

Most of CRC's memberships have September expirations. A substantial amount of the cash receipts are collected during the early part of the racquetball season due to the renewal of the annual membership fees and heavy court usage. However, cash receipts are not as large in the spring and drop significantly in the summer months.

CRC is considering changing its membership and fee structure in an attempt to change its cash receipts. Under the new membership plan, only an annual membership fee would be charged, rather than a membership fee plus hourly court fees. There would be two classes of membership as follows:

Individual	\$250
Family	400

The annual fee would be collected in advance at the time the membership application is completed. Members would be allowed to use the racquetball courts as often as they wish during the year under the new plan.

All future memberships would be sold under these new terms. Current memberships would be honored on the old basis until they expire. However, a special promotional campaign would be instituted to attract new members and to encourage current members to convert to the new membership plan immediately.

The annual fees for individual and family memberships would be reduced to \$200 and \$300, respectively, during the two-month promotional campaign. In addition, all memberships sold or renewed during this period would be for 15 months rather than the normal one-year period. Current members also would be given a credit toward the annual fee for the unexpired portion of their membership fee, and for all prepaid hourly court fees for league play that have not yet been used.

CRC's management estimates that 60 to 70 percent of the present membership would continue with the club. The most active members (45 percent of the present membership) would convert immediately to the new plan, while the remaining members who continue would wait until their current memberships expire. Those members who would not continue are not considered active (i.e., they play five or less times during the year). Management estimates that the loss of members would be offset fully by new members within six months of instituting the new plan. Furthermore, many of the new members would be individuals who would play during nonprime time. Management estimates that adequate court time will be available for all members under the new plan.

If the new membership plan is adopted, it would be instituted on February 1, well before the summer season. The special promotional campaign would be conducted during March and April. Once the plan is implemented, annual renewal of memberships and payment of fees would take place as each individual or family membership expires.

Required: Your consulting firm has been hired to help CRC evaluate its new fee structure. Write a letter to the club's president answering the following questions.

1. Will City Racquetball Club's new membership plan and fee structure improve its ability to plan its cash receipts? Explain your answer.
2. City Racquetball Club should evaluate the new membership plan and fee structure completely before it decides to adopt or reject it.
 - a. Identify the key factors that CRC should consider in its evaluation.
 - b. Explain what type of financial analyses CRC should prepare in order to make a complete evaluation.
3. Explain how City Racquetball Club's cash management would differ from the present if the new membership plan and fee structure were adopted.

(CMA, adapted)

Case 9-46

Participative Budgeting
(LO 9-2, 9-3, 9-9)

Patricia Eklund, controller in the division of social services for the state, recognizes the importance of the budgetary process for planning, control, and motivational purposes. She believes that a properly implemented participative budgetary process for planning purposes and an evaluation procedure will motivate the managers to improve productivity within their particular departments. Based upon this philosophy, Eklund has implemented the following budgetary procedures.

- An appropriation target figure is given to each department manager. This amount is the maximum funding that each department can expect to receive in the next year.
- Department managers develop their individual budgets within the following spending constraints as directed by the controller's staff.

- Expenditure requests cannot exceed the appropriation target.
- All fixed expenditures should be included in the budget. Fixed expenditures would include such items as contracts and salaries at current levels.
- All government projects directed by higher authority should be included in the budget in their entirety.
- The controller's staff consolidates the budget requests from the various departments into a master budget submission for the entire division.
- Upon final budget approval by the legislature, the controller's staff allocates the appropriation to the various departments on instructions from the division manager. However, a specified percentage of each department's appropriation is held back in anticipation of potential budget cuts and special funding needs. The amount and use of this contingency fund is left to the discretion of the division manager.
- Each department is allowed to adjust its budget when necessary to operate within the reduced appropriation level. However, as stated in the original directive, specific projects authorized by higher authority must remain intact.
- The final budget is used as the basis of control. Excessive expenditures by account for each department are highlighted on a monthly basis. Department managers are expected to account for all expenditures over budget. Fiscal responsibility is an important factor in the overall performance evaluation of department managers.

Eklund believes her policy of allowing the department managers to participate in the budgetary process and then holding them accountable for their performance is essential, especially during times of limited resources. She further believes that the department managers will be positively motivated to increase the efficiency and effectiveness of their departments because they have provided input into the initial budgetary process and are required to justify any unfavorable performances.

Required:

1. Describe several operational and behavioral benefits that are generally attributed to a participative budgetary process.
2. Identify at least four deficiencies in Patricia Eklund's participative policy for planning and performance evaluation purposes. For each deficiency identified, recommend how it can be corrected.

(CMA, adapted)

Jeffrey Vaughn, president of Frame-It Company, was just concluding a budget meeting with his senior staff. It was November of 20x0, and the group was discussing preparation of the firm's master budget for 20x1. "I've decided to go ahead and purchase the industrial robot we've been talking about. We'll make the acquisition on January 2 of next year, and I expect it will take most of the year to train the personnel and reorganize the production process to take full advantage of the new equipment."

In response to a question about financing the acquisition, Vaughn replied as follows: "The robot will cost \$1,000,000. We'll finance it with a one-year \$1,000,000 loan from Shark Bank and Trust Company. I've negotiated a repayment schedule of four equal installments on the last day of each quarter. The interest rate will be 10 percent, and interest payments will be quarterly as well." With that the meeting broke up, and the budget process was on.

Frame-It Company is a manufacturer of metal picture frames. The firm's two product lines are designated as S (small frames, 5×7 inches) and L (large frames, 8×10 inches). The primary raw materials are flexible metal strips and 9-inch by 24-inch glass sheets. Each S frame requires a 2-foot metal strip; an L frame requires a 3-foot strip. Allowing for normal breakage and scrap glass, Frame-It can get either four S frames or two L frames out of a glass sheet. Other raw materials, such as cardboard backing, are insignificant in cost and are treated as indirect materials. Emily Jackson, Frame-It's controller, is in charge of preparing the master budget for 20x1. She has gathered the following information:

1. Sales in the fourth quarter of 20x0 are expected to be 50,000 S frames and 40,000 L frames. The sales manager predicts that over the next two years, sales in each product line will grow by 5,000 units each quarter over the previous quarter. For example, S frame sales in the first quarter of 20x1 are expected to be 55,000 units.
2. Frame-It's sales history indicates that 60 percent of all sales are on credit, with the remainder of the sales in cash. The company's collection experience shows that 80 percent of the credit sales are collected during the quarter in which the sale is made, while the remaining 20 percent is collected in the following quarter. (For simplicity, assume the company is able to collect 100 percent of its accounts receivable.)

Case 9-47

Comprehensive Master Budget; Short-Term Financing; Acquisition of Robotic Equipment
(LO 9-2, 9-3, 9-5, 9-6)

1. Total sales revenue, entire year: \$5,650,000
3. Production budget, S frames, units to be produced, entire year: 254,000
7. Cost of goods sold: \$3,850,000
10. Total assets: \$9,634,700

