research competitive prices but must also pay close attention to how these companies will respond to the marketer's pricing decisions. For instance, in highly competitive industries, such as gasoline or airline travel, competitors may respond quickly to competitors' price adjustments thus reducing the effect of such changes.

Related Product Pricing – For example, a marketer of a new online golf instruction service that allows customers to access golf instruction via their computer may look at prices charged by local golf professionals for in-person instruction to gauge where to set their price. While on the surface online golf instruction may not be a direct competitor to a golf instructor, marketers for the online service can use the cost of in-person instruction as a reference point for setting price.

Primary Product Pricing – For example, Bluetooth headsets are considered complementary to the primary product cell phones. The pricing of complementary products may be affected by pricing changes made to the primary product since customers may compare the price for complementary products based on the primary product price.

Political and Legal Issues

In the legal area, managers must hold on to certain laws. The law generally prohibits companies from discriminating among their customers in setting prices. Adding up, it is also prohibited in collusion price setting, where the major firms in an industry all agree to set their prices at a high level.

Taking political environment to consideration, for an example, if the firms in an industry are perceived by, the public are reaping unduly large profits; there may be political strain on legislators to tax those profits differentially or to mediate in some way to control price.

Task 4 (3. 3)

Case study – Investment Appraisal

Net present value

(-2000) Ã- 1

500 Ã- (1 + r)^-12

500Ã- (1 + r)^-13

600Ã- (1 + r)^-14

600Ã- (1 + r)^-15

400Ã- (1 + r)^-16

There for the answer will be,

(-2000) Ã- 1 = -2000

500 Ã- (1 + 0. 12)^12 = 128. 33

500 Ã- (1 + 0. 12)^13 = 114. 58

600 Ã- (1 + 0. 12)^14 = 122. 77

600 Ã- (1 + 0. 12)^15 = 109. 61

400 Ã- (1 + 0. 12)^16= 65. 24

540. 53

NPV=(-2000) – (540. 53)

= (– 1459. 47)

Internal rate of value

A= 5% B= 10%

500 (1 + 0. 5)^-12= 3. 85 500 (1 + 0. 1)^ -12= 159. 31

500 (1 + 0. 5)^-13= 2. 56 500 (1 + 0. 1)^ -13= 144. 83

600 (1 + 0. 5)^-14= 2. 05 600 (1 + 0. 1)^ -14= 157. 99

600 (1 + 0. 5)^-15= 1. 37 600 (1 + 0. 1)^ -15= 143. 63

400 (1 + 0. 5)^16= 0. 60 400 (1 + 0. 1)^ -16= 87. 05

A= 10. 43 B= 692. 81

IRRA= A+ NPVa (b – a) %

NPVa – NPVb

= 10. 43+ 10. 43 692. 81 – 10. 43 %

10. 43 – 692. 81

= (– 4710. 34)

Concepts of Payback Period

It is said to be " the length of time required to recover the cost of an investment".

Calculated as:

=

The payback period is a simple technique for assessing an investment by considering how long it would take to be repaid. Payback period is easy to calculate and is easy to understand. In addition the payback period has limitations such as, ignorance of time value of money and the ignorance of benefits that occur after the payback period.

For example, if a company project requires an investment of $100, 000 is expected to endow with annual cash flow of $25, 000, the PP would be four years.

Accounting Rate of Return

The accounting rate of return of the investment appraisal goes under a number of guises, with a multitude of definitions as to its calculations. There is no accepted formula for the ARR; therefore, the management of a company should select whichever formula suits them the best. Although a distinction is made between the accounting rates of return based on initial investment and average investment.

The ARR is theoretically similar to payback period, and the flaws in particular, are similar. The highlighted disparity is that it tends to favor higher risk decisions unlike the PP, which leads to excessively traditional decisions.

Task 5 (P4)

Case study – Financial Statements

Purpose of the Main Financial Statements

Financial statements are the basic elements one need to start or manage the business.

Balance sheet

The balance sheet gives an idea of the financing structure of the company. It lists in detail the tangible and intangible goods that the company owns or owes. These goods can be categorized as shown below.

Assets

Current Assets

These can be easily converted in cash within a short period. Such current assets include cash, marketable securities, accounts receivable, inventories and any other item that could be converted into cash with a year's time in the normal course of business.

Fixed Assets

Fixed assets refer to property, plant and equipment, buildings, land and machines owned by the company. They represent long-term liquid investments and support depreciation.

Other Assets

These include any intangible assets, such as patents, copyrights, other intellectual property and notes receivable from employees and officers.

Liabilities

Liabilities are all the debts and obligations a company owes to outside people such as suppliers and banks.

Cash flow Statement

The purpose of this financial statement is to keep an account of the different activities of the council. As for the income statement, the cash flow statement covers only one year. This also provides information on the mode of generation of funds required for payment. Nonetheless, the cash flow statement can also be used to evaluate the cash that would be essential to meet the operating costs.

Income Statement

This type of financial statement keeps an account of the net surplus or deficit. By having a detailed account of the past, one can forecast and assess the future performance of the company.

Profit and Loss Accounts

These summarize the income and expenses of a company in a given period. This can be used to include accruals as well. The P&L can be used in computing net income for the period and identifying major revenue and expenses items that affect net income. For example, if a company has $10 million in monthly revenues and $7. 5 million in expenses, net income for the month is $2. 5 million. The company also may review revenue and expense accounts to identify major customers and suppliers.

Difference between the Formats of Financial Statements for Different Businesses

Difference of P&L in Partnership and Sole trade

Profit

In sole trade, the profit will not be shared among many but only the owner himself will gain it. Yet, in partnership, the profit will be shared among two or more shareholders.

Income

In a sole trade, the income can be earned by the sole trade sales, while in a partnership the income will be gained by shares, dividends received and by sales.

Difference of Balance Sheet in Partnership and Sole trade

Capital

The capital in a sole trade will be invested with the owner's cash, while in partnership, the capital will be by long-term loans or it can also be shareholder capital.

Debentures

Sole trade does not experience debenture, yet in a partnership, debentures can be found.

Assets

Only a few numbers of assets are there in sole trade. In a partnership, a great number of assets can be easily found.

Conclusion

The student has learnt that budgeting allows you to make goals and stay financial prepared for unexpected bills that may arise. It also helps organizations to balance income and expenses. Nonetheless, it is learnt that unit cost of a product is critical, and estimating unit cost is a discipline, which should be applied at all stages of a business. In addition, it should be viewed as an exercise in improving the confidence of estimations. In adding up, there are several methods to make pricing decisions. Hence, these decisions can be very crucial in day-to-day business activities, and also to gain the market leader position. Nonetheless, it has been clear that investment projects are a series of cash inflows and out flows. Last but not the least it has been learnt how important financial statements are for companies and the different financial statements that are in practice, in different types of businesses.