

## June 2016

### A2 GCE APPLIED BUSINESS

F253/SM Constructing a Financial Strategy

STIMULUS MATERIAL FOR ACADEMIC YEAR 2015–2016

SERIES 10

This stimulus material must be used for the June 2016 examination session.

**OCR supplied materials:**

None

**Other materials required:**

- A calculator may be used

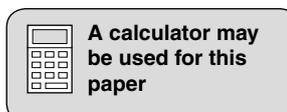


#### INSTRUCTIONS TO TEACHERS

- This stimulus material provides a vocational context for the internally assessed unit: F253 – Constructing a Financial Strategy.
- Each year **one** scenario will be released on OCR's website which will provide an authentic vocational context for candidates' subsequent investigations.
- It is imperative that this material is used for the **June 2016** examination session. New stimulus material (**Series 11**) will be issued for the academic year 2016–2017.
- There are no separate marking criteria with this stimulus material. A solution will, however, be provided for **Series 10** in the **Principal Moderator's report for June 2016**.
- Please bear in mind that, due to the nature of this unit, candidates will have many opportunities to revisit their figures and you need to be able to ensure that the work of each candidate is their own. Therefore, it may be that **Tasks B–G** of this unit are supervised to ensure that individual, authentic evidence is produced.

#### INFORMATION FOR CANDIDATES

- This stimulus material has been created to provide you with a vocational context for the internally assessed unit: F253 – Constructing a Financial Strategy.
- If you have any questions regarding the stimulus material, you must consult both your teacher and the unit specification.
- It is anticipated that, where necessary, you use an approved calculator to complete the **Tasks** as outlined in the stimulus material.
- This document consists of **16** pages. Any blank pages are indicated.



## Introduction

Evan had always enjoyed photography, particularly landscape photography around the Cotswolds where he lives. When he turned 40 his twin daughters, Poppy and Lily, persuaded him to exhibit some of his photographs at a local craft fair. His photographs proved popular. The girls encouraged him to exhibit his photographs at other fairs and exhibitions. Although his photographs sold well, Evan realised that he was sometimes losing customers because the prints were either too big or too small, or framed when the customer would have liked an un-framed canvas or acrylic print. The girls had noticed this too. They helped him set up a website where potential customers could view his work and order exactly what they wanted. This meant that there would be lower outlay costs for Evan as more of the photographs would be printed to order. That year the girls, aged 16, persuaded him to take leavers' photographs for their friends from school. Evan found that he had a talent for portrait photographs.

In 2013, Evan was made redundant from the factory where he had worked since he was 18. He could have moved with the company, which was being relocated to much larger premises nearly 80 miles away, but he decided to take the redundancy package offered to him instead. The girls helped him to make this decision and suggested that he turned his lucrative hobby into a proper business. *Capturing Cotswolds Limited* was set up on 1 July 2013. Evan, Managing Director, owns 52% of the shares and the girls, also directors, each hold a 24% stake in the business. Poppy is responsible for marketing and exhibitions and Lily is responsible for the finances and the website – although both are directly involved in the day-to-day activities of the business, such as editing the photographs.

Two years on, the business is still very much in its infancy. Although successful, the three directors have found it difficult working from the small office/study at their home. Evan is being asked to do more and more portrait work and has recently started wedding photography. Poppy often takes his work to exhibitions and has established retail space in some local art galleries and craft centres. The storing of stock is becoming a problem. Lily is being kept busy with orders from the website.

*Capturing Cotswolds Limited* has cash sales (from the website) and credit sales (from the commissioned work). In addition, photographs displayed in the local art galleries and craft centres are on a sale or return basis, with a percentage of the sale value going to the art gallery or craft centre.

At a recent board meeting, all three directors agreed that they needed larger premises to accommodate a photographic studio, office space for both Poppy and Lily and additional storage space. They also agreed that they needed two part-time assistants: one to arrange appointments for customers, and the other to pack and post the website orders. Although employing two part-time assistants would not directly increase sales, Evan is less likely to miss enquiries, Poppy will have more opportunity to promote the business and all three directors will have more time for the lengthy process of editing photographs. Evan also needs more equipment including studio lighting, stage settings and backgrounds. The directors of *Capturing Cotswolds Limited* would like to replace the company's unreliable van with two new ones. Poppy wishes to have the company name and contact details on both vans, so that the business gets more publicity when out on location.

Lily favours the leasing of the vans and the premises, whereas Evan would prefer outright purchase.

The estimates of the costs are as follows:

- van – outright purchase price of each van £11 950 **or** monthly leasing charge of £160 per van
- premises – outright purchase price of £180 000 **or** monthly rental of £750.

In addition, the directors estimate that the new equipment will cost in the region of £17 000. Evan will make a director's loan to the business of £10 000 (funded from his redundancy package) to help pay for the purchase of this equipment.

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Furthermore, there will be additional staff costs to consider. The directors have agreed that the new staff should, initially, be paid £1 per hour over the national minimum hourly wage, rising to £2 per hour over the minimum following the successful completion of a six-month probationary period.

**TASK A**

You are Poppy and Lily's cousin and are studying a financial unit as part of a business management qualification at college. They have asked you to write a report to help Evan and themselves to understand the need for, and the importance of, financial record keeping.

- (i) The directors of *Capturing Cotswolds Limited* currently do not fully understand the implications for a business if it fails to accurately record all its financial transactions. They have asked you to explain the reasons, using examples, why accurate financial records need to be kept for a business such as *Capturing Cotswolds Limited*. These include the need to:
- calculate profit and loss accurately
  - meet legal requirements
  - show the assets and liabilities of the business
  - compare the business' financial position to previous years
  - prepare accurate budgets/forecasts for future years
  - obtain additional finance
  - plan any future expansion.
- (ii) The directors are unsure of the consequences to *Capturing Cotswolds Limited* if its financial information is found to be inaccurate. To help Evan, Poppy and Lily you have been asked to explain the following consequences to *Capturing Cotswolds Limited* of its financial information being inaccurate:
- criminal action
  - cash-flow problems from a high tax bill or criminal action
  - shareholders losing confidence
  - potential shareholders being unwilling to invest due to a lack of confidence in the business
  - bad public image
  - change in management structure.

(iii) Evan, Poppy and Lily do not understand some of the technical accounting language. They would welcome your explanation of the different types of income and expenditure which are often included in a set of final accounts. You need to explain each of the following to them so that they understand how and why the following are accounted for in the books:

- capital and bank loans
- assets such as premises and vehicles, including items bought on credit
- expenses for running a business, e.g. wages, electricity
- items/services purchased for resale, including those bought on credit
- items/services sold, including those sold on credit.

You should also include an explanation of the following source documents and how they are used:

- invoices
- credit notes
- bank records, e.g. direct debits and till receipts.

(iv) You must also explain to the directors of *Capturing Cotswolds Limited* how a series of final accounts are created, including the processes and financial documents used.

Your explanation must show your understanding of each of the following processes:

- the division of ledgers
- double-entry transaction recording
- the balancing of accounts accurately
- the creation of a trial balance
- the creation of a profit and loss account and a balance sheet.

These could be in written format and/or with the use of diagrams.

(v) In your report to Evan, Poppy and Lily you must explain the types of error which can occur when preparing accounts. You should include an example for each type of error to demonstrate depth of understanding. These include:

- omissions
- compensating errors
- errors of principle.

**[On completion of TASK A you will be assessed on Assessment Objective 1 which has a 9 mark tariff]**

*Note: For the purposes of this stimulus material, VAT transactions and Corporation Tax have been ignored.*

**TASK B**

At the start of trading on 1 February 2015, the following selected balances were extracted from the books of *Capturing Cotswolds Limited*.

	£
Brean Family (Debtor)	800
Kalthoski Family (Debtor)	890
Sachdev Family (Debtor)	624
Sky Lane Gallery (Creditor)	45
John England Frames (Creditor)	612
Canvas and All Prints (Creditor)	1 450
Sales	91 745
Purchases	36 698
Bank (Dr)	10 123
Cash	132
Exhibition costs	3 100
Discount received	2 814
Commission paid	3 515
Carriage inwards	1 834
Carriage outwards	1 943
Motoring expenses	1 109
Advertising costs	686
Insurance	707

During trading on 1 February 2015 the following source documents required processing.

Sales Invoice	£160	to	Brean Family for an additional framed photograph
Sales Invoice	£95	to	Sachdev Family for five more unframed prints
Sales Invoice	£625	to	Williams – wedding photography package deposit
Cash sales (from the website)	£415		Paid directly into the bank
Purchase Invoice	£107	from	John England Frames for framing for orders
Purchase Invoice	£213	from	Canvas and All Prints for photographic printing ordered (including £13 postage)
Cheque issued	£612	to	John England Frames
Cheque issued	£1 421	to	Canvas and All Prints in settlement of £1 450 after taking a 2% cash discount
Cheque received	£445	from	Kalthoski Family – first of two equal payments to clear their account
Cheque received	£800	from	Brean Family

In addition, the bank statement shows:

Direct debit paid	£101	to	ABPL Insurance
Direct debit paid	£98	to	Cotswold News and Gossip Ltd for advertising
Credit transfer received	£624	from	Sachdev Family
Credit transfer received	£625	from	Williams

**You are required to:**

- (i) open the relevant ledger accounts ensuring the opening balances are clearly shown
- (ii) post the information from the source documents and the bank statement to the relevant ledger accounts
- (iii) balance off the accounts as at the close of trading on 1 February 2015
- (iv) bring down the balances ready to start trading on 2 February 2015.

**TASK C**

On 20 June 2015 Lily wanted to check that the books of *Capturing Cotswolds Limited* balanced by producing a trial balance. She is aware that a suspense account may need to be created if the trial balance does not balance. Lily extracted the following balances as at 20 June 2015.

	£
Sales	144 061
Purchases	61 894
Ordinary share capital @ £1 each	20 000
Retained profit	2 520
Motor vehicles (cost)	4 000
Provision for depreciation of motor vehicles	1 000
Equipment (cost)	10 000
Provision for depreciation of equipment	2 000
Discount received	4 550
Commission paid	5 590
Exhibition costs	5 010
Telephone and Internet	585
Insurance	1 111
Advertising	1 018
Carriage inwards	2 200
Carriage outwards	2 284
Bad debts written off	250
Directors' remuneration	27 500
Sundry expenses	203
Interest received	186
Motoring expenses	1 793
Membership of the Federation of Small Businesses	100
Stock at 1 July 2014	4 210
Bank (Dr)	12 040
Cash	203
Creditors	2 916
Debtors	19 142
Dividends paid	18 000

**You are required to:**

- (i) prepare the trial balance as at 20 June 2015 creating a suspense account, if appropriate

After preparing the trial balance, the following errors were found:

- 1 discounts received of £64 were credited to purchases in error
- 2 the telephone and internet account had been understated by £28
- 3 sundry expenses include advertising expenses of £60
- 4 interest received has been overstated by £10
- 5 an entry for postage of £31 has been credited to carriage out, instead of carriage in.

- (ii) prepare a statement clearly showing how each of the above errors should be corrected. You should use journal entries and a suspense account
- (iii) prepare a corrected trial balance as at 20 June 2015.

**TASK D**

On 30 June 2015 the following balances were extracted from the books of *Capturing Cotswolds Limited*.

	£
Sales	154 810
Purchases	64 799
Ordinary share capital @ £1 each	20 000
Retained profit	2 520
Motor vehicles (cost)	4 000
Provision for depreciation of motor vehicles	1 000
Equipment (cost)	10 000
Provision for depreciation of equipment	2 000
Discount received	5 130
Commission paid	5 815
Exhibition costs	5 250
Telephone and Internet	692
Insurance	1 212
Advertising	1 176
Carriage inwards	3 024
Carriage outwards	2 417
Bad debts written off	250
Directors' remuneration	27 500
Sundry expenses	159
Interest received	184
Motoring expenses	1 886
Membership of the Federation of Small Businesses	200
Stock at 1 July 2014	4 210
Bank (Dr)	18 179
Cash	197
Creditors	3 174
Debtors	19 852
Dividends paid	18 000

**Additional information:**

- 1 Stock as at 30 June 2015 is valued at £6370.
- 2 The Membership of the Federation of Small Businesses account includes a prepayment of £100.
- 3 There are accrued advertising costs of £163, accrued directors' remuneration of £2500, and accrued telephone expenses of £62.
- 4 Depreciation per annum on motor vehicles is to be provided at 25% using the reducing balance method. Depreciation on equipment is provided at 20% using the straight line method.
- 5 *Capturing Cotswolds Limited* has recovered £100 of the bad debt, which has been mishandled as a cash sale.
- 6 *Capturing Cotswolds Limited* has proposed a final dividend of £18000.

**You are required to prepare in an appropriate professional format for *Capturing Cotswolds Limited*:**

- (i) a trading, profit and loss and appropriation account for the year ended 30 June 2015
- (ii) a balance sheet as at 30 June 2015.

**[On completion of TASKS B, C and D you will be assessed on Assessment Objective 2 which has a 14 mark tariff]**

**TASK E**

*Capturing Cotswolds Limited* is a private limited company.

- (a) Explain the key issues and potential pitfalls which the company must consider when constructing final accounts, particularly in relation to:
  - (i) possible templates and/or layouts
  - (ii) legal requirements.
- (b) Compare the summary reports which would be provided to shareholders by a public limited company with the information provided by a private limited company such as *Capturing Cotswolds Limited*.

**TASK F**

The following ratios have been calculated from *Capturing Cotswolds Limited's* final accounts for the year ended 30 June 2014.

	<b>Year ended 30 June 2014</b>
Gross profit percentage	56.5%
Net profit percentage	24.5%
Return on capital employed	140%
Current ratio	1.61:1
Acid test ratio	1.20:1
Stock turnover	40 days
Debtor collection period	59 days
Creditor payment period	7 days
Earnings per share	£1.75
Dividend cover	1 times

**Note:** For the purpose of your calculations 100% of *Capturing Cotswolds Limited's* purchases are on credit and 70% of sales are on credit for the years to 30 June 2014 and 30 June 2015.

**You are required to:**

- (i) use the formulae provided in Appendix 1 to calculate (where appropriate to two decimal places) relevant ratios from *Capturing Cotswolds Limited's* final accounts for the year ended 30 June 2015
- (ii) analyse and interpret these ratios, taking into account the limitations of using ratios to make decisions about the financial viability of a business, in order to comment on the financial position of *Capturing Cotswolds Limited*.

**[On completion of TASKS E and F you will be assessed on Assessment Objective 3 which has a 12 mark tariff]**

**TASK G**

The directors are pleased with how *Capturing Cotswolds Limited* is developing and its success to date. Although they have plans for the future of *Capturing Cotswolds Limited*, they are unsure of the best way to finance these plans.

**You are required to:**

write a report recommending to Evan, Poppy and Lily the best course of action for *Capturing Cotswolds Limited* with regard to its future plans to:

- acquire studio, office and storage space
- finance the new equipment
- finance the recruitment, wages and possible training costs of two part-time members of staff
- ensure that the liquidity of the company is not adversely affected.

Justify your recommendations.

**Please note:** this task will be assessed for *Quality of Written Communication*.

**[On completion of TASK G you will be assessed on Assessment Objective 4 which has a 15 mark tariff]**

## Appendix 1

### Accounting Ratios

#### Profitability

$\frac{\text{Gross Profit}}{\text{Net Sales}}$	× 100	=	Gross Profit Percentage
$\frac{\text{Profit before Tax}}{\text{Net Sales}}$	× 100	=	Net Profit Percentage
$\frac{\text{Profit before Tax}}{\text{Capital Employed}}$	× 100	=	Return on Capital Employed
$\frac{\text{Expenses}}{\text{Net Sales}}$	× 100	=	Expenses as a Percentage of Sales

#### Solvency/Liquidity

$\frac{\text{Current Assets}}{\text{Current Liabilities}}$		=	Current Ratio
$\frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}}$		=	Acid Test Ratio

#### Performance

$\frac{\text{Average Stock}}{\text{Cost of Sales}}$	× 365	=	Stock Turnover
$\frac{\text{Net Sales}}{\text{Fixed Assets (NBV)}}$		=	Fixed Asset Turnover
$\frac{\text{Closing Debtors}}{\text{Credit Sales}}$	× 365	=	Debtor Collection Period (days)
$\frac{\text{Closing Creditors}}{\text{Credit Purchases}}$	× 365	=	Creditors Payment Period (days)

#### Shareholder

$\frac{\text{Profit attributable to Ordinary Shareholders}}{\text{Number of Ordinary Shares}}$		=	Earnings per share
$\frac{\text{Earnings per share}}{\text{Net Dividend per share}}$		=	Dividend Cover



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