

Scenario I:

Klein Electronic Company is assembling the quarter one budget for fiscal year 2005. The master budget has been produced, along with some possible alternatives.

Scenario I (S1) is to lower the amount of inventory held by the company for the next months sales. The original budget had inventory calculated at 40% of next month's sales. Scenario I is calculated at 20% inventory of next months sales (S1 Exhibit 1). While Ms Sevingny believes this will reduce operating expenses by \$20,000, the numbers shown in this alternative budget do not show that to be true. The lack of reduced operating expenses is because the goods must still be purchased to meet projected sales. In the end, there is an increase in contribution margin ratio from 38% in the original budget to 43% in scenario one. There is a decrease in the current ratio. Even though liabilities in the form of Notes Payable decreased, so did the amount of assets in the form of inventory held by the company (S1, Exhibit 3). Klein Electronics debt equity ratio hardly improves, the company is still at 79% debt to 21% equity (S1, Exhibit 5). Break even in sales decreases slightly in Scenario I due to a combination of factors. By requiring less carryover inventory (20% instead of 40%) the company needs to borrow a little less short-term money to keep minimum cash balance. With less money borrowed, interest paid on the notes is also lower. Still, with the large amount of assets being financed by debt, the company has a high leverage.

Overall Scenario I does create a positive impact on the company's profits. The Master Budget projects a net loss of \$7,500 while Scenario I shows slightly less net loss at \$6,706. Scenario I is an improvement over the Master Budget, but not enough to generate a profit for Klein Electronics.

Scenario I:

Exhibit 1

Klein Electronic Company
Budgeted Purchases
Quarter Ending September 30, 2004

	<u>July</u>	<u>August</u>	<u>September</u>
Next mon't budgeted sales	288750	440000	451000
Ratio of inventory to future sales	0.2	0.2	0.2
Budgeted ending inventory	57750	88000	90200
Add budgeted sales	247500	288750	440000
Required available merchandise	305250	376750	530200
Deduct beginning inventory	100000	57750	88000
Inventory to be purchased	<u>205250</u>	<u>319000</u>	<u>442200</u>

Exhibit 2

Klein Electronic Company
Income Statement
For Quarter ending September 30, 2004

Sales		1,775,000
Cost of goods sold:		
Beginning inventory	100,000	
Purchases	966,450	
Goods available for sale	<u>1,066,450</u>	
Ending inventory	90,200	
Cost of goods sold		<u>976,250</u>
Gross Margin (Profit)		798,750
Operating expenses:		
Commissions exp	142,000	
Bad debt expense	30,100	
Selling, general & Administrative Expenses	588,750	
Depreciation – Building	6,249	
Depreciation – Equip	11,667	
Total operating expenses		<u>778,766</u>
Income from operations		19,984
Other expense:		
Notes Int Exp	9,190	
Bond interest expense	17,500	26,690
Income before taxes		<u>-6,706</u>
Income taxes		0
Net Income		<u><u>-6,706</u></u>
Basic earnings per share:		-\$0.22

Scenario I:

Exhibit 3

Klein Electronic Company
Balance Sheet
Quarter Ending September 30, 2004

Assets			
Current Assets			
Cash		40,000	
Account Receivable	581,350		
Less Allowance for doubtful accounts	-50,100	<u>531,250</u>	
Inventories		90,200	
Total Current Assets			661,450
Property, Plant & Equipment Assets			
Land		830,000	
Building	500,000		
Less Accumulated depreciation	-236,249	<u>263,751</u>	
Equipment	1,000,000		
Less Accumulated depreciation	-51,667	<u>948,333</u>	
Total Property, Plant & Equipment Assets			<u>2,042,084</u>
Total Assets			<u><u>2,703,534</u></u>
Liabilities and Equity			
Current Liabilities			
Accounts Payable		132,660	
Income Taxes Payable			
Dividends payable		15,000	
Notes Payable		925,080	
Commissions Payable (8% Sep sales)		64,000	
Bond Interest Payable (Aug & Sep)		13,333	
Bonds Payable, Maturing 7/31/2024	1,000,000		
Less discount on Bonds payable	<u>19,833</u>	<u>980,167</u>	
Total Current Liabilities			2,130,240
Stockholders' Equity			
Common Stock, \$10 par value		300,000	
Net income		-6,706	
Retained Earnings		280,000	
Total stockholders' Equity			<u>573,294</u>
Total Liabilities and Equity			<u><u>2,703,534</u></u>

Scenario I:

Exhibit 4

Klein Electronic Company			
Statement of Cash Flows			
Quarter Ending September 30, 2004			
Cash flows from operating activities			
Cash Received from customers	1,413,650		
Cash paid for merchandise	-868,790		
Cash paid for commissions	-138,000		
Cash paid for interest on short term loans	-9,190		
Cash paid for Selling, General, & Admin Exp	-588,750		
Cash paid for taxes	-50,000		
Net cash provided by operating activities		-241,080	
Cash flows from investing activities			
Cash paid for equipment purchase	-800,000		
Net cash provided by investing activities		-800,000	
Cash Flows from Financing activities			
Cash received from Short term loan	865,080		
Cash paid to retire bond	-800,000		
Cash paid for retired bond interest	-24,000		
Cash received from Bond issue	980,000		
Net cash provided by financing activities		1,021,080	
Net increase (decrease) in cash		-20,000	
Cash balance at beginning of Quarter		60,000	
Cash balance at end of Quarter		40,000	

Exhibit 5

Contribution Margin Ratio:			
<u>Sales – Variable Costs</u>	730550		
Sales	1775000	0.41	
Current Ratio:			
<u>Current Assets</u>	661.450		
Current Liabilities	2130240	0.31	
Debt Ratio			
<u>Total Liabilities</u>	2,130,240		
Total Assets	2,703,534	0.79	
Equity Ratio			
<u>Total Equity</u>	573,294		
Total Assets	2,703,534	0.21	
Debt-to-Equity Ratio:			
<u>Total Liabilities</u>	2,130,240		
Total Stockholder Equity	573,294	3.72	
Break Even Sales			
<u>Fixed costs</u>	588,750		
Contribution Margin Ratio	0.41	1,430,472	