

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced GCE

BUSINESS STUDIES

2875

Further Accounting and Finance

Thursday

22 JUNE 2006

Afternoon

1 hour 30 minutes

Additional materials:
8 page Answer Booklet

Candidates may use calculators in this examination.

TIME 1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Write your name, Centre number and candidate number in the spaces provided on the answer booklet.
- Answer **all** questions.
- Write your answers on the separate answer booklet provided.
- If you use extra sheets of paper, fasten these sheets to the answer booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [] at the end of each question or part question.
- The total number of marks for this paper is 60.
- You will be awarded marks for the quality of written communication where an answer requires a piece of extended writing.

This question paper consists of 3 printed pages and 1 blank page.

Brown and Brown plc [BBP]

“2005 has been a very difficult year for us,” said Alistair Brown, Chief Executive of Brown and Brown plc (BBP). “Competition is getting tougher all the time and customers are becoming more demanding in their requirements. However, I believe that my rescue plan for the company is working.”

BBP is a national retail chain selling women’s fashion clothing. Competition is increasing because: 5

- there has been a growth in the number of fashion stores;
- supermarket chains are now selling good quality products;
- Internet sites are increasing their share of market sales.

“Just look what has happened to other major high street clothing retailers,” said Alistair, “we certainly cannot be complacent.” 10

Alistair had come under attack at the Annual General Meeting in 2004 when shareholders complained about the fall in profits and dividends that year. Alistair promised tough measures to deal with the problems. Costs had to be cut and this meant introducing a policy of downsizing the business. Some stores were closed. Shareholders demanded a better return on their investment and Alistair’s policies were designed to achieve that along with some cash being returned to the shareholders. 15

These policies have now been in operation for a year. Table 1 is a summary of the most recent financial figures taken from BBP’s published accounts.

Table 1 20

Summary financial data for BBP

	2003	2004	2005
Sales £m	550	530	400
Gross Profit Margin	21%	18%	12%
Net Profit Margin	8%	5.5%	7%
Return on capital	10%	4.5%	6%
Asset turnover [times]	0.75	0.7	0.85

The Board of Directors of BBP was deeply divided on Alistair’s strategy. Some wanted a more pro-active approach towards increasing sales. They were unhappy with his focus on cost savings just by closing shops. “Costs can be cut by running our shops more efficiently,” said one. “I’ve been looking at some of our performance indicators (see Table 2) and feel that there is much room for improvement here. The business used to have sales growth as an objective and I don’t remember any decision to change that.” 30

Table 2

	2004	2005
Stock turnover (days)	45	55
Debtor collection period (days)	36	50
Creditor payment period (days)	25	20

35

“The net profit of £28m before tax in 2005 is a modest result for a business of our size” said another director. Other stakeholders expressed concern as well. Staff representatives were worried about the impact that the downsizing policy was having on job security. “The accounts only tell half the story. Jobs have already been lost and those that remain are at an increasing risk,” they suggested. 40

The financial press also carried stories about the accounting procedures being used in the construction of the accounts. Suggestions had been made of “window dressing” to help cover up some of the shortcomings. 45

Certainly the financial accounts produced at the end of 2005 incorporated a number of significant changes. The balance sheet of the business looked very different at the end of the year compared with the start. The sale of a number of shops had reduced the value of the fixed assets significantly. Changes in the methods of asset valuation had been introduced along with a stock write down of £10 million. The latter was due to a number of factors: 50

- the closure of a number of stores;
- overstocking of certain product lines;
- changes in ladies’ fashions.

This had meant that surplus stock had to be disposed of at less than its book value. All of these changes had impacted on both the balance sheet and the profit and loss account. 55

Answer **all** questions.

- 1 (a) Calculate for 2005:
- (i) the capital employed; [2]
- (ii) the value of stock. [2]
- (b) Analyse the liquidity implications for BBP of the data in Table 2. [6]
- (c) Discuss possible causes of changes in both gross and net profit margins of BBP over the last three years. [10]
- (d) Using all relevant information, evaluate the impact of Alistair’s strategy of downsizing on the performance of BBP in 2005. [16]
- 2 (a) Analyse the impact of the “stock write down” on the financial accounts of BBP. [6]
- (b) Assess the usefulness of BBP’s published final accounts to the stakeholders of the business. [16]

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