PERCENT OF SALES METHOD / DFN

WHAT YOU NEED TO KNOW FOR THE TEST:

- The order of the six steps
- What spontanous accounts do and which ones they are
- What discretionary accounts do and what they are
- How to use Assets = Liabilities + Owners Equity to find DFN
- How to figure out percentage increase based on projected sales number
- How to increase a spontaneous account by the percentage of sales increase
- The four ways to decrease DFN*
- How to calculate Sustainable Growth Rate*

* See the sheet on DuPont/SGR for these two

MEMORIZE THE ORDER OF THE 6 STEPS:

1) Project sales revenues and expenses
2) Forecast change in spontaneous balance sheet accounts
3) Deal with discretionary accounts
4) Calculate retained earnings
5) Determine total financing needs/assets
6) Calculate DFN

HOW MUCH WILL SALES GO UP?

(New Amount – Old Amount) / Old Amount

Example:

If sales are projected to rise from $1455 this year to $1710 next year, then the formula will be

($1710 – $1455m) / $1455

$255 / $1455

.1753

This means sales are going to go up 17.53% next year.

WHAT ARE SPONTANEOUS ACCOUNTS?

A spontaneous account goes up when sales go up

When you sell more stuff, you need more inventory, you make more sales on credit, you buy more, you pay more hours for labor, etc. These accounts will go up in proportion to how much sales went up.

The spontaneous accounts include:

Cash	Accts Payable
Accts Receivable	Accruals
Inventory	

WHAT ARE DISCRETIONARY ACCOUNTS?

A discretionary account doesn't automatically go up when sales go up

These accounts are only going to go up at management's discretion. (In other words, just because sales go up doesn't mean that you're going to take out another 30-year building loan.)

The discretionary accounts include:

Long-term Debt	Common Stock
Notes Payable	

WHAT ABOUT FIXED ASSETS?

They may or may not go up

Most of the test questions say fixed assets are at full capacity and will change proportionally with sales. If you see that, just treat fixed assets as you would a spontaneous account.

HOW TO CALCULATE THE INCREASE

The two-step way:

1. Multiply amount by the growth percentage
2. Add to original amount

EXAMPLE: Accounts Receivable will increase 17.53%

$980 x .1753 = increase of $172

$980 + $172 = $1152

The one-step way:

1. Multiply amount by 1 + the growth percentage

EXAMPLE: Accounts Receivable will increase 17.53%

$980 x 1.1753 = $1152

DISCRETIONARY FINANCING NEEDED (DFN)

	This Yr	Next Yr		This Yr	Next Yr
Assets			**Liabilities**		
Total Current Assets	5,329	**6264**	**Total Liabilities**	3,071	**3,754**
Net PP&E	725	1,515	**Owner's Equity**	2,983	3,294
Total Assets	**6,054**	**7,779**	**Total Liab. & Owner's Equity**	**6,054**	**7,048**

If we grow 17.53% next year, we'll need $7,779 in Total Assets. Since our total of Liabilities and Owners Equity is only $7,048, we are going to need $731 in Discretionary Financing