Effective Financial Planning

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1. Discuss some of the problems that a business could face if it is unable to manage its working capital effectively.

A business that could not manage its working capital effectively would be exposed to higher solvency issues. This is due to its inability to fulfill its current obligations as they fall due, such as creditors/suppliers and short-term bank loans. This leads to a lower credit rating of the business. This also means that in the future, the business would have more difficulty obtaining sources of finance to run its daily operations as well as expansions. Thus, the business would likely experience downturn in its business cycle, and eventually bankruptcy, if it could not manage its working capital effectively.

2. Examine some of the advantages and disadvantages for a business that records its inventory using:

a) a periodic inventory system

b) a perpetual inventory system.

A periodic inventory system is a “counting” method of inventory system. The major advantage of this inventory method is that it is cheaper and simple to operate due to reduced control costs of continuous record-keeping. The major disadvantage is the inability to control theft activities because costs of goods sold is only determined through counting beginning and end inventory quantity without much record of the activities in between.

Perpetual inventory systems are those which continuously update the inventory level on stock. The major advantage of this method is that it provides greater information on the inventory activities, and is therefore an effective theft control method. The main disadvantage is that this system can be very expensive to run and maintain, particularly in businesses with large inventories such as retail businesses.

3. Explain the difference between fixed and variable costs.

Fixed costs are costs that are incurred in the business that do not vary, or ’fixed‘ (relative to varying input) within the specified time and/or production level. This includes that of the property rent that regardless of the production level of the business, the periodic rent payments are still the same (‘fixed‘). Variable costs are incurred where costs fluctuate with the input or production level of the business. This includes that of inventories where more stocks are purchased with increase demand for the products of the business. For example, in a bakery an oven is a fixed cost, but flour is a variable cost determined by how many loaves of bread are produced.

4. Examine the ways in which a company can manage its cash flows.

Effective cash flow management could be done through different stages. Firstly, a cash budget should be prepared which incorporates the normal level of cash requirement as well as specific cash flow objectives. Secondly, specific strategies to improve cash flows should be used such as distribution of payments and effective credit policy which aims to increase the rate of cash inflows and minimise cash outflows. Thirdly, a cash control system should be designed to record cash activities accurately and efficiently. Lastly, the company should evaluate the cash flow statement periodically to review cash flow performance as well as improvements.

5. Discuss why an auditor may be considered to have a 'conflict of interest' if it has a commercial relationship with a company that it is auditing.

An auditor which has a commercial relationship with a company that it is auditing may give a biased audit result in favour of the company. The auditor would want to increase its own share return which would be in conflict of interest to the auditing standard which aims to give a consistent, efficient, and unbiased audit to the company's financial statements.

6. Liz, the owner of a small education company, is thinking of buying a new photocopier. However, she is concerned that the cost of buying this could put a strain on her company's working capital. Discuss some of the strategies that Liz could employ to reduce the financial burden of the new photocopier on the company.

A number of strategies could be discussed to reduce the financial burden of the new photocopier. Firstly, Liz could lease the photocopier which is the rental agreement where Liz has the right to use the photocopier in return for a series of smaller payments. This distributes the major payment into different periods which would reduce current liabilities thus improving the company's working capital. Secondly, Liz could take up long-term loan if the photocopier is expected to deliver long-term gain or benefits to the company. This will increase non-current liabilities without any impacts on the company's working capital.

7. Dabu Ltd is a small company that manufactures shoes in northern New South Wales. Although Dabu Ltd is profitable and has a reputation as a high quality producer, it has often had trouble paying its suppliers. Dabu sells a lot its products on credit and has a number large accounts receivable. Discuss how Dabu might be able to improve its cash flow in the short term.

A number of strategies could be used by Dabu to improve its cash flow in the short term. Firstly, Dabu should factor its accounts receivable to increase its cash level. By selling its debts to a business that specialises in debt collection, Dabu will have the finances to pay its suppliers. Secondly, due to the fact that it sells a lot of its products on credit, an effective credit policy should be implemented which involves that of discounts for early payments and penalties for late payments. Dabu could also use its creditors' payment policies, such as discounts for early payments, to its advantage.

8. Snake Ltd is a stock exchange listed company with a reputation as a successful corporate raider. Snake Ltd management believe that Dabu Ltd would be a profitable acquisition if they were to shift production to a low-wage country. Dabu Ltd currently employs over 150 people and is the largest employer in its community. Discuss the ethical aspects of Snake Ltd's proposed takeover.

The first ethical consideration which is associated with the takeover is corporate raiding and asset stripping. This involves Snake Ltd identifying that the Dabu Ltd market value and profit could be improved with replacement of management.

On the one hand, it could sell off the assets of Dabu Ltd for a quick profit. This would result in a massive increase in unemployment in the community. This unethical act can lead to lower living standards of both the people and community that is associated with Dabu Ltd.

On the other hand, Snake Ltd could exploit the minimum working standards in the low-wage country which may involve low pay and poor/unsafe working conditions. Similarly, this unethical act is expected to lower the living standard in the host country. However, there are possibilities that the business could prosper under the new or improved management which could increase both employment and living standards in the low-wage country, particularly as Snake Ltd has a reputation as a successful corporate raider on the stock exchange.

