



**A STUDY ON ACCOUNTS RECEIVABLES USING VARIANCE ANALYSIS
IN ALLIED ENTERPRISES, COIMBATORE**

by

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BONAFIDE CERTIFICATE

Certified that this project report titled “**A Study on Accounts Receivables Using Variance Analysis in Allied Enterprises, Coimbatore**” is the bonafide work of Ms. S. Parameswari, who carried out the project under my supervision. Certified further, that to the best of my knowledge the work reported herein does not form part of any other project report or dissertation on the basis of which a degree or award was conferred on an earlier occasion on this or any other candidate.

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DECLARATION

I, hereby declare that this project report entitled as “ **A Study on Accounts Receivables using Variance Analysis in Allied Enterprises, Coimbatore**”, has undertaken for academic purpose submitted to Anna University in partial fulfillment of requirement for the award of degree of Master of Business Administration. The project report is the record of the original work done by me under the guidance of Ms.S.Sangeetha, Asst Prof (SRG) during the academic year 2011-2012.

I, also declare hereby, that the information given in this report is correct to the best of my knowledge and behalf.

Place: Coimbatore

Date:

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(S.PARAMESWARI)

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CHAPTER – 1

1.1. INTRODUCTION

Debtors constitute a substantial portion of current assets of large majority of companies. In India, trade debtors, after inventories, are the major components of current assets. They form about one-third of current assets in India. Granting credit and creating debtors amount to the blocking of the firms funds. The interval between the sale and the date of payments has to be financed out of working capital. This necessitates the firm to get funds from banks or other sources. Thus, trade debtors represent investment. As substantial amounts are tied up in trade debtors, it needs careful analysis and proper management.

Trade credit arises when a firm sells its products or services on credit and does not receive cash immediately. It is an essential marketing tool, acting as a movement of goods through production and distribution stages to customers. A firm grants trade credit to protect its sales from the competitors and to attract the potential customers to buy its products at favorable terms. Trade credit creates accounts receivables or trade debtors, also referred to as book debts in India that the firm is expected to collect in the near future. The customers from whom the receivables or book debts have to be collected in the future are called trade debtors or simply as debtors and represent the firms claim or asset.

The credit sale has three characteristics:

1. It involves an element of risk that should be carefully analyzed. Cash sales are totally risk less, but not the credit sales as the cash payment are yet to be received.
2. It is based on economic value. To the buyer, the economic value in goods or services passes immediately at the time of sale, while the seller expects an equivalent value to be received later on.
3. It implies futurity. The buyer will make the cash payment for goods and services received by him in a future period.

Accounts Receivable Definition:

Money which is owed to a company by a customer for products and services provided on credit. This is treated as a current asset on a balance sheet. A specific sale is generally treated as an account receivable after the customer is sent an invoice.

Accounts receivable is one of a series of accounting transactions dealing with the billing of customers who owe money to a person, company or organization for goods and services that have been provided to the customer. In most business entities this is typically done by generating an invoice and mailing or electronically delivering it to the customer which is to be paid within an established timeframe called credit or payment terms.

While booking a receivable is accomplished by a simple accounting transaction, the process of maintaining and collecting payments on the accounts receivables subsidiary account balances can be a full time proposition. Depending on the industry in practice, accounts receivable payments can be received up to 10 – 15 days after the due date has been reached. These types of payment practices are sometimes developed by industry standards, corporate policy, or because of the financial condition of the client.

On a company's balance sheet, accounts receivable is the amount that customers owe to that company. Sometimes called trade receivables, they are classified as current assets. To record a journal entry for a sale on account, one must debit a receivable and credit a revenue account. When the customer pays off their accounts, one debits cash and credits the receivable in the journal entry. The ending balance on the trial balance sheet for accounts receivable is always debit.

Since not all customer debts will be collected, businesses typically record an allowance for debts which is subtracted from total accounts receivable. When accounts receivable are not paid, some companies turn them over to third party collection agencies or collection attorneys who will attempt to recover the debt via negotiating payment plans, settlement offers or legal action.

Outstanding advances are part of accounts receivables:

If a company gets an order from its customers with advance agreed in payment terms. Since no billing is being done to claim the advances several times this area of collectible is not reflected in Accounts Receivables. Ideally, since advance payment is mutually agreed term, it is the responsibility of the accounts department to take out periodically the statement showing advance collectible and should be provided to sales & marketing for collection of advances. The payment of accounts receivable can be protected either by a letter of credit or by Trade Credit Insurance.

Companies can use their accounts receivable as collateral when obtaining a loan(Asset-based lending) or sell them through Factoring (Finance). Pools or portfolios of accounts receivable can be sold in the capital markets through a Securitization.

NATURE OF CREDIT POLICY:

A firm's investment in accounts receivable depends on:

- The volume of credit sales
- The collection period

The volume of credit sales is a function of the firm's total sales and the percentage of credit sales to total sales. Total sales depends on market size, firm's market share, product quality, intensity of competition, economic condition etc. The financial manager hardly has any control over these variables. The percentage of credit sales to total sales as mostly influenced by the nature of business and industry norms.

The major controllable decision variables include the following:

- Credit standards and analysis
- Credit terms
- Collection policy and procedures.

CREDIT STANDARDS:

The term credit standards represent the basic criteria which a firm follows in selecting customers for the purpose of credit extension. The firm may have tight credit standards: that is, it may sell mostly on cash basis, and may extend credit only to the most reliable and financially strong customers. Such standards will result in fewer bad debt losses, and less cost of credit administration. But the firm may not be able to expand sales. The profit sacrificed on lost sales may be more than the cost saved by the firm. On the contrary, if the credit standards are loose, the firm may have large sales. But the firm will have to carry large receivables. The cost of administering credit and bad-debt will also increase. Thus the choice of optimum credit standards involves a tradeoff between incremental return and incremental costs.

CREDIT ANALYSIS:

The next aspect of credit policies of a firm is credit analysis and investigation. Credit standards influence the quality of the firm's customers.

There are two aspects of the quality of the customers:

- The time taken by the customers to repay credit obligation
- The default rate.

The Average Collection Period (ACP) determines the speed of payment by customers. It measures the number of days for which credit sales remains outstanding. The longer the collection period, the higher will be the firm's investment in accounts receivable.

Default Rate can be measured in terms of bad debts losses ratio – the proportion of uncollected receivable. Bad debts losses ratio indicates default risk. Default risk is that the customer will fail to repay the credit obligation.

CREDIT TERMS:

The stipulation under which the firm sells on credit to customers are called credit terms. These include:

- The credit period
- The cash discount

Credit period:

The length of time for which credit is extended to customers is called the credit period. The firm's credit period may be covered by the industry norms. But depending on its objectives, the firm may lengthen the credit period. On the other hand, the firm may also tighten its credit period if customers are defaulting too frequently and bad debt losses are building up.

The firm lengthens its credit period to increase its operating profit through expanded sales. However there will be net increase in operating profit only when the cost of extended credit period is less than the incremental operating profit. With the increased sales and extended credit period, investment would increase. Two factors cause this increase:

- Incremental sales result in incremental receivable and
- Existing customers will take more time to repay credit obligation i.e., the average collection period will increase, thus increasing the level of receivable.

Cash discounts:

A cash discount is reduction in payment offered to customers to include them to repay credit obligation within a specific period of time, which will be less than normal credit period. It is usually expressed as a percentage of sales. Cash discount terms indicate the rate of discount and the period for which it is available. If the customer does not avail the offer, he must make payment within the payment with in the normal credit period. A firm uses cash discount as a tool to increase sales and accelerate collection form customers. Thus the level

receivable and associated costs may be reduced. The cost involved the discount taken by customers.

Collection policy and procedure:

A collection policy is needed because all customers do not pay the company's bills in time. Some customers are slow- payers while some are non-payers. The collection efforts should, therefore aim at accelerating collection from slow player and reducing bad debt losses. A collection policy should ensure prompt and regular collection. Prompt collection is needed for fast turnover of working capital, keeping collection cost and bad debtors alert, and they tend to pay their dues promptly.

The collection policy should lay down clear cut collection procedures. The collection procedures for the past dues or delinquent accounts should be established in unambiguous terms. The slow paying customers are needed to be handled very tactfully. Some of them may be permanent customers the collection process initiated quickly without giving any chance to them may antagonize them, and the firm may lose the competitors.

The responsibility for collection and follow up should be explicitly fixed. The finance department maintains the records and information. It is responsible for collection, it will consult the sales department before initiating an action against the non-paying customers. Similarly the sales department must obtain past information about the customer from the finance department before granting credit to them.

Though the collection procedures should be firmly established, individual cases should be dealt with on their merits. Some customers may be temporarily in tight financial position and in spite of their best intentions may not be able to pay on due date. This may be due to recessionary conditions. Or other factors beyond the control of the customers. Such cases need special considerations. The collection procedure against them should be initiated only after they overcome their financial difficulties and do not intend to pay promptly.

The company should decide about offering cash discount for prompt payment. Cash discount is a cost to a firm for ensuring faster recovery of cash. Some customers fail to pay within the specified discount period, yet they may take payment after deducting the amount of cash discount. Such cases must be promptly identified and necessary action should be initiated against to them to recover the full amount.

The credit evaluation procedure of the individual accounts should involve the following steps:

- Credit information
- Credit investigation
- Credit limits

The firm should follow a well laid down collection policy and procedure to collect dues from its customers. When the normal credit period granted to a customer is over, and he has not made the payment, the firm should send a polite letter to him reminding that the accounts in overdue. If the customer does not respond, the firm may send a polite letter to him reminding him that the account is overdue. If receivable still remains uncollected; letters may be followed by telephone, telegram and personal visit for the firm representative. If the payment is still not may, the firm may initiate a legal action against the customer. Before taking the legal the action the firm must examine the customer's financial condition. If it is, legal action against him will simply hasten is in insolvency. The firm will not be able to get anything from the customers. Under such situation, it is better to be patient and wait, or accept reduced payment in settlement of the account.

1.2. STATEMENT OF THE PROBLEM

In this study the effort has been made to conduct a detailed analysis of Receivables Management functions in Allied Enterprises. For this purpose, detailed research has been conducted such as:

- Existing system of Accounts Receivable adopted by the company.
- To analyze how the receivables are effectively managed by the company.
- To improve the model of the accounts receivables management of the company.

1.3. OBJECTIVES OF THE STUDY

Primary objective:

- To study the Accounts Receivables using Variance Analysis in Allied Enterprises, Coimbatore.

Secondary Objective:

- To understand the variance based model that compares actual performance to budget.
- To identifies the impact of collection experience, sales pattern and sales quantity influences on receivable balances
- To suggest a model for the accounts receivables management of the company.

1.4. ORGANISATION PROFILE

Allied Enterprises is situated in Coimbatore, the industrial city of India, and is involved in manufacturing children's products under the brand name of "CHIKKOO". Their products were first launched in 1990. They manufacture Baby carriages, Swings, Baby Push Chair, Perambulators, Study Desk, Playpen and a lot of other products in steel tubes. They are proud to say that they have created a market for the products emphasizing better service to the customer, better presentation of products and better customer handling in the sales outlets and further more rationalized credit controls.

Their products have created a great boom in the Indian market and have already won the prestigious awards like

- Indira Priyadarshini Awards – 95
- National Achievers Awards - 95
- Gem of India Award - 95
- Udhog Pragati Award – 96

for the outstanding work, contribution and achievements.

They have wide areas of operation. Their markets are spread over the Tamil Nadu, Kerala, Goa, Andhra Pradesh, Gujarat, Calcutta, Maharashtra and Madhya Pradesh. They have a sister concern called MBC Enterprises situated at Coimbatore itself.

Product Profile:

A baby walker is a device that can be used by infants who cannot walk on their own to move from one place to another. Patents have been issued for baby walkers as early as 1851. Modern baby walkers have a base made of hard plastic sitting on top of wheels and a suspended fabric seat with two leg holes. A baby walker often has toys attached to the top to entertain the baby. It is designed for a child between 4 and 16 months.

A bassinet, bassinette or cradle is a bed specifically for babies from birth to about four months, and small enough to provide a “cocoon” that small babies find comforting. Some bassinets are designed to rock or swing freely, with many carriers finding their child calmed by this action. A Perambulator is also another kind of baby transport that keeps the baby and the person who looks after the baby comfortable.

There are various models of cradles that are being prepared in the manufacturing unit. With the production of these types of cradles and other equipments for a baby, the company earns high levels of customer satisfaction by delivering good quality comfortable products to the customers.

Sources of Raw Materials:

The company sources its raw materials from within the domestic boundaries of the country. Their main raw materials are MS tubes, Rods, Cotton printed cloth, Mosquito net and foam. There are also various other accessories required for the process of manufacture of the different models of baby products.

Markets:

The products of the company reach various parts of the country through a dedicated group of distributors. The distributors of the company account for about two hundred numbers. The products have markets in Kerala, Tamil Nadu, Andhra Pradesh, Goa, Maharashtra, Calcutta, Gujarat and Madhya Pradesh.

CHAPTER – 2

2.1. REVIEW OF LITERATURE

Grzegorz Michalski (2003)¹ in “Small and Medium Enterprises Accounts Receivable Management with Value of Liquidity” in View revealed “increase in the level of accounts receivables in a firm increases both net working capital and the costs of holding and managing accounts receivables. Both of these decrease the value of the firm, but a liberal policy in accounts receivable coupled with the portfolio management approach could increase the value. Efforts to assign ways to manage these risks were also undertaken; among them, special attention was paid to adapting assumptions from value of liquidity theory as well as gauging the potential effect on the firm value.”

Gamble, Richard H (1998)² in the Automated Receivables Management System Revealed “An automated receivables management system that provides a self service collection environment using an electronic network, such as the Internet or a PCS, as a medium for communication and transaction execution. Comprehensive collections services are provided in a fully automated fashion, including account decisioning, treatment specification, communication channel specification, and communication to the customer and method for payment/response from the customer using the electronic channel. The electronic network operates as a fully-automated electronic receivables environment, providing a medium for notification, receiving funds and customer responses, while allowing the creation of a test and control environment for experimentation on a customer level”

¹ **Grzegorz Michalski (2003)**, “Small and Medium Enterprises Accounts Receivable Management with Value of Liquidity in View”, *Wroclaw University of Economics*, pp. 357-369, 2003.

² **Gamble, Richard H (1998)**, “Automated Receivables Management System”, *Magazine article from Independent Banker*, Vol. 48, No. 7, July 1998.

Richard Pike & Nam Sang Cheng (2001)³ in their research titled “An Examination of Policy Choices, Practices and Late Payment in UK Companies”, have listed down the following guidelines for credit management. (1) Examine the type of firm most likely to enter into specialist external credit management structural arrangements; and (2) identify contextual and credit policy choices influencing the credit period taken and late payment of debts. The researchers found that the specialist intermediaries are not particularly common in large firms. The paper also identifies a number of contextual and policy variables that help explain variation in debtor days and late payment by customers.

Richard G.P. McMahon, Scott Holmes (1991)⁴ In “Small business financial management practices in North America”. He has specified his research base as the failures of many small firms due to their careless financial management. Recent years have seen increased attention to financial management in small business training and education programs and in the many books and articles written for small business. His research identified and highlighted the trends in the financial management practice of small firms. This will assist policymakers in understanding the financial environment in which small firms operate and the possible impact of the current and proposed policies directed at the small business sector.

Maureen F. McNichols (2007)⁵ in “Research design in earnings management Studies” had stated that trade-offs associated with three research designs commonly used in the earnings management literature: those based on aggregate and specific accruals and those based on the distribution of earnings after management. A key theme of the paper is that empirical procedures for aggregate accruals studies lag both our theories of incentives to

³ **Richard Pike & Nam Sang Cheng (2001)**, "An Examination of Policy Choices, Practices and Late Payment in UK Companies", *Journal Article*, 9-2001.

⁴ **Richard G.P. McMahon, Scott Holmes (1991)**, "Small business financial management practices in North America", *Journal of Small Business Management*, April 1991.

⁵ **Maureen F. McNichols (2007)**, "Research design in earnings management Studies", *Journal Of Accounting And Economics*, Vol 24, pp.99-126, 1997.

manage accruals and our institutional knowledge of how accruals behave. Empirical findings suggest that aggregate accruals models that do not consider long-term earnings growth are potentially miss specified and can result in misleading inferences about earnings management behaviour. It is suggested that future progress in the earnings management literature is more likely to come from application of specific accrual and distribution-based tests than from aggregate accruals tests.

David Burgstahler (1997)⁶ in “Earnings management to avoid earnings decreases and losses” This paper provides evidence that firms manage reported earnings to avoid earnings decreases and losses. Specifically, in cross-sectional distributions of earnings changes and earnings, we lead to unusually low frequencies of small decreases in earnings and small losses and unusually high frequencies of small increases in earnings and small positive income. We find evidence that two components of earnings, cash flow from operations and changes in working capital, are used to achieve increases in earnings. We present two theories, based on stakeholder use of information-processing heuristics and prospect theory, about the motivation for avoidance of earnings decreases and losses.

2.2. THEORITICAL UNDERSTANDING

There are several articles has appeared in the literature discussing the monitoring of accounts receivables. The techniques of Days Sales Outstanding (DSO) and Aging Schedule often misleading and still appear to be the primary vehicles used by the analysts to evaluate a firm’s accounts receivables balance.

Lewellen and Johnson and then Stone highlighted the deficiencies of these conventional calculations. They showed the conventional procedure will misleading and

⁶ **David Burgstahler (1997)**, “Earnings management to avoid earnings decreases and losses”, *Journal of Accounting and Economics*, Vol 24, pp.99-126, 1997.

capable of frequent errors. Their criticism centered on the sensitivity of the calculations to the sales pattern and the sales averaging period selected.

Many analysts recognize that receivables can be influenced by sales effects, and they attribute this to seasonal or cyclical factors. They attempt to eliminate, or at least minimize, these effects by comparing calculated DSO ratios and Aging schedules against those historical periods. However, this approach may not be very satisfactory. History seldom repeats itself exactly; because the changes in the level of interest rates, customer mix, and many other factors that make it difficult to make meaningful comparisons. In this case of competitors, it is difficult to make comparisons because of product mix, and geographic locations of company.

One way to overcome these problems is to abandon DSO measures and Aging schedule and rely on balance fractions or payment patterns. Another approach is to use an Accounting Based Variance Analysis Model.

The Variance Analysis Model compares an actual against budgeted receivable performance. A real advantage of using a budget is that it can overcome the many problems inherent in historical data. The budget amounts, then condition expected to exist during the budget period can be incorporated into the accounts receivable budget. This is obviously better than comparing actual performance to some prior period that may not be representative of conditions prevailing during the budget period.

Additional advantage of a variance methodologies are as follows:

Errors in sales projections and collections forecasts are readily evident. This provides management with the opportunity to assess budget assumptions and improve the quality of forecasts.

The DSO calculations are independent of both the sales averaging period and any sales trend, thus overcoming criticisms of traditional measurement techniques. The independence of the DSO calculate on allows identification of a collection experience and a sales effect variance.

The sales effect variance can be decomposed into components that allow the influence of sales on receivable balances to be better understood.

The total variance between actual and budgeted performance can be separated into a collection experience variance and a sales effect variance. Latter variance can be subsequently split into pattern and quantity variances.

A VARIANCE ANALYSIS MODEL:

The expression variance analysis is usually considered in a statistical context as the sum of squared deviations from the mean. The usage of expressions here is considerably different.

The Cost Accountant's definition of variance is defined as the difference between actual and budgeted amount. This approach also requires explicit definition of the meaning of the word budget. In this case the accounts receivables is calculated by multiplying single estimates for expected sales by single estimates for expected days sales outstanding. The resulting figure is referred to as a **static budget** (i.e., ex ante budget) budget.

If the actual sales differ from expected sales, a revised budget is determined to reflect the new sales level. The ex post budget is called **Flexible budget**. The flexible budget is the pivotal budget for separating the total variance into components that explain the discrepancy between actual and budgeted performance.

COLLECTION EXPERIENCE VARIANCE (CEV):

The Collection Experience Variance isolates the efficiency of actual collections relative to revised (i.e., flexible) budget collections. The importance of this revision is that the flexible budget accounts for the fact at sales have changed from original budget expectations. The flexible budget, however, does not change the Days Sales Outstanding measure.

Calculation of the collection experience variance (CEV) requires recasting the static monthly receivables budgets into the flexible budgets based on actual sales performance, holding budgeted collection effort (i.e., budgeted DSO) constant. The flexible budget indicate the expected levels of accounts still outstanding from each month given that actual monthly sales

differ from budgeted monthly sales. The differences between actual accounts receivables and the flexible budget for accounts receivable represent pure collection experience variances, a combined pure collection experience and joint collection- sales pattern variance.

Actual receivables outstanding in each month j are unwritten as the product of two factors:

- Actual sales per day (ASPD_j) and
- Actual days sales outstanding (ADSO_j).

ASPD_j is calculated by dividing each month's sales by the number of business days (i.e., 25).

ADSO_j is calculated using the traditional ratio: **Receivables_j × days/sales_j**. A similar calculation is performed for budgeted days sales outstanding (BDSO_j). Collection experience variance plus joint effect (JE) is measured as

Actual Sales Per Day × (actual days sales outstanding – budgeted days sales outstanding).

Mathematically, the CEV Plus JE for month j is calculated as:

$$CEV_j + JE_j = ASPD_j [ADSO_j - BDSO_j]$$

Where, CEV_j is the Collection Experience Variance for month j.

JE_j is the Joint Effect for month j

ASPD_j is the Actual Sales Per Day for month j

ADSO_j is the Actual Days Sales Outstanding for month j

BDSO_j is the Budgeted Days Sales Outstanding for month j

SALES EFFECT VARIANCE (SEV):

By restating the static budget to a flexible budget in order to eliminate the influence of changing sales, the collection experience variance was isolated. Now the flexible budget is also used to eliminate the influence of collection experience on total variances so that the effect of sales on accounts receivable balances can be measured. The sales effect variance (SEV) is measured as the difference between the flexible budget and the static budget.

Mathematically, the SEV for month j is calculated as

$$SEV_j = BDSO_j [ASPD_j - BSPD_j]$$

Where, BDSO_j is the Budgeted Days Sales Outstanding for month j

BSPD_j is the Budgeted Sales Per Day for month j

ASPD_j is the Actual Sales Per Day for month j

An understanding of Sales Effect Variance is important in analyzing resource allocation. And separating the sales effect variance into its pattern and quantity components, the significance of sales on receivables is then discovered.

SALES PATTERN VARIANCE (SPV):

A sales pattern variance is known to be present when differences exist between actual and budgeted monthly sales effect variance. The pattern variance is not as straightforward as either the collection experience variance or the sales effect variance. Whereas these variances can be calculated for each month, independent of all other months, the pattern variance must be use all months to date that have receivable balances outstanding (either actual, budget, or both).

The pattern variance compares the composition of the flexible budget (which eliminates the collection experience influence) against what accounts receivable should be when actual sales per day for month j are restated in their budgeted proportions.

Mathematically, the SPV for month j is calculated as:

$$SPV_j = BDSO_j [ASPD_j - RASPD_j]$$

Where, BDSO_j is the Budgeted Days Sales Outstanding for month j

ASPD_j is the Actual Sales Per Day for month j

RASPD_j is the Restated Actual Sales Per Day for month j and

RASPD = Total Actual Sales Per Day × Budgeted Proportions for monthly sales per day.

SALES QUANTITY VARIANCE (SQV):

The remaining component of the sales effect variance is the sales quantity variance. It represents the true sales volume effect on outstanding accounts receivables. This variance is calculated as the difference between the sales effect variance and the sales pattern variance.

Mathematically, the SQV for month j is calculated as:

$$SQV_j = [RASPD_j \times BDSO_j] - [BSPD_j \times BDSO_j]$$

Where, RASPD_j is the Restated Actual Sales Per Day for month j and

BSPD_j is the Budgeted Sales Per Day for month j

BDSO_j is the Budgeted Days Sales Outstanding for month j

And it also can be calculated as:

$$[(\text{Total actual sales} - \text{Total budgeted sales}) / \text{Total days in the period}] \times \text{Total DSO}$$

OVERALL ANALYSIS:

The significance of the aforementioned variance analysis model can be revealed by comparing it to the traditional models of Days Sales Outstanding (DSO) and aging schedules. It is interesting to note that the collection experience variance is diametrically opposite the interpretation of the aging schedule. The aging schedule is simply not able to disaggregate the various influences. Analysis of the variance also directs management's attention to both explicit and implicit assumptions in the static budget. For example, the monthly sales pattern variances indicate that management did not have a very clear understanding of how sales would actually occur. A reconciliation of sales assumptions with actual performance should improve future resource allocation decisions.

A CHANGING CREDIT POLICY:

If credit policy changes, it is necessary to incorporate any changes into the analysis to correctly state the variances.

CHAPTER - 3

RESEARCH METHODOLOGY

3.1. Type of research:

Descriptive Analysis is used in this study. The main purpose of descriptive research is the description of an existing status of Accounts Receivables Management.

3.2. Sources of data:

Secondary data are used for the study. Secondary sources of data were the various accounting books maintained by Allied Enterprises, Coimbatore.

3.3. Research Tool:

Variance analysis is used for the study. This study uses the various components of its model. They are:

- Collection Experience Variance
- Sales effect Variance
- Sales Pattern Variance
- Sales quantity variance
- Overall Analysis

3.4. Period of the study:

The study uses the financial reports of the past financial year that is 1st April 2011- 31st March 2012.

3.5. Limitations:

- The study is limited to the past 1 year data only.
- The study uses only the secondary data predominantly thus any effects in the secondary data are bound to be reflected.
- This study is applicable only to Allied Enterprises, Coimbatore.

CHAPTER - 4
ANALYSIS AND INTERPRETATION

TABLE. NO. 4.1

**THE TABLE SHOWING THE RECEIVABLES INFORMATION OF ALLIED ENTERPRISES FOR THE
YEAR 2011-2012**

MONTHS	STATIC BUDGET (Amount in Rs.)	ACTUAL RECEIVABLES (Amount in Rs.)
April	4000	3560
May	3000	2500
June	7500	7300
July	5000	6200
August	5000	5000
September	5000	5830
October	3000	4100
November	3000	3000
December	4000	5500
January	6500	6950
February	6800	8000
March	8000	13000
TOTAL	60800	70940

Source : Secondary Data

INTERPRETATION:

The table shows the information on Accounts receivables based on the budgeted value and the actual value. The actual receivable column represents the amount outstanding from the credit sales made in the financial year 2011-12. Similarly the budgeted receivables mentioned. In the first three months the actual amount are lesser than the budgeted amount i.e., April to June. From the July, the actual amount outstanding is higher than the budgeted amount. In the month of August and November the values are same. In March the actual value Rs.13000 is found to be very high from the budget.

TABLE. NO. 4.2
THE TABLE SHOWING THE SALES INFORMATION OF ALLIED ENTERPRISES FOR THE YEAR
2011-2012

MONTHS	STATIC BUDGET	PERCENTAGE (Composite)	ACTUAL Receivables	PERCENTAGE (Composite)
April	8000	8.33	5000	5
May	8000	8.33	7000	7
June	8000	8.33	9500	10
July	8000	8.33	5000	5
August	8000	8.33	6500	7
September	8000	8.33	10000	10
October	8000	8.33	8400	9
November	8000	8.33	6500	7
December	8000	8.33	7300	8
January	8000	8.33	8850	9
February	8000	8.33	9140	9
March	8000	8.33	13100	14
TOTAL	96000	100.00	96290	100.00

Source : Secondary Data

INTERPRETATION:

The table shows the information on Sales based on the budgeted value and the actual value. The actual sales column represents the credit sales made during the financial year 2011-12. Similarly the budgeted credit sales also mentioned.

For the whole year, the budget is estimated to be Rs.8000. In the month of March, the actual credit sale Rs.13100 is found to be very high than the budgeted level. And credit sale Rs.5000 in the month of April and July is found to be less than the budgeted level.

TABLE. NO. 4.3
THE TABLE SHOWING AN AGING SCHEDULE OF ALLIED ENTERPRISES
FOR THE YEAR 2011-2012

MONTHS	STATIC BUDGET	PERCENTAGE (Composite)	ACTUAL RECEIVABLE	PERCENTAGE (Composite)
April	4000	7	3560	5
May	3000	5	2500	4
June	7500	12	7300	10
July	5000	8	6200	9
August	5000	8	5000	7
September	5000	8	5830	8
October	3000	5	4100	6
November	3000	5	3000	4
December	4000	7	5500	8
January	6500	11	6950	10
February	6800	11	8000	11
March	8000	13	13000	18
TOTAL	60800	100	70940	100

Source : Secondary Data

INTERPRETATION:

The table shows the information of the budgeted receivables and the actual receivables. The receivables outstanding per month are mentioned in percentage. In the month of March, the actual percentage (18%) is found to be very high than the budgeted level (13%). And in the month of April the percentage is found to be less than the budgeted level.

TABLE. NO. 4.4
THE TABLE SHOWING PER DAY SALES OF ALLIED ENTERPRISES
FOR THE YEAR 2011-2012

MONTHS	BUDGETED SALES PER DAY	ACTUAL SALES PER DAY
April	320	200
May	320	280
June	320	380
July	320	200
August	320	260
September	320	400
October	320	336
November	320	260
December	320	292
January	320	354
February	320	366
March	320	524
TOTAL	3840	3852

Source : Secondary Data

INTERPRETATION:

The table shows the information of actual and budgeted sales per day. The actual sale per day is found to be less than the budgeted sale per day for first 6 months and more than the budgeted level for next 6 months. The actual amount per day increased for three consecutive months i.e., from January to March of 2012. It indicates increase in the demand for the product of an organization.

Assumption:

The number of Working days per month is taken as 25 days.

PHASE 1:

The variance analysis is used to compare the actual amount and days to the budgeted amount and days accordingly. The conventional study on Accounts Receivables is Aging Schedule and the Days Sales Outstanding. The below table is the first phase of the study. The three months i.e., January, February and March of 2012 data only used for analysis because in those months the actual amount is found to be high than the budgeted level.

TABLE. NO. 4.5
THE TABLE SHOWING THE CONSOLIDATED RECEIVABLES AND SALES INFORMATION OF
ALLIED ENTERPRISES

MONTH	RECEIVABLE		SALES				AGING SCHEDULE	
	Actual	Static Budget	Actual	%	Static Budget	%	Actual	Static Budget
January	6950	6500	8850	28	8000	33.3	25%	30%
February	8000	6800	9140	30	8000	33.3	29%	32%
March	13000	8000	13100	42	8000	33.3	46%	38%
Total	27950	21300	31090	100	24000	100	100%	100%

MONTHS	SALES PER DAY		MONTHLY DSO		BUSINESS DAYS
	Actual	Budget	Actual	Budget	
January	354	320	19.63(20)	20.31(20)	25
February	366	320	21.85(22)	21.25(21)	25
March	524	320	24.81(25)	25(25)	25
Total	1244	960			

Source : Secondary Data

INTERPRETATION:

The above tables shows the conventional method of managing accounts receivables i.e., Aging Schedule and Days Sales Outstanding according to actual and budgeted receivables outstanding sales per day and credit sales. The calculation per day of this will be used for further analysis in Phase 2. (Monthly DSO = Receivables* days/sales)

PHASE 2:

The budget amount and then condition expected to exist during the budget period can be incorporated into the accounts receivable budget. This is obviously better than comparing actual performance to some prior period that may not be representative of conditions prevailing during the budget period. Last three months data is used for the analysis because the actual amount is found to be high than the budgeted level. So it is considered to be better than using other months.

TABLE. NO. 4.6**THE TABLE SHOWING THE ACTUAL SALES OF ALLIED ENTERPRISES**

MONTH	ACTUAL SALES PER DAY	ACTUAL DAYS SALES OUTSTANDING	TOTAL
January	354	19.63(20)	6950
February	366	21.85(22)	8000
March	524	24.81(25)	13000

Source : Secondary Data

Actual sales = Actual Sales Per Day × Actual Days Sales Outstanding

INTERPRETATION:

The above table shows the actual sales of the organization. An actual sales amount Rs. 6950 is for the month of January and Rs.8000 and Rs.13000 is for the month of February and March respectively. It indicates that there is an improvement in the sales continuously.

TABLE. NO. 4.7
THE TABLE SHOWING THE BUDGETED SALES BASED ON ACTUAL DSO OF ALLIED
ENTERPRISES

MONTH	BUDGETED SALES PER DAY	ACTUAL DAYS SALES OUTSTANDING	TOTAL
January	320	19.63(20)	6282
February	320	21.85(22)	6992
March	320	24.81(25)	7450

Source : Secondary Data

Budgeted Sales Based On Actual DSO = Budgeted Sales Per Day × Actual Days Sales Outstanding

INTERPRETATION:

The above table shows the budgeted sales of the organization based on the actual days the amount is outstanding. The budgeted sales amount based on actual DSO Rs. 6282 is for the month of January and Rs.6992 and Rs.7450 is for the month of February and March respectively. The budgeted sales based on Actual DSO for the month of March Rs.7450 is found to be high.

TABLE. NO. 4.8
THE TABLE SHOWING THE BUDGETED SALES BASED ON BUDGETED DSO OF ALLIED
ENTERPRISES

MONTH	BUDGETED SALES PER DAY	BUDGETED DAYS SALES OUTSTANDING	TOTAL
January	320	20.31(20)	6500
February	320	21.25(21)	6800
March	320	25(25)	8000

Source : Secondary Data

The Budgeted Sales Based on budgeted DSO = Budgeted sales per day × Budgeted days sales outstanding

INTERPRETATION:

The above table shows the budgeted sales of the organization based on the budgeted days the amount is outstanding. The budgeted sales amount of Rs. 6500, Rs.6800 and Rs.8000 is for the month of January, February and March respectively. In the month of March, the budgeted sale based on budgeted DSO is Rs.8000 which is found to be high.

TABLE. NO. 4.9

THE TABLE SHOWING THE FLEXIBLE BUDGET OF ALLIED ENTERPRISES

MONTH	ACTUAL SALES PER DAY	BUDGETED DAYS SALES OUTSTANDING	TOTAL
January	354	20.31(20)	7190
February	366	21.25(21)	7778
March	524	25(25)	13100

Source : Secondary Data

Flexible Budget: Actual sales per day × Budgeted days sales outstanding

INTERPRETATION:

The above table shows the actual sales of the organization based on the budgeted days the amount is outstanding. The actual sales amount of Rs. 7190, Rs.7778 and Rs.13100 is for the month of January, February and March respectively. In the month of March, the actual sale based on budgeted DSO is Rs.13100 which is found to be high.

TABLE. NO. 4.10

THE TABLE SHOWING THE RESTATED ACTUAL SALES BASED ON BUDGETED DSO OF ALLIED ENTERPRISES

MONTH	RESTATED ACTUAL SALES PER DAY (RASPD)	BUDGETED DAYS SALES OUTSTANDING	TOTAL
January	414.63	20.31(20)	8408
February	414.63	21.25(21)	8811
March	414.63	25(25)	10366

Source : Secondary Data

Restated Actual Sales Based on Budgeted DSO = Actual sales per day Restated in Budget Proportion × Budgeted days sales outstanding:

Actual sales per day Restated in Budget Proportion = Total Actual Sales Per Day × Budgeted Proportions for monthly sales per day

INTERPRETATION:

The above table shows the restated actual sales of the organization based on the budgeted days the amount is outstanding. The restated actual sales amount based on budgeted DSO Rs. 8408, Rs.8811 and Rs.10366 is for the month of January, February and March respectively. In the month of March, the restated actual sale based on budgeted DSO is Rs.10366 which is found to be high.

TABLE. NO. 4.11

THE TABLE SHOWING THE STATIC BUDGET OF ALLIED ENTERPRISES

MONTH	BUDGETED SALES PER DAY	BUDGETED DAYS SALES OUTSTANDING	TOTAL
January	320	20.31(20)	6500
February	320	21.25(21)	6800
March	320	25(25)	8000

Source : Secondary Data

Static Budget = Budgeted sales per day × Budgeted days sales outstanding

INTERPRETATION:

The above table shows the static budget sales of the organization based on the budgeted days the amount is outstanding. The budgeted sales amount based on budgeted DSO Rs. 6500, Rs.6800 and Rs.8000 is for the month of January, February and March respectively. In the month of March, the static budget amount is Rs.8000 which is found to be high.

COLLECTION EXPERIENCE VARIANCE

The CEV is the difference between the actual budget and the flexible budget. The actual days sales outstanding based on the actual sales per day is compared to the actual days sales outstanding based on the budgeted sales per day.

The differences between actual sales and budgeted sales to the actual days sales outstanding then the differences actual sales and budgeted sales to budgeted days sales outstanding is combined together to derive the value (i.e., -22, 30 and 450 in the table).

TABLE. NO. 4.12

THE TABLE SHOWING THE COLLECTIVE EXPERIENCE VARIANCE OF ALLIED ENTERPRISES

MONTH	ASPD × ADSO	BSPD × ADSO	DIFF	ASPD × BDSO	BSPD × BDSO	DIFF	CEV
January	6950	6282	668	7190	6500	690	-22
February	8000	6992	1008	7778	6800	978	30
March	13000	7450	5550	13100	8000	5100	450

Source : Secondary Data

INTERPRETATION:

The above table shows the collective experience variance. In a month of January, the collective experience is negative (-22.) i.e., the actual budget is less than the flexible budget. And in the month of February and March, it is positive i.e., Rs.30 and Rs. 450 accordingly. The positive collection position of Rs.30 and rs.450 for February and March, respectively, indicate inferior collection effort, since actual DSO for these months exceed their flexible budget counterparts.

JOINT EFFECT VARIANCE**TABLE. NO. 4.13****THE TABLE SHOWING THE JOINT EFFECT VARIANCE OF ALLIED ENTERPRISES**

MONTH	ASPD	ADSO	BDSO	CEV	JE
January	354	19.85(20)	20.31(20)	-22	0
February	366	21.85(22)	21.25(21)	30	396
March	524	24.81(25)	25(25)	450	0

Source : Secondary Data**Joint effect** = CEV + JE = ASPD [ADSO-BDSO]

$$JE = [ASPD (ADSO-BDSO)-CEV]$$

Where, CEV_j is the Collection Experience VarianceJE_j is the Joint EffectASPD_j is the Actual Sales Per DayADSO_j is the Actual Days Sales OutstandingBDSO_j is the Budgeted Days Sales Outstanding**INTERPRETATION:**

The above table shows the joint effect variance. The joint experience variance for two months is zero i.e., January and March. The February variance is considered, however, includes Rs.396, joint collection experience-sales pattern effect.

COLLECTION EXPERIENCE VARIANCE PLUS JOINT ANALYSIS

TABLE. NO. 4.14

**THE TABLE SHOWING THE COLLECTION EXPERIENCE VARIANCE PLUS JOINT EFFECT
VARIANCE OF ALLIED ENTERPRISES**

MONTHS	CEV	JE	TOTAL
January	-22	0	-22
February	30	396	426
March	450	0	450
CEV + JE	458	396	854

Source : Secondary Data

Collection Experience Variance Plus Joint Effect Variance = CEV + JE = ASPD [ADSO - BDSO]

INTERPRETATION:

The above table shows the collective experience variance plus joint effect variance. The differences between actual accounts receivable and flexible budget for accounts receivable represents pure collection experience for January and March, and a combined collection experience and joint collection- sales pattern variance for March. This CEV and JE added together and arrived value of Rs.854.

SALES PATTERN VARIANCE

TABLE. NO. 4.15

THE TABLE SHOWING THE SALES PATTERN VARIANCE OF ALLIED ENTERPRISES

MONTHS	BDSO	ASPD	RASPD	SPV
JANUARY	20.31(20)	354	414.63	-1231.40
FEBRUARY	21.25(21)	366	414.63	-1033.39
MARCH	25(25)	524	414.63	2734.25
TOTAL				469.46

Source : Secondary Data

Sales Pattern Variance = BDSO [ASPD – RASPD]

Where, RASPD_j is the Restated Actual Sales Per Day

INTERPRETATION:

The above table shows that the composition of the flexible budget (which eliminates CEV) against what accounts receivable should be when actual sales per day for restated in their budgeted proportions. The calculation indicates that the changed sales pattern, relate to budget, has on accounts receivables. in the month of January and February the SPV is negative which indicates that the proportion of total actual sale, are less than static budgeted proportion. And in the month of March, the SPV is positive.

Overall, the shift in sales from a budgeted constant pattern to an actually increasing pattern is resulted in Rs. 469.46 greater investment in receivables than budgeted.

SALES QUANTITY VARIANCE

TABLE. NO. 4.16

THE TABLE SHOWING THE SALES QUANTITY VARIANCE OF ALLIED ENTERPRISES

MONTHS	RASPD × BDSO	BSPD × BDSO	SQV
JANUARY	8408	6500	1908
FEBRUARY	8811	6800	2011
MARCH	10366	8000	2366
TOTAL			6285

Source : Secondary Data

$$\text{Sales Quantity Variance} = [\text{RASPD} \times \text{BDSO}] - [\text{BSPD} \times \text{BDSO}]$$

INTERPRETATION:

The above table shows the sales volume effect on outstanding accounts receivable. The SQV is positive for all the three months which indicates that the accounts receivable is less than budgeted level. It is a positive for an organization.

SALES EFFECT VARIANCE**TABLE. NO. 4.17****THE TABLE SHOWING THE SALES EFFECT VARIANCE OF ALLIED ENTERPRISES**

MONTHS	ASPD × BDSO	BSPD × BDSO	SEV
JANUARY	7190	6500	690
FEBRUARY	7778	6800	978
MARCH	13100	8000	5100

Source : Secondary Data

$$\text{Sales Effect Variance} = [\text{ASPD} \times \text{BDSO}] - [\text{BSPD} \times \text{BDSO}]$$

INTERPRETATION:

The above table shows that the information on the flexible budget and the static budget. In all the months the Sales Effect Variance is positive. The values are Rs.690, Rs.978 and Rs.5100 for the month of January, February and March respectively. It indicates that the revised receivable budget for accounts receivables outstanding from all the months should be higher than that indicated by its associated static budget.

TOTAL VARIANCE**TABLE. NO. 4.18****THE TABLE SHOWING THE TOTAL VARIANCE OF ALLIED ENTERPRISES**

MONTHS	ACTUAL RECEIVABLE	BUDGETED RECEIVABLE	TOTAL VARIANCE
JANUARY	6950	6500	450
FEBRUARY	8000	6800	1200
MARCH	13000	8000	5000
GRAND TOTAL			6650

Source : Secondary Data

INTERPRETATION:

The total variance between accounts receivables and static budget balance, as of the end of March is Rs.6650. This variance is unfavorable since the actual receivable exceeds the budget level. Understand the factors contributing to this variance and to assign responsibility will be useful. This should result in better monitoring and control of accounts receivable investment and timely corrective action.

CHAPTER - 5

FINDINGS, SUGGESTIONS AND CONCLUSION

5.1. FINDINGS

FINDINGS FOR PHASE 1:

1. The Accounts Receivables for the Financial Year 2011-2012, the first three months the actual amount is lesser than the budgeted amount i.e., April to June. From the July, the actual amount outstanding is higher than the budgeted amount. In the month of August and November the values are same. In the month of March the actual value Rs.13000 is found to be very high from the budget.
2. The credit sales for the financial year 2011-2012, in the month of March, the actual credit sale Rs.13100 is found to be very high than the budgeted level. And credit sale Rs.5000 in the month of April and July is found to be less than the budgeted level. The difference
3. The Aging Schedule for the financial year 2011-2012, In the month of March, the actual percentage (18%) is found to be very high than the budgeted level (13%). And in the month of April the percentage is found to be less than the budgeted level.
4. The Sales Per Day for the financial year 2011-2012, The actual sale per day is found to be less than the budgeted sale per day for first 6 months and more than the budgeted level for next 6 months. The actual amount per day increased for three consecutive months i.e., from January to March of 2012. It indicates increase in the demand for the product of an organization.

FINDINGS FOR PHASE 2:

1. The Actual Credit Sales for the three months in the financial year 2011-2012, An actual credit sales Rs. 6950 is for the month of January and Rs.8000 and Rs.13000 is for the month of February and March respectively. It indicates that there is an improvement in the sales continuously.
2. The Budgeted Credit Sales Based on Actual DSO for the three months in the financial year 2011-2012, the budgeted sales amount based on actual DSO Rs. 6282 is for the month of January and Rs.6992 and Rs.7450 is for the month of February and March respectively. The budgeted sales based on Actual DSO for the month of March Rs.7450 is found to be high.
3. The Budgeted Credit Sales Based on Budgeted DSO for the three months in the financial year 2011-2012, the budgeted credit sales amount of Rs. 6500, Rs.6800 and Rs.8000 is for the month of January, February and March respectively. In the month of March, the budgeted credit sale based on budgeted DSO is Rs.8000 which is found to be high.
4. The Flexible Budget for the three months in the financial year 2011-2012, the actual credit sales amount of Rs. 7190, Rs.7778 and Rs.13100 is for the month of January, February and March respectively. In the month of March, the actual credit sale based on budgeted DSO is Rs.13100 which is found to be high.
5. The Restated Actual Sales Based on Budgeted DSO for the three months in the financial year 2011-201, the restated actual credit sales amount based on budgeted DSO Rs. 8408, Rs.8811 and Rs.10366 is for the month of January, February and March respectively. In the month of March, the restated credit actual sale based on budgeted DSO is Rs.10366 which is found to be high.

6. The Static Budget for the three months in the financial year 2011-2012, the budgeted credit sales amount based on budgeted DSO Rs. 6500, Rs.6800 and Rs.8000 is for the month of January, February and March respectively. In the month of March, the static budget amount is Rs.8000 which is found to be high.
7. The Collection Experience Variance for the three months in the financial year 2011-2012, In a month of January, the collective experience is negative (-22.) i.e., the actual budget is less than the flexible budget. And in the month of February and March, it is positive i.e., Rs.30 and Rs. 450 accordingly. The positive collection position of Rs.30 and rs.450 for February and March, respectively, indicate inferior collection effort, since actual DSO for these months exceed their flexible budget counterparts.
8. The Joint Effect Variance for the three months in the financial year 2011-2012, The joint experience variance for two months is zero i.e., January and March. The February variance is considered, however, includes Rs.396, joint collection experience-sales pattern effect.
9. The Collection Experience Variance Plus Joint Effect Variance for the three months in the financial year 2011-2012, The differences between actual accounts receivable and flexible budget for accounts receivable represents pure collection experience for January and March, and a combined collection experience and joint collection- sales pattern variance for March. This CEV and JE added together and arrived value of Rs.854.
10. The Sales Pattern Variance for the three months in the financial year 2011-2012, In the month of January and February the SPV is negative which indicates that the proportion of total actual sale, are less than static budgeted proportion. And in the month of March, the SPV is positive. Overall, the shift in sales from a budgeted constant pattern to an actually increasing pattern has resulted in Rs. 469.46 greater investment in receivables than budgeted.
11. The Sales Quantity Variance for the three months in the financial year 2011-2012, The SQV is positive for all the three months which indicates that the accounts receivable is less than budgeted level. It is a positive for an organization.

12. The Sales Effect Variance for the three months in the financial year 2011-2012, In all the months the SEV is positive. It indicates that the revised receivable budget for accounts outstanding from all the months should be higher than that indicated by its associated static budget.
13. The Total Variance for the three months in the financial year 2011-2012, The total variance between accounts receivables and static budget balance, as of the end of March is Rs.6650. This variance is unfavorable since the actual receivable exceeds the budget level.

5.2. SUGGESTIONS

1. The differences between actual accounts receivables and the flexible budget for accounts receivable represent pure collection experience variances. So facilitating the flexible budget will be helpful to enhance the Pure Collection Experience of the accounts receivables.
2. Restating the static budget to a flexible budget will helpful to eliminate the influence of changing sales.
3. This Study analyzes the variances on accounts receivables per day basis. The same way this method can be used to analyze the receivables district wise. Since Allied Enterprises supplies their products to various states. The sales vary according to their demand. So they can maintain their receivable well by focusing on state wise.

5.3. CONCLUSION

Traditional measures of day's sales outstanding and aging schedules are unable to isolate a number of factors that influence account receivable balances. This study proposes An Accounting-based Variance Model that compares actual performance to budget and that identifies collection experience, sales pattern, and sales quantity influences on accounts receivable balances. Thus it overcomes the deficiencies of the traditional models. An understanding of these variances provides the organization the mechanism of effective receivables management.