CASE 6B – CHESTER & WAYNE

Chester & Wayne is a regional food distribution company. Mr. Chester, CEO, has asked your assistance in preparing cash-flow information for the last three months of this year. Selected accounts from an interim balance sheet dated September 30, have the following balances:

Cash	$142,100	Accounts payable	$354,155
Marketable securities	200,000	Other payables	53,200
Accounts receivable	$1,012,500		
Inventories	150,388		

Mr. Wayne, CFO, provides you with the following information based on experience and management policy. All sales are credit sales and are billed the last day of the month of sale. Customers paying within 10 days of the billing date may take a 2 percent cash discount. Forty percent of the sales is paid within the discount period in the month following billing. An additional 25 percent pays in the same month but does not receive the cash discount. Thirty percent is collected in the second month after billing; the remainder is uncollectible. Additional cash of $24,000 is expected in October from renting unused warehouse space.

Sixty percent of all purchases, selling and administrative expenses, and advertising expenses is paid in the month incurred. The remainder is paid in the following month. Ending inventory is set at 25 percent of the next month's budgeted cost of goods sold. The company's gross profit averages 30 percent of sales for the month. Selling and administrative expenses follow the formula of 5 percent of the current month's sales plus $75,000, which includes depreciation of $5,000. Advertising expenses are budgeted at 3 percent of sales.

Actual and budgeted sales information is as follows:

Actual:		**Budgeted:**	
August	$750,000	October	$826,800
September	787,500	November	868,200
		December	911,600
		January	930,000

The company will acquire equipment costing $250,000 cash in November. Dividends of $45,000 will be paid in December.

The company would like to maintain a minimum cash balance at the end of each month of $120,000. Any excess amounts go first to repayment of short-term borrowings and then to investment in marketable securities. When cash is needed to reach the minimum balance, the company policy is to sell marketable securities before borrowing.

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Questions (use of spreadsheet software is recommended):

1. Prepare a cash budget for each month of the fourth quarter and for the quarter in total. Prepare supporting schedules as needed. (Round all budget schedule amounts to the nearest dollar.)
2. You meet with Mr. Chester and Mr. Wayne to present your findings and happen to bring along your PC with the budget model software. They are worried about your findings in Part 1. They have obviously been arguing over certain assumptions you were given.

   a. Mr. Wayne thinks that the gross margin may shrink to 27.5 percent because of higher purchase prices. He is concerned about what impact this will have on borrowings. Comment.
   b. Mr. Chester thinks that "stock outs" occur too frequently and wants to see the impact of increasing inventory levels to 30 and 40 percent of next quarter's sales on their total investment. Comment on these changes.
   c. Mr. Wayne wants to discontinue the cash discount for prompt payment. He thinks that maybe collections of an additional 20 percent of sales will be delayed from the month of billing to the next month. Mr. Chester says "That's ridiculous! We should increase the discount to 3 percent. Twenty percent more would be collected in the current month to get the higher discount." Comment on the cash-flow impacts.