

3.7: Cash Flow: Exam Practice Question



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3.7 CASH FLOW: EXAM PRACTICE QUESTION

Read the case study information below and answer the questions that follow.

COFFEE CALL SEEKS FUNDS FOR EXPANSION



Coffee Call is a small, independent coffee shop. It is run by two sisters, Georgina and Caroline Evers-Swindell. They are keen to increase sales by using the shop space more effectively and install three new tables. This will, however, require a significant investment and the sisters have approached the bank with a business plan for the expansion with the aim of securing loan finance. The sisters have been approached by a venture capitalist who is willing to fund the expansion in return for a 20% stake in Coffee Call. The sisters are concerned to keep the liquidity of the business secure during the expansion.

The following cash flow data have been produced by Coffee Call's accountant for the period January to June:

- Sales for the first three months of the year will be \$20,000, rising to \$40,000 in the following three months once Coffee Call has installed the extra seating
- Material costs are 50% of sales and are paid each month
- Electricity and gas cost \$4,000, with half paid in February and the remainder in September

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- Staff wages of \$2,000 are paid each month, but this will rise to \$3,000 after three months once Coffee Call has expanded
- Georgina and Caroline draw \$10,000 each out of the business in March
- Marketing costs of \$500 are paid each month
- A loan of \$20,000 is taken out in February to fund the expansion
- The \$20,000 cost of fitting the new tables is paid in March
- The sisters believe the tables can be fitted in three days without any disruption to sales
- The opening cash balance is \$7,000.

QUESTIONS: 25 MARKS, 45 MINUTES

1. Define the terms:
 - a. Loan finance
 - b. Liquidity

[4 marks]
2. Explain why material costs have been forecast to be 50% of sales.

[4 marks]
3. Prepare a cash flow forecast for Coffee Call for the first six months of the year.

[8 marks]
4. Evaluate the following strategies Coffee Call has for dealing with cash flow problems.
 - a. Reducing cash outflow
 - b. Improving cash inflows
 - c. Looking for additional finance

[9 marks]