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RECOGNISING ACHIEVEMENT

Thursday 14 June 2012 – Afternoon

A2 GCE BUSINESS STUDIES

F294/01/RB Accounting

RESOURCE BOOKLET

To be given to candidates at the start of the examination **Duration:** 2 hours

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INSTRUCTIONS TO CANDIDATES

- The information required to answer questions 1–6 is contained within this Resource Booklet.

INFORMATION FOR CANDIDATES

- The information contained within this Resource Booklet is based on one or more real businesses.
- This document consists of **8** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

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Langfords plc (LP)

Langfords plc (LP) manufactures high quality leather for the fashion and sports industries. LP sells its products to many of the companies which own leading fashion and sports global brands.

Douglas Underwood, LP's Chairman, has personal concerns over the challenge to LP in maintaining its market position. The battle for market share increasingly focuses on price levels and Douglas understands that LP must continually seek strategies to reduce costs. For example, in 2010 LP took the decision to shut down its Scottish factory with the loss of 150 jobs.

One of LP's current strategies to achieve cost reductions is to acquire low cost production facilities in the developing world. In December 2011, LP bought out one of its suppliers of leather – Africa Quality Tannery (AQT). LP has traded with AQT for over ten years. AQT operates in Ethiopia and is a major local employer with a labour force of 400 workers. AQT's continued success is vital for the wealth generation in its community.

Douglas knows that, in the medium term, the acquisition of AQT will reduce LP's average unit cost of production. His first priority for AQT is to instigate a training programme for its workforce, alongside investment in new machinery. At the same time, LP's financial team has recommended that there is scope for even lower production costs by reducing AQT's employment levels by 40%. It would also be possible to reduce materials costs by 20% by reducing leather wastage and stock loss. See Table 1 for a summary of AQT's most recent Profit and Loss Account (Income Statement).

Table 1 – AQT Profit and Loss Account (Income Statement) for the year ending 30 June 2011 (Figures converted to pounds sterling)

	2011 £
Revenue	853,098
Cost of sales*	500,956
Gross Profit	**352,142**
Distribution costs	68,248
Administration costs	143,200
Loss on foreign currency transactions	34,717
Net Profit	**105,977**

***Cost of sales breakdown**

Direct labour	364,750
Materials	136,206
Total cost of sales	**500,956**

Douglas is reluctant to make these recommended changes without careful consideration of the wider issues. This tough approach to the African business would raise corporate social responsibility questions for LP, but Douglas' priority has to be the long term security and wealth of LP's shareholders. Its major shareholder, with 25% of ordinary shares, is a USA multi-national company.

Douglas is particularly mindful of these issues at this time of year as LP's Annual Report and Accounts for 2011 are about to be published (see Fig. 1 for quotes from the Chairman's Report). The acquisition of AQT is reflected in LP's Balance Sheet and Profit and Loss Account (see Tables 2 and 3).

Fig. 1 – Extracts from Langfords plc Annual Report 2011

The negotiations with government agencies in Ethiopia ended in an agreement to buy AQT for £3.25 million. This acquisition is a major deal which will enable us to benefit from manufacturing in a lower cost environment.

As ever, our employees have demonstrated loyalty and flexibility throughout the recent changes and I thank them for their contribution and commitment.

Whilst there is much work to be done to benefit from the recent changes to the business, we will continue to build upon our core values of quality, technical expertise, customer service and innovation within existing and new markets.

With the Olympics in 2012, we anticipate a higher profile for UK businesses and look forward to a lasting positive impact on our sales revenue.

Table 2 – Langfords plc Balance Sheet as at 31 December 2011

	2011 £'000	**2010 £'000**
Fixed Assets (Non-current)	**6,962**	**3,808**
Current Assets		
Stock	6,875	4,708
Debtors	3,212	4,411
Cash	198	13
Total Current Assets	**10,285**	**9,132**
Total Assets	**17,247**	**12,940**
Current Liabilities		
Trade creditors	7,801	6,820
Overdraft	26	30
Total Current Liabilities	**7,827**	**6,850**
Long Term Borrowings	**5,230**	**2,381**
Total Liabilities	**13,057**	**9,231**
Net Assets	**4,190**	**3,709**
Equity		
Issued Ordinary Share Capital £1 nominal value	**3,120**	**3,120**
Reserves	**1,070**	**589**
Total Equity	**4,190**	**3,709**

Table 3 – Langfords plc Profit and Loss Account (Income Statement) for the year ending 31 December 2011

	2011 £'000	2010 £'000
Revenue	23,702	25,158
Cost of sales	18,892	20,556
Gross Profit	**4,810**	**4,602**
Distribution costs	1,604	1,542
Administration expenses	2,416	2,046
Loss on foreign currency transactions	28	279
Profit from trading	**762**	**735**
Interest costs	273	256
Taxation	8	12
Profit for year attributable to equity shareholders	**481**	**467**

The production of high quality leather is a demanding process. LP's customers insist on a product with a consistent colour and without flaws in the grain. To achieve this requires experience and the skill to maximise the number of pieces which can be cut from each piece of leather. Despite advances in technology, the best results are still achieved from employing highly skilled leather workers.

The finishing and cutting department is divided into cost centres which specialise in the manufacture of specific products. For example, the making of sports gloves such as those used for skiing, golf and baseball. The financial performance of the sports gloves cost centre is an issue. Levels of productivity and wastage are subject to significant variance from week to week and shift to shift. There are two shifts per day, 10 workers per shift – Monday to Friday.

The cost centre's supervisors blame the performance on the variability in quality of the leather they receive from Africa. However, LP's recently appointed Management Accountant, Erika Berger, believes the supervisors' assessment is only part of the answer and she would like to introduce a standard costing system. Until recently, she worked at one of LP's main Eastern European competitors where a standard costing system was in operation.

Erika has focused her research on the sports gloves cost centre. She has made some calculations for the two shifts' performance over a recent typical weeks production (see Table 4). She believes that the results are quite revealing and wishes to raise the issue of standard costing at the next management meeting.

Table 4 – Standard costing data for a recent week – sports gloves cost centre

	Shift A		Shift B	
	Standard	**Actual**	**Standard**	**Actual**
Production hours	350	340	350	345
Output (pieces)	1,400	1,156	1,400	1,105
Total direct labour cost	£4,200	£4,284	£4,200	£4,416
Total direct materials cost	£22,750	£19,941	£22,750	£19,669
Total indirect costs	£1,000	£1,100	£1,000	£1,100

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