

ADVANCED GCE

APPLIED BUSINESS

Constructing a Financial Strategy

F253/SM

STIMULUS MATERIAL FOR ACADEMIC YEAR 2010–2011

SERIES 5

OCR supplied materials:

None

Other materials required:

- A calculator may be used

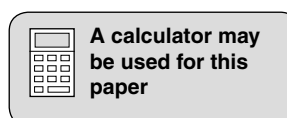


INSTRUCTIONS TO TEACHERS

- This stimulus material provides a vocational context for the internally assessed unit – 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 in the **academic year 2010–2011**. New stimulus material (**Series 6**) will be issued for the academic year 2011–2012.
- There are no separate marking criteria with this stimulus material. A solution will, however, be provided for **Series 5** in the **Principal Moderator's report for June 2011**.
- 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 – 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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Introduction

Weston Party Caterers Ltd

Sammi and Macie are two sisters who live with their husbands and children in the Midlands. For years they have been involved in helping out at, and arranging, parties for friends and family. After much encouragement from their families, they set up in business as *Weston Party Caterers Ltd* in 2004, with capital of £30 000. Sammi and Macie each own 10 000 £1 shares in the company. Their parents, Hamid and Jay, also own 5 000 £1 shares each and have provided invaluable help in setting up the business, based on their own experience as restaurateurs. 5

Sammi and Macie's brother, Ahmed, provided a loan in 2007, repayable in 2012, which the sisters used to buy bouncy castles and other equipment. This enabled them to take advantage of a number of requests to expand the business into children's parties with larger number of guests and local events such as fairs. *Weston Party Caterers Ltd* rents a building, an old coaching house, which was previously unused at Hamid and Jay's restaurant. Initially, the rent was a very minimal amount but the sisters and their parents have just agreed an increase. *Weston Party Caterers Ltd* also pays a contribution to Hamid and Jay towards the rates bill. The old coaching house has been appropriately fitted out to meet all necessary food and health and safety regulations. 10

In the first few years of business, Sammi and Macie had been reasonably successful and the business had produced a useful source of income. Their focus, however, remained on their families and their children's upbringing, as opposed to taking advantage of all the opportunities which had arisen for the expansion of the business. As they have contact with other parents through their children's schools, many of the events for which they have catered have been children's parties, school events, and work related events and parties for parents. Although *Weston Party Caterers Ltd* has to deal with seasonal demand, it still has a reputation for providing a good quality of service at a reasonable price. 15

As Sammi and Macie's children are now in their teens and are less reliant on their parents, the two sisters wish to expand their business and focus on weddings, anniversaries and corporate events. They recognise that these functions will be more challenging, they will require advertising and longer term planning, as well as more sophisticated choices of food and the use of professional waiting staff, as required. However, there should also be the opportunity for higher profits. 20

Sammi and Macie are quite cautious, but confident in their abilities following their years in business. They intend to expand the business slowly in order to ensure they protect *Weston Party Caterers Ltd's* reputation. They think they can manage some expansion straight away without acquiring additional vehicles, apart from occasionally hiring vans and minibuses to transport food and staff. They recognise that *Weston Party Caterers Ltd* will require additional finance to enable it to provide the extended credit periods which are typical of the corporate market. *Weston Party Caterers Ltd* will also need to finance additional stock. They are not sure if an overdraft facility will be sufficient or if another loan will be needed. 30

If the new line of business proves to be successful, *Weston Party Caterers Ltd* will be ready to expand again in 2012. It would then need to move to new, larger premises, which may be bought or rented depending on financial circumstances. At that time *Weston Party Caterers Ltd* would also need additional vehicles and equipment – this would probably mean that more finance would be needed, although other members of the family might be prepared to support the business. 35

TASK A

In the years the sisters have been in business they have paid a local accountant to complete *Weston Party Caterers Ltd's* accounts. They now feel that they should have a greater understanding of their business' finances. They would welcome some advice in non-technical language.

Sammi and Macie are your aunts and you are currently studying accounting at a local college. They have asked you to write a report to help them achieve a greater understanding of the financial aspects of their business and to have something in writing to which they can refer whenever they are meeting their accountant, bank manager and other stakeholders so that they will have a good understanding of the language used.

(i) In your report you should explain the reasons why accurate financial records need to be kept. These include the need to:

- calculate accurately profit and loss;
- meet legal requirements;
- show the assets and liabilities of the business;
- compare the business' financial position with previous years;
- prepare accurate budgets/forecasts for future years;
- obtain additional finance;
- plan any future expansion.

(ii) As Sammi and Macie are expanding the business they feel that they should be prepared in case financial problems occur. They have seen their parents go through some financial difficulties with their business but have not, until now, really appreciated some of the difficulties which could arise. To help with this, you have been asked to explain the following consequences to *Weston Party Caterers Ltd* of its financial information being less than accurate:

- criminal action;
- cash-flow problems from a high tax bill or criminal action;
- shareholders losing confidence and investing elsewhere;
- bad public image;
- changes to management structure.

(iii) Sammi and Macie have asked for your help because they do not understand some of the technical accounting language. They feel they should know more so they can hold their own in discussions with their accountant, bank manager and other stakeholders. They would welcome you adding a clear explanation of different types of income and expenditure to your report so that they can 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 explanations of the following source documents and how they are used:

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

- (iv) Sammi and Macie appreciate that final accounts should be useful to them but they do not understand how these relate to invoices, cheques received and cheques paid and would welcome clarification so that they may be able to use financial information in a useful way.

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

- the division of ledgers;
- double-entry transaction recording;
- 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) On one occasion Sammi and Macie had provided a children's birthday party in exchange for a year's free hairdressing and beauty treatments. They left the transaction out of the accounts but explained what they had done to the accountant who had referred to this as an error of omission.

In your report explain the types of error which can occur when preparing accounts so that Sammi and Macie can avoid making such errors in future. The errors you should cover include:

- omissions;
- compensating errors;
- errors of principle.

You should include an example of each type of error to demonstrate depth of understanding.

[On completion of TASK A you will be assessed on assessment objective one 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 May 2010, the following selected balances were extracted from the books of *Weston Party Caterers Ltd*.

	£
J & P Allison (Debtor)	400
Cindi Palmer (Debtor)	380
Panjay Hotel (Debtor)	850
Comfort Foods Ltd (Creditor)	1 320
Klassic Kakes (Creditor)	290
Sanji Service Centre (Creditor)	860
Sales	108 170
Purchases	66 290
Rent and rates	1 200
Motor vehicle expenses	2 330
Bank charges paid	50
Discount allowed	280
Discount received	1 690
Sales returns	80
Purchases returns	930
Cash	130
Bank	5 160

During trading on 1 May 2010, the following source documents required processing.

Purchase Invoice	£490	from	Comfort Foods Ltd
Purchase Invoice	£350	from	Klassic Kakes
Sales Invoice	£150	to	J & P Allison
Sales Invoice	£130	to	Cindi Palmer
Credit Note received	£20	from	Comfort Foods Ltd for goods returned
Credit Note issued	£50	to	Panjay Hotel for an agreed refund
Receipt	£80		Cash payment for motor expenses
Purchase Invoice	£460	from	Cooper's Garage for vehicle repairs
Cheque issued	£460	to	Cooper's Garage - issued immediately upon receipt of invoice by <i>Weston Party Caterers Ltd</i>
Credit Note received	£40	from	Klassic Kakes for goods returned
Cheque issued	£800	to	Hamid and Jay for rent for the two month period to 30 June 2010
Cheque received	£392	from	J & P Allison, on account, after deduction of 2% cash discount
Cheque issued	£280	to	Klassic Kakes, after taking £10 cash discount
Cheque received	£784	from	Panjay Hotel, in full settlement of account after the refund and after taking 2% cash discount
Cheque issued	£860	to	Sanji Service Centre
Cheque issued	£1 274	to	Comfort Foods Ltd, after taking 2% cash discount

In addition, the bank statement shows:

Bank charges paid	£10	
Standing order paid	£100	to Hamid and Jay for share of rates

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 close of trading on 1 May 2010;
- (iv) bring down the balances ready for start of trading on 2 May 2010.

TASK C

On 15 May 2010, Sammi and Macie decided they wanted to check that the books of *Weston Party Caterers Ltd* balanced by producing a trial balance. They are aware that a suspense account may need to be created if the trial balance does not balance. They extracted the following balances as at 15 May 2010.

	£
Sales	124 880
Purchases	87 900
Ordinary shares @ £1 each	30 000
Retained profit	4 950
Motor vehicles (cost)	16 000
Provision for depreciation of motor vehicles	10 240
Equipment (cost)	36 000
Provision for depreciation of equipment	7 200
Discount allowed	330
Discount received	1 760
4% loan	5 000
Rent and rates	2 100
Sales returns	140
Purchases returns	1 030
Stock as at 1 June 2009	7 330
Dividends paid	3 000
Wages and salaries	17 990
Debtors	3 420
Light and heat	620
Balance at bank (Dr)	4 130
Sundry expenses	2 270
Creditors	4 260
Insurance	690
Motor vehicle expenses	3 130
Telephone	470
Loan interest	100
Cash	170
Bank charges paid	70
Accounting fees	650

You are required to:

- (i) prepare the trial balance as at 15 May 2010, creating a suspense entry – if appropriate.

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

1. the sundry expenses account contained a debit entry for £130 which related to light and heat;
2. sales returns of £30 had been debited to sales;
3. sundry expenses of £2 700 had been correctly posted to the bank account but had been debited to sundry expenses as £270;
4. a transfer of £80 from bank to cash had been omitted from the books;
5. a recently opened bank savings account with a balance of £380 was omitted from the trial balance.

- (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 15 May 2010.

TASK D

On 31 May 2010, the following balances were extracted from the books of *Weston Party Caterers Ltd.*

	£
Sales	136 300
Purchases	96 300
Ordinary shares @ £1 each	30 000
Retained profit	4 950
Motor vehicles (cost)	16 000
Provision for depreciation of motor vehicles	10 240
Equipment (cost)	36 000
Provision for depreciation of equipment	7 200
Discount allowed	374
Discount received	2 050
4% loan	5 000
Rent and rates	2 100
Sales returns	300
Purchases returns	1 120
Stock as at 1 June 2009	7 330
Dividends paid	3 000
Wages and salaries	18 970
Debtors	3 700
Light and heat	820
Balance at bank (Dr)	2 660
Sundry expenses	4 720
Creditors	1 536
Insurance	720
Motor vehicle expenses	3 380
Telephone	530
Loan interest	100
Cash	102
Bank charges paid	90
Accounting fees	700
Bank savings	500

Additional information:

1. Stock as at 31 May 2010 is valued at £7 710.
2. Rent was prepaid by £400 at 31 May 2010.
3. The loan is repayable in 2012. Interest should be accrued for the year.
4. The directors have decided to make a provision for doubtful debts of 2% of closing debtors.
5. Wages and salaries of £250 were accrued due at 31 May 2010.
6. Accrued sundry expenses at 31 May 2010 were £90.
7. Savings account interest accrued at 31 May 2010 was £2.
8. Depreciation is to be provided as follows:
 - motor vehicles at 40% per annum using the reducing balance method;
 - equipment at 10% per annum using the straight line method.
9. The directors have proposed a final dividend of 5%.

You are required to prepare, in an appropriate professional format for *Weston Party Caterers Ltd*:

- (i) a trading, profit and loss account and appropriation account for the year ended 31 May 2010;
- (ii) a balance sheet as at 31 May 2010.

[On completion of TASKS B, C and D you will be assessed on assessment objective two which has a 14 mark tariff]

TASK E

Weston Party Caterers Ltd is a private limited company.

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

TASK F

The following ratios have been calculated from *Weston Party Caterers Ltd's* final accounts for the year ended 31 May 2009.

	Year ended 31 May 2009
Gross profit percentage	35.41%
Net profit percentage	2.86%
Return on capital employed	12.65%
Current ratio	4.1:1
Acid test ratio	2.0:1
Stock turnover	25 days
Debtor collection period	7 days
Creditor payment period	10 days
Earnings per share	15p
Dividend cover	1.1 times

Note: For the purpose of your calculations, 100% of *Weston Party Caterers Ltd's* purchases and sales are on credit.

You are required to:

- (i) **using the formulae provided in Appendix 1**, calculate (where appropriate to two decimal places) relevant ratios from *Weston Party Caterers Ltd's* final accounts for the year ended 31 May 2010;
- (ii) analyse and interpret these ratios in order to comment on the financial position of *Weston Party Caterers Ltd*, taking into account the limitations of using ratios, to make decisions about the financial viability of a business.

[On completion of TASKS E and F you will be assessed on assessment objective three which has a 12 mark tariff]

TASK G

Sammi and Macie are reasonably certain about their plans for *Weston Party Caterers Ltd*. However, they are unsure about future financing needs.

You are required to:

write a report to Sammi and Macie as to the best course of action in view of *Weston Party Caterers Ltd's* plans to:

- obtain short-term finance;
- finance additional fixed assets in 2012.

Justify your recommendations.

[On completion of TASK G you will be assessed on assessment objective four which has a 15 mark tariff]

Appendix 1

Accounting Ratios

Profitability

<u>Gross Profit</u> Net Sales	× 100	=	Gross Profit Percentage
<u>Profit before Tax</u> Net Sales	× 100	=	Net Profit Percentage
<u>Profit before Tax</u> Capital Employed	× 100	=	Return On Capital Employed
<u>Expenses</u> Net Sales	× 100	=	Expenses as a Percentage of Sales

Solvency

<u>Current Assets</u> Current Liabilities	=	Current Ratio
<u>Current Assets – Stock</u> Current Liabilities	=	Acid Test Ratio

Performance

<u>Average Stock</u> Cost of Sales	× 365	=	Stock Turnover
<u>Net Sales</u> Fixed Assets (NBV)	=		Fixed Asset Turnover
<u>Closing Debtors</u> Credit Sales	× 365	=	Debtor Days
<u>Closing Creditors</u> Credit Purchases	× 365	=	Creditor Days

Shareholder

<u>Profit attributable to ordinary shareholders</u> Number of ordinary shares	=	Earnings per share
<u>Earnings per share</u> Net dividend per share	=	Dividend cover

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