

OCR

Oxford Cambridge and RSA

June 2017

A2 GCE APPLIED BUSINESS

F253/SM Constructing a Financial Strategy

STIMULUS MATERIAL FOR ACADEMIC YEAR 2016–2017

SERIES 11

This stimulus material must be used for the June 2017 examination session.

OCR supplied materials:

None

Other materials required:

- A calculator may be used

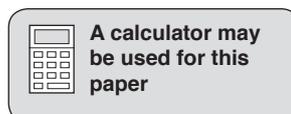


INSTRUCTIONS TO TEACHERS

- 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 2017** examination session. New stimulus material (**Series 12**) will be issued for the academic year 2017–2018.
- There are no separate marking criteria with this stimulus material. A solution will, however, be provided for **Series 11** in the **Principal Moderator's report for June 2017**.
- 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.



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Fern Fabrics Limited

Fern left university in 2010 having gained a degree in textiles. By 2012, she was earning her living by making soft furnishings and other textile products, the majority of which were one-off commissioned items. She was supplementing this income by making low-value items for craft fairs (novelty pin cushions, needle cases, baby quilts, cushion covers etc).

When Fern moved into her own flat in 2013, she made friends with Richard, one of her new neighbours. Richard had taken early retirement from his job as a civil engineer in London. He had seen some of her commissioned work and recognised that Fern had a real talent. He began helping Fern with her craft fair stall. A few months later, Fern mentioned to Richard that she was frustrated at not being able to source unusual fabrics. Richard, who likes to travel, and has friends and family around the world, started bringing back fabrics from his travels. 5
10

From the way Fern's customers and clients reacted to the fabrics Richard sourced, Fern and Richard realised that there was a market for unusual fabrics. Richard, therefore, suggested that when he was on his travels he would source fabrics in larger quantities. Fern and Richard decided that it would be best for Fern to set up a new business selling fabrics. As a result *Fern Fabrics Limited* was set up in March 2014. The company issued a total of 10 000 shares to three shareholders. Fern has a 60% shareholding, Richard a 30% shareholding and Fern's mother Iris, a 10% shareholding. Fern, Richard and Iris are also directors of *Fern Fabrics Limited*. The directors agreed that the financial year-end of *Fern Fabrics Limited* would be 31 August. 15

The company has been trading for approximately two and a half years and is now making a profit. *Fern Fabrics Limited* only sells fabrics online; Richard thinks that this is holding the business back, as many customers have commented that they would buy more if they were able to inspect the fabric first-hand. 20

At the board meeting of *Fern Fabrics Limited* last month, Richard suggested that the business could rent shop premises. It could then employ two people full-time; one to run the shop and one to manage the online fabric sales. A third employee would also be needed part-time to cover busy periods in the shop. Iris suggested that the company would need to borrow some money for fitting-out the new shop and for additional advertising. She also suggested that the business should consider purchasing or leasing a small van for transporting fabrics, as the company's current car is not practical for this purpose and has broken down twice in the last month. 25

At the latest board meeting, the directors of *Fern Fabrics Limited* agreed on a plan for the business' future. Iris has found a small business premises to rent on a trading estate. The rent seems reasonable at £12 600 per annum and it has a small forecourt where customers could park. The shop would be open from Monday to Saturday. Fern has calculated that in addition to the rent, the business would need shop fittings at a one-off cost of £5 000. Richard has researched advertising and thinks that the business would need to increase the annual advertising budget by £1 000. Richard has also investigated the price of a small van for the business. To hire a small van over a 60-month lease period would cost £280 per month, whereas to purchase the same van now would cost £11 600. 30
35

TASK A

You are Fern's cousin and are studying a financial unit as part of a business management qualification at college. The directors of *Fern Fabrics Limited* have asked you to write a report to help improve their understanding of the need for, and the importance of, financial record keeping.

- (i) The directors of *Fern Fabrics 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 *Fern Fabrics 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 *Fern Fabrics Limited* if its financial information is found to be inaccurate. To help Fern, Richard and Iris, you have been asked to explain the following consequences to *Fern Fabrics Limited* of its financial information being inaccurate:
- criminal action
 - cash-flow problems from a high tax bill or criminal action
 - existing 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) Fern, Richard and Iris do not understand some 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
- fixed 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 *Fern Fabrics Limited* how a series of final accounts are created, including the processes and financial documents used.

Your explanation should demonstrate an 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 Fern, Richard and Iris 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 business on 1 July 2016, the following selected balances were extracted from the books of *Fern Fabrics Limited*.

	£
Swag Fabrics Ltd (Debtor)	625
Notable Furnishings (Debtor)	980
Cushions, Throws and Bows (Debtor)	246
Patterns from Patna (Creditor)	620
Marrakech Threads (Creditor)	216
Hentiyn Wholesale Fabrics (Creditor)	900
Sales	78 154
Purchases	35 318
Bank (Dr)	9 032
Discount received	1 413
Telephone and internet expenses	1 610
Carriage inwards	1 984
Carriage outwards	1 633
Travel expenses	1 842
Advertising costs	540
Insurance	425

During trading on 1 July 2016 the following source documents required processing.

Sales Invoice	£240	to	Swag Fabrics Ltd
Sales Invoice	£105	to	Cushions, Throws and Bows
Sales Invoice	£100	to	Williamson
Cash sales (via the Internet)	£206		Paid directly into the bank
Purchase Invoice	£850	from	Patterns from Patna
Purchase Invoice	£265	from	Hentiyn Wholesale Fabrics, this includes carriage inwards of £15
Cheque issued	£1470	to	Patterns from Patna
Cheque issued	£882	to	Hentiyn Wholesale Fabrics in settlement of £900 after taking a 2% cash discount
Cheque received	£100	from	Williamson
Cheque received	£625	from	Notable Furnishings

In addition the bank statement shows:

Direct Debit paid	£130	to	ZNL Insurance
Direct Debit paid	£116	to	Marrakech Threads
Credit Transfer received	£625	from	Swag Fabrics Ltd
Credit Transfer received	£105	from	Cushions, Throws and Bows

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 July 2016
- (iv) bring down the balances ready to start trading on 2 July 2016.

TASK C

On 31 July 2016 Fern wanted to check that the books of *Fern Fabrics 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. Fern extracted the following balances as at 31 July 2016:

	£
Sales	85 657
Purchases	39 806
Ordinary share capital @ £1 each	10 000
Retained profits	4 103
Motor vehicles (cost)	2 000
Provision for depreciation of motor vehicles	500
Equipment (cost)	5 000
Provision for depreciation of equipment	1 000
Discount received	1 546
Stationery expenses	691
Telephone and internet expenses	1 708
Insurance	570
Advertising costs	575
Carriage inwards	2 092
Carriage outwards	1 729
Bad debts written off	239
Directors' remuneration	22 000
Sundry expenses	301
Interest received	134
Travel expenses	2 037
Membership of the Federation of Small Businesses	100
Stock at 1 September 2015	9 126
Bank (Dr)	1 413
Cash	127
Debtors	6 613
Creditors	8 365
Dividends paid	15 000

You are required to:

- (i) prepare the trial balance as at 31 July 2016, creating a suspense account if appropriate
- (ii) prepare a statement clearly showing how each of the errors below should be corrected. You should use journal entries and a suspense account.

- 1 discounts received of £46 were credited to sales in error
- 2 the telephone and internet account had been understated by £82
- 3 purchases include packaging costs of £25, this should have been charged to carriage inwards
- 4 stationery has been understated by £10
- 5 an entry for taxi fares of £43 has been credited to interest received. It should be travel expenses.

- (iii) prepare a corrected trial balance as at 31 July 2016.

TASK D

On 31 August 2016 the following balances were extracted from the books of *Fern Fabrics Limited*.

	£
Sales	91 233
Purchases	40 324
Ordinary share capital @ £1 each	10 000
Retained profits	4 103
Motor vehicles (cost)	2 000
Provision for depreciation of motor vehicles	500
Equipment (cost)	5 000
Provision for depreciation of equipment	1 000
Discount received	1 653
Stationery expenses	798
Telephone and internet expenses	1 860
Insurance	640
Advertising costs	644
Carriage inwards	2 301
Carriage outwards	1 891
Bad debts written off	239
Directors' remuneration	22 000
Sundry expenses	326
Interest received	99
Travel expenses	2 135
Membership of the Federation of Small Businesses	100
Stock at 1 September 2015	9 126
Bank (Dr)	2 919
Cash	98
Debtors	7 501
Creditors	6 314
Dividends paid	15 000

Additional information:

- 1 Stock as at 31 August 2016 is valued at £12 691.
- 2 The insurance includes a prepayment of £100.
- 3 There are accrued advertising costs of £82, accrued directors' remuneration of £2000, and accrued telephone expenses of £18.
- 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 *Fern Fabrics Limited* has an additional bad debt of £40 to write off.
- 6 *Fern Fabrics Limited* has declared a final dividend of £3000. This takes the total dividend for the year to £18 000.

You are required to prepare in an appropriate professional format for *Fern Fabrics Limited*:

- (i) a trading, profit and loss and appropriation account for the year ended 31 August 2016
- (ii) a balance sheet as at 31 August 2016.

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

TASK E

Fern Fabrics Limited is a private limited company.

- (a) Explain the key issues and potential pitfalls 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 *Fern Fabrics Limited*.

TASK F

The following ratios have been calculated from *Fern Fabrics Limited's* final accounts for the year ended 31 August 2015.

	Year ended 31 August 2015
Gross profit percentage	54.79%
Net profit percentage	21.43%
Return on capital employed	119.12%
Current ratio	1.56:1
Acid test ratio	1.10:1
Stock turnover	109 days
Debtor collection period	90 days
Creditor payment period	28 days
Earnings per share	£1.68
Dividend cover	1.12 times

Note: For the purpose of your calculations 100% of *Fern Fabrics Limited's* purchases are on credit and 25% of sales are on credit for the years to 31 August 2015 and 31 August 2016.

You are required to:

- (i) **use the formulae provided in Appendix 1** to calculate (where appropriate to two decimal places) relevant ratios from *Fern Fabrics Limited's* final accounts for the year ended 31 August 2016
- (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 *Fern Fabrics 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 *Fern Fabrics Limited* is developing and its success to date. Although they have plans for the future of *Fern Fabrics Limited*, they are unsure of the best way to finance these plans.

You are required to:

write a report to Fern, Richard and Iris recommending an appropriate course of action for *Fern Fabrics Limited* with regard to its future plans to:

- acquire the business premises
- finance the shop fittings
- finance the recruitment, wages and possible training costs of the new staff
- acquire a small van
- advertise the business within the given budget
- ensure 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 (days)
$\frac{\text{Net Sales}}{\text{Fixed Assets (NBV)}}$		=	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
$\frac{\text{Earnings per share}}{\text{Dividend per share}}$		=	Dividend Cover

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