JET2 Financial Analysis

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Jonathan Horsman

Western Governors University

JET2 Task 2

Course Mentors – Kenneth Cassell, Patricia Cherry, Sankaran Venkateswar

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A. Summary Report

A1) Budgetary Items that raise a concern on budget planning

There are several budgetary concerns within the budget planning. These are only a few of the noticed issues that should be reviewed in the Proforma for Competition Bikes, Inc.

Sales Budget. In the Sales Budget section, CB has budgeted to build 3,510 units in Year 9. After reading the storyline, there had been a 15% drop in sales because of the economic downturn. This Proforma suggests that the company should increase the units by 110 from year 8. This is a concern because sales will likely continue to remain relatively flat for year 9. After reading about the decline in professional rider's sponsorship, this is not a strong indicator to support a projected sales increase to 3510. Typical economic recoveries do not happen within a year and will most likely remain flat. CB should look into other areas where the company can gain a profit other than in sales. One area would like be in Advertising or testing the effectiveness of the website creation and maintenance. Another area would be to break down the sales forecasting into quarters. Quarterly sales projections could show the required units needed based upon seasonal trend demand. The inventory can be adjusted higher for the summer quarters and decreased during the winter quarters.

Cash Receipts. This section concerns me in regards to the increase of accounts receivable. The beginning balance of 609,960 balloons up to 629,694, this is a 19,734 difference. This number shows that the company is not interested in minimizing the accounts receivable.

This is scary because of the economic climate, the loss of sponsorships can lead to more difficulty getting the unpaid accounts paid. The company should be improving their collection efforts and even renegotiating credit terms to increase collections. Another suggestion would be to have a budget identifies uncollectible receivables; this would give a more accurate view of realistic budget projections and concerns.

Raw Materials Budget. With the raw materials budget for frame materials, the ending target inventory is the same as the beginning inventory. They both reflect the same number of -5,897. Since these are the components, this can mean many things. The first meaning the company does not want to decrease or minimize inventory buildup. The second meaning could be the company does not want to return unused parts. The third might be the company has no use for the available inventory for future use. This is a concern because the company could save money by using the available inventory and even count it against future orders. It is recommended that the company find ways to deplete the available inventory which will save cash while helping to reduce the total cost of the frame materials.

Another concern with the Raw Materials budget is the number of Carbon Fiber Sheets per Unit. This number is 42 for each unit, even though the storyline talks about a waste allowance of 2 sheets per unit. The allowance of only 2 sheets is extremely close. It is recommended that the company increases the amount of sheets. If no error or waste occurs, that extra material could be used to help manufacture even more units. The company should budget for more carbon fiber sheets so that production will never stop. The advantage of the increased quantity could lead to better pricing on bulk purchases which will help lower the unit cost.

Expected Cash Disbursements. Within the section called 'Expected Disbursements", the company could reduce the amount of 2,324,027 by using the available inventory for frame materials and components against future orders.

Manufacturing Overhead Budget. Under the Facility and General Operations Level Costs, we see a line item for Utilities and Services in the amount of 55,747. This is confusing because utilities are stated in the S, G & A budget section. If this number is correct then this would show an increase of over 30% from the previous years. I would recommend taking it out of the Manufacturing Overhead Budget in the Facility, and General Operations level costs section as Utilities and Services and make sure it is correct in the S, G & Admin Budget under Utilities.

Selling, General, and Administrative Budget. The section for Facility and General Operations Level Expenses has brought three noticeable concerns. The first concern is the budget for Advertising at 28,412. This number seems low considering the effects of increase advertising had on the previous years. For year 7, it had spent 32,760, and the Net Sales had shown a success to 5,980,000. This 2% gross margin budget for advertising appears to be too low and should be increased. This company decreased advertising in year 8 to 27,428 and this decreased visibility in the market which appears to have caused sales to falter. It is recommended that the company increase their advertising budget to at least the year 7 advertising budget number of 32,760. Website creation and Maintenance has had the same constant budget expense over year 6, 7, 8. It is recommended to increase this budget to see how the website can attract new customers, advertise products and increase company exposure to the public. The third concern is the Research and Development budget. Since this company's success has certainly been based on innovative products with the cutting edge technology, this company should not give up that competitive edge over the competition. In year 6, R&D expense was 71,460. Year 7 saw an increase to 98,280 which had its most productive year only to decrease the R&D budget to 82,284 in year 8. Even though 85,237 is a turn in the right direction for year 9, it is recommended to increase this budget closer to the year 7 numbers of 98,280. The Research and Development gross margin budget of 6% is very low.

A2) Evaluation of the Flexible Budget and its Variances

Flexible Budget is based upon different levels of activity. It is a very useful tool for comparing actual costs experienced to the cost allowable for the activity level achieved, i.e. it is dynamic in nature as compared to static. A series of budgets can be readily developed to fit any activity level. Flexible budgeting distinguishes between fixed and variable cost, thereby allowing for a budget that can be automatically adjusted to the level of activity actually attained (Flexible Budget Definition, 2013)

A flexible budget measures the activity volume than being fixed in an amount. These figures are based on the actual output. With a variance, it is the difference between a budgeted, standard or planned amount that is incurred or sold. Variances can be calculated for both revenues and costs. With a flexible budget (variable budget) can adjust to different levels of activities. These differences are determined by the actual results and the flexible budget variances. Variances that are viewed as Favorable (F) occur when the actual results exceed what is budgeted. While the Unfavorable variances (U) are the result of when actual results fall below what is budgeted. Often, the results may vary from the master budget due to the sales not being the same as forecasted or cost of unit activity and fixed costs were not as expected. By evaluating the organizational performances, the variances can be isolated to reveal the causes. Price variances are favorable with the actual prices is less than the standard. While the quantity variance is favorable with the actual quantity used is determined to be less the standard quantity.

The following are Competition Bikes favorable and unfavorable variances: Competition Bikes had planning budget to sell 3,510 units for the year totaling 5,247,450. In reality, they actually only sold 3,423 units for 5,096,847. This means that the activity variance was -130,065. This translates to the company earning less than they had anticipated which is considered unfavorable. This company was overly optimistic for a Planned Budget of 5,247,450 over year 8 of 5,083,000 for a total of 164,450 which is unfavorable for the net sales variance. The company should have created flexible budget by calculating their budget by getting an array of sales amounts.

Direct materials, Direct Labor, Manufacturing Overhead–Variable all received favorable activity variances of -56,509, -26,100 and -8,224. This favorable result is because fewer products were sold and the company required less materials, labor and manufacturing overhead. These favorable variances are caused by the direct result of the unfavorable net sales.

Variable Selling Expenses had a favorable activity variance of -3,902 because it costs less to sell fewer products. The Total Variable Costs saw a favorable variance of – 98,349 which translate to the company spending a considerable amount less than they had budgeted.

With Research and Development, it had a favorable variance of -2,397 from 85,238 to 82,841. The benefit was to lowering Total Operating Expenses. However, CB was budgeting

6% of their projected Gross Margin for the R&D. When they were not meeting their sales targets, this was cut back as well.

Even though all of these favorable variances appear to be a good sign, they are definitely not. After totaling up all of the favorable variances which equals to -98,349, this does not compensate for the unfavorable Net Sales loss of 130,065. This Contribution Margin loss of 31,716 warrants that the company to take corrective action on those unfavorable variances.

A2a) Recommended corrective actions for areas of concern based on a variance analysis.

The following are areas of concern that would require correction action based upon the variance analysis.

The first of concern is the unfavorable variance in net sales. The net sales saw a variance of -150,603 between the Actual Output compared to the Planning Budget. The best corrective action is to create a more realistic forecast for the year 10. This would hopefully minimize such a large unfavorable variance for the next year. A suggestion would to be use the previous years 6, 7, 8 and 9 actual net sales output to create a more obtainable goal. If the forecast is too high, the whole company is going to be affected by the lower net sales. A corrective action for a missed forecast should require the monitoring of all costs which include manufacturing, labor and material costs. If the net sales continue to miss the forecast, training for the employees must be implemented. This training would include employees to be more efficient in their roles and streamline the work process. Training and education like 7S, Six Sigma and other Lean management programs will help increase the output. Even if the sales forecasts are low this education will help ensure the company get the most profit.

The second area of recommended corrective action would be in the Advertising Expenses. CB had budgeted for 28,412 but had actually increased to 31,462. Since the budget was supposed to be 2% of the company Gross Margin, this numbered should have actually decreased and not increased in the amount for year 9. The only explanation is that the CB had just started an advertising campaign, but it was not counted into the budget. Recommendation is to get a future advertising budget from the marketing department so that the Budget Planning can foresee the future advertising campaigns. This would help them to budget accordingly.

The third area that needs corrective action would be in the Transportation Out variance. Transportation Out appears to have budgeted for $30 per unit sale. This $30 per unit comes from the total amount of 105,300 divided by the number of project units of 3,510. Since the Actual output of units was 3,423 and the Transportation Out was at 108,297 that means cost for each unit was 31.64. This shows that the shipping service has increased their rate. The company should look into another shipping company or adjust their shipping costs for year 10 to compensate for the rate increase.

The last area requiring corrective action is the active variance noticed for both the Contribution Margin and the Operating Income. Since this activity variance is at -31,716, this shows how well the company performs and should be investigated by every department manager. The investigation should include all operations, finance and even engineering departments. These departments should be involved in determining the discrepancies and responsibility. If these variances can be identified, it will increase revenue and reduced costs. In order to have success, new control procedures can help reduce the variance. These new control procedures should include the staff that can help find unknown solutions. Management also needs to be accountable for unfavorable variances. The managers should work together to determine and evaluate the best strategy to implement new sales and marketing plans. With close analysis, a solution will appear on how to improve labor productivity and financial performance. Monthly meetings to discuss these discrepancies is the best way to manage all variances. All variances regarding Competition Bikes should include the Management By Exception process to ensure that the variances are handled as early as possible.

A2b) Concept of Management by Exception and how they could be applied to the Variances.

Practice whereby only the information that indicates a significant deviation of actual results from the budgeted or planned results is brought to the management's notice. Its objective is to facilitate management's focus on really important tactical and strategic tasks. In MBE, the decision that cannot be made at one level of management is passed on to the next higher level. (Management By Exception (MBE), 2013) The Managers at Competition Bikes can use management by exception to the significant variances in the flexible budget. Those significant variances can be investigated further to determine the best course of action. However, some small occurrences may need to be investigated if the issue becomes a reoccurring trend because this could be a sign of a growing problem. I also recommend that items of income or spending that show only small variances would require no action but should still be watched closely. For Competition Bikes, the most significant variances were in the Net Sale and the Total Variable Costs. These two variances were the largest in the budget, with Net Sales coming in at -150,603 and the Total Variable Costs having a variance of -162,561. Both of these variances had a large impact on the company's bottom line for the year 9. Competition Bikes should have a manager practicing management by exception should immediately begin investigating these variances and taking corrective action to prevent the same situation from repeating in year 10. MBE can serve as a motivator for department heads to work together in combating the variances in a collaborative way for finding solutions and new strategies.

References

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