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Thursday 20 June 2013 – Morning

A2 GCE BUSINESS STUDIES

F294/01/RB Accounting

RESOURCE BOOKLET

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To be given to candidates at the start of the examination

Duration: 2 hours

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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Neptune Pleasure Cruises Ltd (NPCL)

Neptune Pleasure Cruises Ltd (NPCL) is a long established business offering short ferry trips and sightseeing cruises from its base in a seaside resort. The business is seasonal, only operating from the beginning of April until the end of September.

NPCL operates three boats, each with a maximum capacity of 50 passengers. During the early and late season this capacity is rarely required (April's average capacity utilisation is, for example, 40%). However, in the high season (July and August) 100% capacity utilisation is regularly achieved. The boats are over 25 years old; however, they still reflect value on NPCL's balance sheet due to the fact that the business uses a declining balance depreciation method for all of its fixed assets.

The age and condition of the boats is an ongoing problem. There are several occasions every season when trips are cancelled due to mechanical breakdowns. Roger Jolliffe, the Managing Director and a shareholder, is keen to replace the oldest and most unreliable boat, but continues to be frustrated by the lack of sufficient funds available for such a major investment (**see Table 1**).

Table 1 – NPCL's Profit and Loss Account (Income Statement) Summary for the year ending 31 October 2012

	£
Revenue	251 530
Cost of sales*	151 522
Gross Profit	100 008
Administration costs – including salaries	62 067
Boat-mooring, licence fees and winter storage	16 750
Boat-repairs and maintenance	11 043
Other costs	7908
Net Profit	2240
***Cost of sales comprises:**	
Direct labour	122 199
Direct materials – fuel, etc.	29 323
Total cost of sales	151 522

NPCL's business fortunes are affected by many external influences; however, the biggest impact on its trading performance is the direct competition it experiences from Bright Star Sailings Ltd (BSSL). BSSL has operated from the same harbourside since 2005 when it was formed by Elizabeth Brown – a former NPCL employee. BSSL operates two boats, each with a maximum capacity of 80 passengers. BSSL, however, offers fewer trips per day than NPCL. Both the boats are less than 10 years old and, in comparison to NPCL, offer passengers better facilities, including a refreshment bar and more indoor seating in the event of poor weather.

In October 2012, BSSL introduced a new product 'Naughtycal Nights'. Elizabeth had noticed the rapid increase in hen and stag weekends occurring in the resort and decided to offer party cruises on Friday and Saturday nights during the winter. This initiative would also extend the use of BSSL's boats beyond the tourist season.

Despite extensive marketing and a competitive pricing strategy, Elizabeth was very disappointed by the level of demand achieved and the first season's financial results (**see Table 2**). She wondered whether it was worth continuing with the 'Naughtycal Nights' from October 2013.

Table 2 – BSSL's Profit and Loss Statement for 'Naughtycal Nights'
1 October 2012–31 March 2013

	£
Sales revenue	41 250
Cost of sales	25 375
Gross profit	15 875
Additional overheads	8790
Allocation of existing overheads*	7441
Net profit	(356)

*10% of existing overheads apportioned to 'Naughtycal Nights' based on the number of cruises generated by the venture.

In an effort to attract passengers both businesses have, and continue to, wage a fierce price and promotional war. Roger believes it is essential to run NPCL's boats at full capacity and so will often reduce prices in order to achieve this objective. Every day, the employees (mainly family members who are also shareholders) of both businesses can be seen on the harbourside distributing leaflets and attempting to persuade tourists to take a cruise. On occasions these selling tactics have become too competitive and have resulted in heated arguments between the two sets of employees.

It was a huge surprise, therefore, when Roger received a phone call from Elizabeth. In summary she admitted to Roger that the continuing intense competition was serving no good purpose for either company. His surprise turned to amazement when Elizabeth suggested that the two companies should explore the option to merge. Furthermore, she was happy to provide Roger with a summary of BSSL's latest audited accounts, providing he was willing to provide her with NPCL's latest accounts.

They agreed to meet to explore the feasibility of a merger. Before this meeting Roger wanted to make a thorough analysis of BSSL's accounts in order to consider its financial performance and value as a going concern (**see Tables 3 and 4**).

Table 3 – BSSL's Profit and Loss Account (Income Statement) for the year ending 31 October 2012

	£
Revenue	186790
Cost of sales	107361
Gross Profit	79429
Administration costs	49875
Boat-mooring, licence fees and winter storage	12250
Boat-repairs and maintenance	3765
Other costs	8520
Net Profit	5019

Table 4 – NPCL and BSSL's Balance Sheets as at 31 October 2012

	NPCL		BSSL	
	£	**£**	**£**	**£**
Fixed (non-current) assets				
Boats	12160		85450	
Other	10390	22550	12350	97800
Current assets				
Stock	200		340	
Debtors	0		0	
Cash	12380	12580	0	340
Current liabilities				
Trade creditors	1250		3210	
Overdraft	0	1250	5700	8910
Net current assets		11330		–8570
Long term borrowings		0		64050
Total net assets		33880		25180
Equity				
Share capital		1000		5000
Profit and Loss Account		32880		20180
Equity Shareholders' funds		33880		25180

Roger also considered what he thought were the key strengths of each business (**see Fig. 1**).

Fig. 1 – Key strengths of NPCL and BSSL

NPCL	BSSL
Experienced and well qualified employees	Innovative marketing strategies to extend demand beyond the peak tourist season, eg ‘Naughtycal Nights’ and party cruises introduced in October 2012
Excellent customer satisfaction levels	Impressive online promotion, including website
Prime harbourside position	Newer and better maintained boats

In addition to these key strengths, there would certainly be some major cost savings: for example, the annual cost of mooring and licence fees. However, Roger had several worries, including how the two businesses could operate in harmony after years of animosity between the respective owners and employees. There might even be rationalisation opportunities in terms of the number of employees required and this would inevitably be met with resistance among the employees.

Another issue was how the two boards of directors would come to an agreement on the valuation of each business. Balance sheet value, as displayed in Table 4, is a starting point, but even these figures might be unreliable for several reasons.

Roger was not a majority shareholder in NPCL and other shareholders were certainly more cautious when it came to making strategic business decisions. If it was to succeed, the case for merger would certainly have to be watertight in both financial and commercial terms.

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