



**June 2014**

**A2 GCE APPLIED BUSINESS**

**F253/SM** Constructing a Financial Strategy

**STIMULUS MATERIAL FOR ACADEMIC YEAR 2013–2014**

**SERIES 8**

**This stimulus material must be used for the June 2014 examination session.**

**OCR supplied materials:**

None

**Other materials required:**

- A calculator may be used

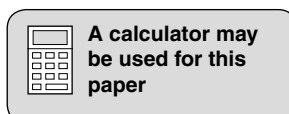


**INSTRUCTIONS TO TEACHERS**

- This stimulus material provides a vocational context for the internally assessed unit: 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 for the **June 2014** examination session. New stimulus material (**Series 9**) will be issued for the academic year 2014–2015.
- There are no separate marking criteria with this stimulus material. A solution will, however, be provided for **Series 8** in the **Principal Moderator's report for June 2014**.
- 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: 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.



## The Plumbing Tree Ltd

Robert, Angus and Emma met and became friends at college when Robert and Angus were studying to become plumbers and Emma was learning to become a heating engineer. After qualifying in 2000 they all worked for various firms in the Manchester area. They are now in their early 30s. Robert married in 2005, Emma in 2007 and Angus is single. Robert has a young child.

Robert, Angus and Emma had been keen to run their own businesses. They had discussed the idea of working together for some time and in June 2008 set up *The Plumbing Tree Ltd*. Robert, Angus and Emma, the only directors of the company, each invested £10 000 in share capital in the company. 5

They only had sufficient money to buy one van and the necessary tools and equipment, to rent lock-up premises, purchase stock and run the company initially. Robert, Angus and Emma, the directors, decided to tender for business contracts and to sub-contract for large building companies so that they were able to work together and share their limited resources. 10

Robert, Angus and Emma were willing to work long hours and this, together with their experience and skills, meant that the company was soon recognised and respected for its quality of work, ability to innovate and business acumen. The business quickly made good profits and generated a strong cash-flow. The company was able to buy a second van in December 2009. This helped the company take on more jobs at different sites. 15

Unfortunately the lock-up premises were too small to house two vans, so Angus had to park one outside his home. One night the van was broken into and stock and equipment stolen. This prompted the company to buy its own premises, using retained profit, in the summer of 2011. The company borrowed £20 000 for fixtures and fittings and additional stock. The company also continued to rent the lock-up premises. Having its own premises proved useful for the company because it was possible to use part of the building as a showroom for heating systems. Each of the directors took it in turn to act as the salesperson and Emma discovered that demonstrating and selling products was something at which she was particularly good. 20 25

By the end of 2011 all three directors were working seven days a week. Robert, however, said he was concerned that the quality of the company's work would suffer and also that he was missing spending time with his family. Angus argued that he was content to take more work, as long as he was rewarded for it. His ambition was to move to Aberdeen, his original home, and start his own business there. He was keen to build up his savings before moving to Scotland, hopefully in 2015. Nevertheless, after suffering from various minor illnesses in 2012, Angus saw the need for the company to employ additional heating engineers so that jobs could be completed satisfactorily and on time. 30

The company advertised for staff and it was inundated with applications from good heating engineers who were keen to work with Robert, Angus and Emma. The directors selected two experienced and excellent workers who began work in November 2012. 35

The company was able to take on more work and easily absorbed the additional costs of employing the two heating engineers.

In spring 2013 Robert, Angus and Emma held a meeting to discuss the future of *The Plumbing Tree Ltd*. They considered a number of contracts which should mean the company would be working at full capacity until winter 2013. They decided that the company would need to take on two more employees in the summer of 2013 so that it could fulfil all of its contracts. Although Robert, Angus and Emma had been concerned just with business survival for the first couple of years, they now felt that they could think about further expansion. 40

As three of the contracts were long-term, the company would need to obtain up to £10000 finance in order to ensure that it would be able to pay wages and its bills until payments were received from customers. The directors decided that they also needed to review the company's current policy of invoicing customers and paying suppliers at the end of each month. 45

In addition the directors identified that the £20000 loan obtained in 2011 had to be repaid in June 2014 and recognised that they had to consider how to deal with the situation in 2015 when Angus was planning to leave the company. One of the employees the company had taken on during 2012 used to run his own plumbing and heating business and had mentioned an interest in buying into *The Plumbing Tree Ltd* if Angus was serious about leaving. The directors know the employee has £20000 available as capital; however, they are slightly concerned that as he is 60 years old he may only be interested in a short-term investment. 50  
55

**TASK A**

You are currently studying accounting at a local college. Emma, your sister, has asked if you could write a report for Robert, Angus and herself which would help them achieve a greater understanding of the financial aspects of their business. This will give them 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) *The Plumbing Tree Ltd* found that some of its work had been delayed after the robbery from the van until equipment could be replaced. In addition, sometimes there have been delays in writing up the books and invoicing customers because the directors were too busy. As the directors are hoping to expand the business they feel that they should be prepared in case future financial problems occur. To help with this, you have been asked to explain the following consequences to *The Plumbing Tree Ltd* of its financial information being less than accurate:

- criminal action
- cash-flow problems from a high tax bill or criminal action
- potential shareholders being unwilling to invest due to a lack of confidence in the business
- bad public image
- changes to management structure.

(iii) Robert, Angus and Emma do not understand some of the technical accounting language. They feel that they should know more so that 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, eg 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, eg direct debits and till receipts.

- (iv) Robert, Angus and Emma appreciate that final accounts should be useful to them but they do not understand how these relate to invoices, cheques received and 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) In your report explain the types of error which can occur when preparing accounts so that Robert, Angus and Emma can avoid making such errors. 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 1 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 2013, the following selected balances were extracted from the books of *The Plumbing Tree Ltd*.

	£
Evening's Repose Hotel Ltd (Debtor)	750
Tracy's Tresses Hair Stylists (Debtor)	660
Jason's Builders Ltd (Debtor)	1 490
Heatside Boilers Ltd (Creditor)	2 240
Pypes Heating Supplies (Creditor)	400
Xpert Mouldings (Creditor)	1 380
Sales	447 700
Purchases	176 100
Rent and rates	6 760
Motor vehicle expenses	27 980
Bank charges paid	170
Discounts allowed	770
Discounts received	1 580
Sales returns	3 370
Purchase returns	3 820
Cash	940
Bank (Dr)	7 360

During trading on 1 May 2013, the following source documents required processing.

Purchase Invoice	£705	from	Heatside Boilers Ltd
Purchase Invoice	£460	from	Pypes Heating Supplies
Sales Invoice	£200	to	Evening's Repose Hotel Ltd
Sales Invoice	£180	to	Tracy's Tresses Hair Stylists
Credit Note received	£90	from	Heatside Boilers Ltd for goods returned
Credit Note issued	£40	to	Jason's Builders Ltd for an agreed refund
Receipt	£800		Cash payment for motor vehicle expenses
Purchase Invoice	£790	from	Mancunium Garage for vehicle repairs
Cheque issued	£790	to	Mancunium Garage – issued immediately on receipt of invoice by <i>The Plumbing Tree Ltd</i>
Credit Note received	£60	from	Pypes Heating Supplies for goods returned
Cheque issued	£900	to	Archway Rentals Ltd for rent for the two month period to 30 June 2013
Cheque received	£735	from	Evening's Repose Hotel Ltd, on account, after deduction of 2% cash discount
Cheque issued	£392	to	Pypes Heating Supplies, after taking £8 cash discount
Cheque received	£1 421	from	Jason's Builders Ltd, in full settlement of account after the refund and after taking 2% cash discount
Cheque issued	£1 380	to	Xpert Mouldings
Cheque issued	£2 107	to	Heatside Boilers Ltd, on account, after taking 2% cash discount

No cash sales took place during the day.

Robert checked the company bank statement online. This showed the following which have yet to be recorded in the books of *The Plumbing Tree Ltd*:

Bank charges paid	£25
Standing order paid	£240 to Mancunian Council for 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 2013
- (iv) bring down the balances ready for start of trading on 2 May 2013.

**TASK C**

On 15 May 2013, Robert, Angus and Emma decided that they wanted to check that the books of *The Plumbing Tree 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 2013.

	£
Sales	465 390
Purchases	190 560
Ordinary shares @ £1 each	30 000
Retained profit	7 820
Land and buildings (cost)	61 000
Provision for depreciation of land and buildings	2 000
Motor vehicles (cost)	28 000
Provision for depreciation of motor vehicles	20 920
Fixtures, fittings and equipment (cost)	25 000
Provision for depreciation of fixtures, fittings and equipment	5 000
Discount allowed	850
Discount received	1 965
4% loan	20 000
Rent and rates	8 140
Sales returns	3 550
Purchase returns	4 140
Stock as at 1 June 2012	16 510
Dividends paid	15 000
Wages and salaries	115 870
Debtors	37 700
Light and heat	7 480
Bank (Dr)	6 615
Sundry expenses	28 060
Creditors	23 800
Insurance	1 810
Motor vehicle expenses	29 980
Telephone	2 610
Loan interest	400
Cash	460
Bank charges paid	200
Accounting fees	750



**You are required to:**

- (i) prepare the trial balance as at 15 May 2013, creating a suspense account – if appropriate

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

1. the sundry expenses account contained a debit entry for £60 which related to light and heat
2. sales returns of £90 had been debited to sales
3. sundry expenses of £600 had been correctly posted to the bank account but had been debited to sundry expenses as £60
4. a transfer of £100 from bank to cash had been omitted from the books
5. the total of creditors is incorrect and has been understated by £50 in 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 2013.

**TASK D**

On 31 May 2013, the following balances were extracted from the books of *The Plumbing Tree Ltd.*

	£
Sales	496 100
Purchases	198 180
Ordinary shares @ £1 each	30 000
Retained profit	7 820
Land and buildings (cost)	61 000
Provision for depreciation of land and buildings	2 000
Motor vehicles (cost)	28 000
Provision for depreciation of motor vehicles	20 920
Fixtures, fittings and equipment (cost)	25 000
Provision for depreciation of fixtures, fittings and equipment	5 000
Discount allowed	880
Discount received	2 040
4% loan	20 000
Rent and rates	8 140
Sales returns	3 790
Purchase returns	4 300
Stock as at 1 June 2012	16 510
Dividends paid	15 000
Wages and salaries	120 500
Debtors	53 060
Light and heat	7 840
Bank (Dr)	1 775
Sundry expenses	28 980
Creditors	16 830
Insurance	1 880
Motor vehicle expenses	30 160
Telephone	2 705
Loan interest	400
Cash	260
Bank charges paid	200
Accounting fees	750

**Additional information:**

1. Stock as at 31 May 2013 is valued at £13 465.
2. Rent was prepaid by £450 at 31 May 2013.
3. The loan is repayable in June 2014. Interest at 4% should be charged for the year.
4. The directors have decided to make a provision for doubtful debts of 5% of closing debtors.
5. Wages and salaries of £11 600 were accrued due at 31 May 2013.
6. Accrued sundry expenses at 31 May 2013 were £1 047.
7. Depreciation is to be provided as follows:
  - buildings at 10% per annum using the straight line method. Buildings cost £20 000. There is no depreciation on land
  - motor vehicles at 40% per annum using the reducing balance method
  - fixtures, fittings and equipment at 20% per annum using the straight line method.
8. A final dividend of 5% was paid from the bank account on 31 May 2013. This has not yet been entered into the accounts and the payment should be included in the accounts for the year ended 31 May 2013.

You are required to prepare in an appropriate professional format for *The Plumbing Tree Ltd*:

- (i) a trading, profit and loss account and appropriation account for the year ended 31 May 2013
- (ii) a balance sheet as at 31 May 2013.

[On completion of TASKS B, C and D you will be assessed on Assessment Objective 2 which has a 14 mark tariff]

### TASK E

*The Plumbing Tree 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 which would be provided to shareholders by a public limited company with the information provided by a private limited company such as *The Plumbing Tree Ltd*.

**TASK F**

The following ratios have been calculated from *The Plumbing Tree Ltd's* final accounts for the year ended 31 May 2012.

	<b>Year ended 31 May 2012</b>
Gross profit percentage	50%
Net profit percentage	9.20%
Return on capital employed	95.60%
Current ratio	1.95:1
Acid test ratio	1.2:1
Stock turnover	30 days
Debtor collection period	25 days
Creditor payment period	25 days
Earnings per share	120p
Dividend cover	2 times

Note: 100% of *The Plumbing Tree Ltd's* purchases and sales were on credit for the years to 31 May 2012 and 31 May 2013.

**You are required to:**

- (i) **using the formulae provided in Appendix 1**, calculate (where appropriate to two decimal places) relevant ratios from *The Plumbing Tree Ltd's* final accounts for the year ended 31 May 2013
- (ii) analyse and interpret these ratios, taking into account the limitations of using ratios to make decisions about the financial viability of a business, in order to comment on the financial position of *The Plumbing Tree Ltd*.

**[On completion of TASKS E and F you will be assessed on Assessment Objective 3 which has a 12 mark tariff]**

**TASK G**

Robert, Angus and Emma are pleased with *The Plumbing Tree Ltd's* success to date. Although they have plans for the company's future, they are unsure of the best way to finance these plans.

**You are required to:**

write a report recommending to Robert, Angus and Emma the best course of action in view of *The Plumbing Tree Ltd's* plans to:

- obtain finance to pay wages and its bills
- ensure it is able to finance additional debtors and stock necessary as part of the proposed expansion
- reduce the risks of accepting large long-term contracts
- manage the situation if Angus leaves the company, and if he does, whether to accept capital from an employee/another investor.

Justify your recommendations.

**[On completion of TASK G you will be assessed on Assessment Objective 4 which has a 15 mark tariff]**

## Appendix 1

### Accounting Ratios

#### Profitability

$\frac{\text{Gross Profit}}{\text{Net Sales}}$	$\times 100$	=	Gross Profit Percentage
$\frac{\text{Profit before Tax}}{\text{Net Sales}}$	$\times 100$	=	Net Profit Percentage
$\frac{\text{Profit before Tax}}{\text{Capital Employed}}$	$\times 100$	=	Return On Capital Employed
$\frac{\text{Expenses}}{\text{Net Sales}}$	$\times 100$	=	Expenses as a Percentage of Sales

#### Solvency

$\frac{\text{Current Assets}}{\text{Current Liabilities}}$		=	Current Ratio
$\frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}}$		=	Acid Test Ratio

#### Performance

$\frac{\text{Average Stock}}{\text{Cost of Sales}}$	$\times 365$	=	Stock Turnover
$\frac{\text{Net Sales}}{\text{Fixed Assets (NBV)}}$		=	Fixed Asset Turnover
$\frac{\text{Closing Debtors}}{\text{Credit Sales}}$	$\times 365$	=	Debtor Collection Period (days)
$\frac{\text{Closing Creditors}}{\text{Credit Purchases}}$	$\times 365$	=	Creditor Payment Period (days)

#### Shareholder

$\frac{\text{Profit attributable to ordinary shareholders}}{\text{Number of ordinary shares}}$		=	Earnings per share
$\frac{\text{Earnings per share}}{\text{Net dividend per share}}$		=	Dividend cover



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