Centre Number						Candidate Number				
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Other Names										
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For Examiner's Use	
Examiner's Initials	
Question	Mark
1	
2	
3	
TOTAL	

General Certificate of Education
Advanced Level Examination
June 2012

Applied Business BS15

Unit 15 Financial Accounting for Managers

Tuesday 26 June 2012 9.00 am to 10.30 am

For this paper you must have:
- a calculator.

Time allowed
- 1 hour 30 minutes

Instructions
- Use black ink or black ball-point pen.
- Fill in the boxes at the top of this page.
- Answer **all** questions.
- You must answer the questions in the spaces provided. Do not write outside the box around each page or on blank pages.
- Do all rough work in this book. Cross through any work you do not want to be marked.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- Questions 1(c), 2(c) and 3(c) should be answered in continuous prose. In these questions you will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Answer **all** questions in the spaces provided.

1 Read **Item A** and then answer the questions that follow.

Item A

Fast Trees Ltd

Fast Trees Ltd specialises in growing large trees which are used for landscaping in parks and new developments. Its trees take between three and five years to reach a saleable size, and are grown in pots which weigh up to 100 kilograms.

Fast Trees Ltd is managed by Jack Tyler who bought the business in late 2011. Jack had never run a business before. *Fast Trees Ltd*'s largest customer, *KX Developments Ltd*, was amazed when Jack sent them six invoices and two credit notes in a month but then never sent a statement of account. Instead, Jack phoned the customer to complain that it had not paid the first invoice within the 21 days' payment terms.

After buying the business, Jack had undertaken a detailed stock take to assess the value of the trees he owned. Jack was concerned that when he multiplied the number of trees he owned by their sale price, he calculated that they were worth £390 000, but the accounts for the previous year showed a stock valuation of only £215 000.

Jack consulted *Fast Trees Ltd*'s accountant, Fiona Bird, who said that she had always valued the trees on a prudent basis. Fiona said that she had applied the principle of prudence in which the trees were valued on the basis of the cost of production. Fiona explained that once the trees were sold, the full sale value would be realised and would be included in the accounts.

Jack wanted to invest in new equipment to improve efficiency, but when he approached the bank he was told that there was not enough security to lend him the £120 000 he wanted. Jack explained that his current stock was worth far more than the accountant had included in *Fast Trees Ltd*'s accounts but this did not impress the bank manager.

Jack argued that his business was better than other businesses, as its main asset, the potted trees, were growing and would therefore be more valuable every year. He said that if the bank lent him the money to modernise the business, this would increase its profits by £20 000 a year.

The bank said that Jack's business was based on products which would not be ready to sell for three years or more, and which may die before they could be sold. It said that this created a big cash flow problem as well as being very risky for a lender. The bank also said that Jack did not have a track record of running a business and that he should come back in three years' time when he had proved he could run the current business successfully.

1 (a) (i) Explain the purpose of a credit note.

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1 (a) (ii) Explain why *KX Developments Ltd* might want *Fast Trees Ltd* to send it a statement of account.

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Question 1 continues on the next page

1 (b) Explain why Jack has been advised by the accountant **not** to use the full sale value of the trees to value his stock.

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1 (c) To what extent do you agree with the bank's refusal to lend Jack the money to modernise the business? Use **Item A** to justify your answer.

(12 marks)

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2 Read **Item B** and then answer the questions that follow.

Item B

A new production system

Jack was not prepared to let the bank's refusal to lend him money, to modernise the business, stop him from being successful.

Having researched the market carefully, Jack has discovered that a new production system would allow him to produce some types of trees in one year rather than the three to five years it had previously taken. The new production system would cost him £100 000 to install.

Jack has decided that he will fund this investment by selling some of his existing tree stock at a discount to other tree nurseries. This would also create the space needed to install the new production system. He has estimated that to raise the £100 000, he would need to sell stock valued at £160 000. The advantage of doing this is that he could make the changes quickly and would not need the bank's support.

If he invested £100 000 in this new production system, Jack has estimated that it would:

- increase his production costs
- increase the sales he could generate each year
- reduce the value of stock he had in the business.

Without the investment, *Fast Trees Ltd* would have a high net profit margin of 33% and a low stock turnover ratio of 1 : 0.19.

Figure 1: Fast Trees Ltd forecast financial data for 2013

	Without investment £	**With £100 000 investment in a new production system £**
Forecast trading account for 2013 (extract)		
Sales revenue	120 000	205 000
Cost of goods sold	80 000	150 000
Net profit	40 000	55 000
Forecast balance sheet for 2013 (extract)		
Fixed assets (machinery and vehicles)	45 000	145 000
Value of stock	420 000	260 000
Total assets	465 000	405 000
Net assets (after deducting current liabilities)	415 000	365 000

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2 (a) Using **Figure 1**, calculate the following ratios for *Fast Trees Ltd* if it makes the investment in the new production system.

$$\text{Net profit margin} = \frac{\text{Net profit}}{\text{Sales revenue}} \times 100$$

$$\text{Stock turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Value of stock}}$$

2 (a) (i) Net profit margin ....

Calculations ....

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(2 marks)

2 (a) (ii) Stock turnover ratio ....

Calculations ....

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(2 marks)

2 (b) Using **Item B** and your answers to **Question 2(a)**, analyse the impact that the proposed change in production system will have on *Fast Trees Ltd*'s profitability and efficiency.

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2 (c) Should Jack invest in the new production system for growing trees more quickly? Use all the information available to you to justify your answer.

(14 marks)

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3 Read **Item C** and then answer the questions that follow.

Item C

HDC Engineering

HDC Engineering manufactures specialist water valves which are used in houses and commercial buildings to reduce water use. The business is well established and has money available to expand. Recently, it has identified a new market in the National Health Service (NHS) for specialist water valves which would help with hygiene control.

Tracy Bowles is *HDC Engineering*'s Chief Designer and she has produced an estimate of the costs for installing and running a new production line to make valves for the NHS.

The new production line will cost £700 000 and will be depreciated using the straight line method over five years, with a scrap value of £100 000. It would also have to contribute £300 000 per year to company overheads to cover building, management and finance costs.

- The costs for each valve will be:
  - parts £53
  - manufacturing costs (labour, energy, packaging) £27.
- The selling price for each valve will be £125.

Jess Coles, *HDC Engineering*'s Managing Director, is keen to proceed because market research has suggested that the NHS market for the valves could be 20 000 valves per year. In addition, *HDC Engineering* should be able to develop an export market for the valves.

Jess is cautious about how quickly this could be achieved. She has suggested that they should initially budget on 10 000 valves per year.

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3 (a) Calculate the profit that *HDC Engineering* could achieve if it invests in the new production line and sells 10 000 valves per year.

Item	**If it sells 10 000 valves per year**	
	£	**£**
Sales revenue		1 250 000
Cost of parts		
Manufacturing costs		
Gross profit		
Depreciation of new production line		
Share of company overheads	300 000	
Total expenses		
Net profit		

Calculations ....

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3 (b) Explain how the net profit would change if *HDC Engineering* sells 20 000 valves per year. Use calculations to support your answer.

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3 (c) Do you think that *HDC Engineering* should invest in the new production line? Use **Item C** and your answers to **Questions 3(a)** and **3(b)** to justify your answer.

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END OF QUESTIONS

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