

Please read the instructions printed at the end of this form. One of these sheets, suitably completed, should be attached to the assessed work of each candidate

Unit Title		14 Constructing a Financial Strategy			Unit Code	F253	Session	Jan / June	Year	2	0	0	7				
Centre Name									Centre Number								
Candidate Name									Candidate Number								
Evidence: You construct a financial strategy within a given business context. You will be provided with a series of financial data in the form of a case study which will inform your subsequent investigation.																	
Criteria			Teacher Comment					Page No.									
<p>AO1.1: You identify the reasons behind keeping financial records, the consequences of not producing accurate records and the processes involved in creating a series of final accounts that would be fit for publication; much of your evidence requires further clarification and elaboration;</p> <p>[0 1 2 3]</p>			<p>AO1.2: you demonstrate a sound understanding of the reasons behind keeping financial records, the consequences of not producing accurate records and the processes involved in creating a series of final accounts that would be fit for publication; however, your evidence, at times, does not demonstrate sufficient depth;</p> <p>[4 5 6]</p>			<p>AO1.3: you demonstrate clear and comprehensive understanding of the reasons behind keeping financial records, the consequences of not producing accurate records and the processes involved in creating a series of final accounts that would be fit for publication; your evidence displays both breadth and depth.</p> <p>[7 8 9]</p>			<p>She has shown a clear and comprehensive understanding of the importance of keeping accurate financial records. She thoroughly understands all the processes involved in creating the final accounts. She has demonstrated her knowledge and understanding diagrammatically and has labelled accurately. This understanding & knowledge has allowed her to expand in places to show both breadth & depth</p> <p>Mark 9</p>					<p>3-24 (First section)</p>			
<p>AO2.1: When constructing your final accounts, there are significant errors and weaknesses within them and you present them in an inappropriate format;</p> <p>[0 1 2 3 4 5]</p>			<p>AO2.2: when constructing your final accounts, there are some errors and weaknesses present within them but they are not intrusive, and you present your accounts in an appropriate format;</p> <p>[6 7 8 9 10]</p>			<p>AO2.3: when constructing your final accounts, there are few, if any, errors or weaknesses present within them, and you present them in an appropriate professional format.</p> <p>[11 12 13 14]</p>			<p>She has produced impressive accounts. She is aware of the importance of presentation, and she has a clear working knowledge of those. She has demonstrated how she achieved figures, and can confidently produce final accounts from given data.</p> <p>Mark 14</p>					<p>(Section 2)</p>			

Criteria			Teacher Comment	Page No.
<p>AO3.1: Your analysis and interpretation of the final accounts is limited in scope and your use of accounting ratios is basic and does little to inform discussions on the financial position of your business; your synthesis of gathered data is weak, with little evidence of integrated or strategic thinking; [0 1 2 3 4]</p>	<p>AO3.2: your analysis and interpretation of the final accounts is sound, with a range of accounting ratios informing discussions on the financial position of your business; your synthesis of gathered data is sound, with evidence of integrated and strategic thinking; [5 6 7 8]</p>	<p>AO3.3: your analysis and interpretation of the final accounts is comprehensive and in-depth and you use a wide range of accounting ratios to inform extensive discussions on the financial position of your business; your synthesis of material is comprehensive with frequent demonstration of integrated and strategic thinking. [9 10 11 (12)]</p>	<p>I am impressed with analysis of the business, that she has produced from the accounting ratios. She has demonstrated a clear understanding of these ratios and she has applied outcomes to the business in question, with thoughtful, and constructive knowledge, which is appropriate in the circumstances.</p> <p>Mark 13</p>	Section 3
<p>AO4.1: Your critical evaluation of how your business, in the given context, should plan its financial activities in the future is limited and you make no real attempt to prioritise evidence or to select appropriate lines of argument from information contained within either your final accounts or your research and analysis, resulting in weak, unsupported conclusions; you demonstrate limited clarity and coherence with only basic use of business terminology – errors of grammar, punctuation and spelling may be noticeable and intrusive; [0 1 2 3 4 5]</p>	<p>AO4.2: your critical evaluation of how your business, in the given context, should plan its financial activities in the future is sound; your evidence is prioritised and appropriate lines of argument are selected and presented from information contained within both your final accounts and your research and analysis, resulting in sound conclusions; you demonstrate clarity and coherence, with appropriate use of business terminology – there may be occasional errors of grammar, punctuation and spelling but these are not intrusive; [6 7 8 9 10]</p>	<p>AO4.3: your critical evaluation of how your business, in the given context, should plan its financial activities in the future is comprehensive and in-depth; your evidence is effectively prioritised with appropriate lines of arguments selected and presented from information contained within both your final accounts and your research and analysis, resulting in reasoned, appropriate, logical conclusions; you demonstrate clarity, coherence and fluency with effective and confident use of appropriate business terminology – there are few, if any, errors of grammar, punctuation and spelling. [11 12 13 14 (15)]</p>	<p>Using information from the case study a her ratio outcomes, has produced a viable way forward for Sally, in order to increase the profitability of her business. She has given thoughtful considerations to the long term plans of the business and has made suggestions as to how these can be achieved. Her use of language + business terminology is clear and appropriate. Holistically I felt that this assignment deserved the marks given as there fully is, throughout the task, an impressive understanding of how small businesses can survive in such competitive markets.</p> <p>Mark 15</p>	Section 4
Total/50				
If this work is a re-sit, please tick	Session and Year of previous submission	Jan / June	2 0 0	Please tick to indicate this work has been standardised internally <input checked="" type="checkbox"/>

Please note: This form may be updated on an annual basis. The current version of this form will be available on the OCR website (www.ocr.org.uk). Please complete one Centre Authentication Form (CCS160) for each unit and forward to the moderator with your sample.

Guidance on Completion of this Form

- One sheet should be used for each candidate.
- Please ensure that the appropriate boxes at the top of the form are completed.
- Please enter *specific* page numbers where evidence can be found in the portfolio, and where possible, indicate to which part of the text in the mark band the evidence relates.
- Circle the mark awarded for each strand of the marking criteria in the appropriate box and also enter the circled mark in the final column.
- Add the marks for the strands together to give a total out of 50. Enter this total in the relevant box.

CONSTRUCTING A FINANCIAL STRATEGY UNIT 14

Task A

Unit 14: Constructing a Financial Strategy

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The Business Context Within Which Sally's Strategy Will Take Shape

It is important that Sally records her financial transactions accurately otherwise she will not have a clear idea of how her business is performing and how much profit she is making.

Profit is the driving force behind most businesses, the amount of profit the business has made is used as a measure as to how well it has performed within a set period of time, usually a year. At the end of the trading year the owner(s) will assess how the business has performed by constructing a profit and loss account, this is a summary of all the business transactions; it shows the flow of expenditure and income in the trading period. There are three parts to the profit and loss account.

AO1/3

1. The Trading Account: this shows the revenue earned from selling products and the cost of those sales. Subtracting one from the other gives the gross profit.
2. The Profit and Loss Account: This is an extension of the trading account. Once the business has calculated the gross profit it can then calculate how much profit and loss it has made. This is done by adding in any extra income and then subtracting expenses, such as advertising and taxes. Subtracting the expenses from the gross profit then gives the operating profit, this is a key indicator of the businesses trading performance. After this the business then needs to add any non-operating income, such as dividends from shares held in other companies, to the operating profit. Lastly they have to +/- any interest they may owe/receive, the figure resulting from this is the profit on ordinary activities before tax.
3. Profit and Loss Appropriation Account: This part of the account shows how profit and loss is distributed, most businesses retain a proportion of profit for investment or precaution. Although businesses with share holders are not legally obliged to pay dividends, businesses tend to give share holders dividends to keep them happy, the amount that is paid in dividends is decided by the board of directors, as sole traders, like Sally's

AO1/3

AO1/3

business don't have shareholders all the profit is transferred to the capital account on the balance sheet.

The profit and loss account needs to be kept accurate so that the owners can get a clear idea of how much profit or loss their business is making each year. They also need to be kept correct as some of the information is transferred to the balance sheet, so if incorrect data is put on to the balance sheet then the resulting figures from this is not going to give a true picture of how the business is performing. It is especially important for public limited companies and private limited companies to keep their profit and loss account accurate as by law they have to produce their accounts for the public to view so they can get a true indication as to how the business is performing, which is likely to influence their decision as to whether or not they buy shares. For a sole trader there is a more detailed list of expenses compared to that of a limited company, this allows for a comparison with previous years, so if they are not accurate the owner won't know how his/her business is actually doing.

reason

101/3

reason

reason

The main, and most obvious reason why Sally needs to ensure her profit and loss account is calculated accurately is so she can see her financial situation, whether she is making a profit or a loss. This is particularly important for Sally as her strategic aim for her first three years in business is survival, from the profit and loss account she can see how much profit or loss she has made. In a situation like Sally's where she is a Sole Trader she would have a more detailed list of expenses compared to a limited company. This will allow Sally to make reliable comparisons with previous years if she keeps her accounts accurate. The profit and loss account also needs to be kept accurate for tax purposes, so Sally isn't paying too much or too little tax. If Sally works out her profit and loss account before the end of her trading year (June 1st), she could use some of her profit from that year to buy new stock, pay off outstanding bills or put it into a pension scheme, this way her profit will be reduced which will therefore reduce

reason

reason

"

101/3

her tax, Sally has to pay business tax as it is a legal requirement and will be fined if she does not.

reason

Businesses have a lot of legal requirements to meet throughout the life of their business. Legal requirements concerning the business accounts help protect shareholders and is designed to clarify certain financial information so readers are not misled, it doesn't affect the businesses decisions making or place an unnecessary financial or administration burden.

The Companies Act 1948 and 1967 specifies what should be included on the balance sheet including authorised and issued share capital, details of current assets, debentures, mortgages, short and long term loans, overdrafts, trade creditors and taxation due.

The Companies' Act of 1985 and 1989 regulates public limited companies concerning the preparation and publication of their financial statements. These businesses also have to submit a copy of their accounts annually to Companies' House, as well as this, businesses with a turnover greater then one million pounds are required to have their accounts independently audited. The auditors, who are appointed annually at the general meeting, complete a report after examining the accounts. The report and financial statements are given to the shareholders at the annual general meeting.

reason
ADP/3

The Inland Revenue require a set of financial [?] so that it can calculate how much corporation tax a business has to pay. Also Custom and Excise need the figures from the final account^s to be submitted every three months so they can calculate the VAT liability of the business.

reason

reason

Sally's financial records need to be calculated accurately as a legal requirement. Sally's records will be used by the Inland Revenue to help calculate how much income tax Sally has to pay. Custom and Excise may also need Sally's accounts to calculate her VAT, and the Department for Social Security may also want to

reason

look at Sally's accounts to make sure she has paid enough National Insurance contributions. Sally would probably need to seek financial advice, such as an accountant, in order for her to be certain that her records are accurate so she can avoid investigations and wasting time and money if they are incorrect. If Sally fails to pay any of these or is found not to be paying enough, especially whilst she is still starting out, it will affect her financially and she may be forced to sell some of her assets to cover the costs.

reasons.

A01/3

The assets of a business are the resources for that business. It buys assets to increase the value of the company. On the balance sheet there is a summary of all the assets the business owns and what they are worth. Assets are valued at their original price minus the depreciation if the asset wears down over time. Its fixed assets (which are resources with a life span of over one year e.g. machinery) are shown on the balance are divided into three groups, these are tangible, intangible and financial assets. A businesses liabilities, the money it owes to other businesses for goods it has received on credit, can also be broken down in to groups, current liabilities and long-term liabilities. Current liabilities are debts due to be paid within one year from the purchase of goods purchased on credit these could be items such as corporation tax and overdrafts. Long-term liabilities are also debts the business owes but these are to be paid back over a longer period of time, the most common example of this is a bank loan. It's important to have accurate financial records when assets and liabilities are concerned as the business needs to know what it owns and who it owns.

knowledge.

reasons.

A01/3

It's important for business to have accurate records when comparing them to previous years otherwise the comparisons will be unreliable. By looking at present and past facts and figures the business can identify reoccurring trends and construct plans that either improve or build on them. If a business has access to competitors financial records, for instance if they have to be displayed for legal purposes like a public limited company, then a business can compare

reasons

A01/3

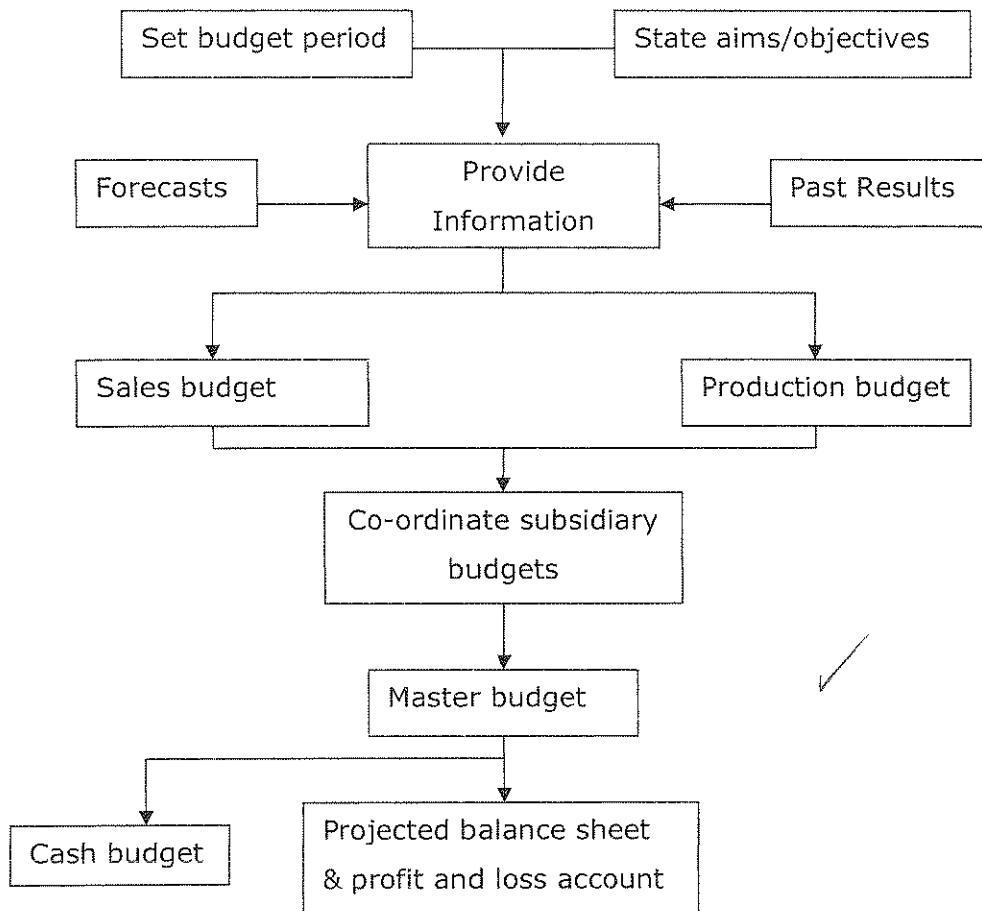
how well it is doing compared to them which will help give it an idea as to its position in the market.

If Sally keeps her financial records accurate then she can look back to previous years and compare her records with present ones to see if her business is improving or not, and to what extent. This is especially important to Sally as her strategic aim is survival. Comparing accounts will give her a true picture of how her business has developed over its first few years in trading. Sally could then use this information to construct a budget suitable for her business and its aims.

reason
A01/3

A budget is "a quantitative economic plan prepared and agreed in advance" (Business Studies 3rd Edition: Dave Hall, Rob Jones, Carlo Raffo) There are different stages involved in the preparation of a budget as different parts of the business provide different information to go into it. Therefore each individual who produces information needs to ensure their information is accurate as in big businesses it can be difficult to find the source of the error. I have shown the different stages in the diagram below (from Business Studies 3rd edition) :

reason.



The first step to preparing a budget is to decide on the period of which it is going to last, usually a year, and to state the aims and objectives of the business. Information then needs to be collected either from past financial documents or from forecasts depending on the business. Once the information is collected the business can then prepare the sales and production budget, which are very important as they are linked and affect all the other budgets. The sales budget will contain information on monthly sales estimates and the price of products/services. The production budget cannot be completed until the sales budget is done, the production budget will then go on to show the materials and labour force needed. After these two budgets have been completed the business should have an idea of whether or not it will be able to meet its sales targets, the

budgets can be adjusted if need be. If not then the subsidiary budget can be drawn up, this is the individual budget for departments within the business. The master budget then goes on to give a summary of what has been agreed in the whole process i.e. the projected figures. The cash budget can also be constructed at this stage which is particular useful as it shows the monthly flow of cash in and out of the business. This will highlight any problems the business may occur, or flaws in the budget.

reasons
10/13

As the majority of budgets tend to contain forecasts, which are estimates of likely future outcomes, based on historical data of the business (e.g. sales information) and human judgement, problems can arise if sales data is not accurate. This in turn will cause the business budget to be incorrect. For the sale of new products it is difficult to predict how they will sell so to help predict these figures a business may undertake market research.

reasons
10/13

The business needs to get its forecasts and predicted sales as accurate and as realistic as possible otherwise the business will be following an unrealistic budget. The consequence of following a budget that is formed upon inaccurate information, is that the business may end up spending more money than it actually should have budgeted which can lead to financial difficulty. As well as this they won't be able to calculate the variance accurately (the difference between the budgeted figure and the actual figure) to see if the business figures are favourable, better than the forecasted figures, or adverse, worse than the forecasted figures. If a business can't work out the variance due to incorrect figures then the business can't analyse them and try to improve their business financially.

reasons
consequence

reasons
10/13

If a budget is produced accurately it can have many valuable benefits such as being able to control income and expenditure and by setting targets which can be understood and followed by employees lower down in the business.

reasons

Sally will need to budget her money in order for her to plan how she is going to spend her money, what she is going to spend it on and when she is going to spend it. By Sally having accurate accounts her budgets and forecasts are likely to be much more realistic and easier to keep to. This will benefit Sally's business as she will be able to predict, and plan for, in advance when she has little money coming in and may need to obtain additional finance.

reason 1
A01/3

Throughout the life of the business the owner is likely to need to obtain additional finance. He/she may be able to borrow money from his/her own personal bank account or from a friend or family member. Depending on the size of the amount needed, the business may need to borrow from a bank in the form of a loan. The bank will want to see the businesses financial records to assess how safe/risky it is to lend the business money, and to decide on the pay back period. It is essential that these records are 100% accurate for two reasons.

reason 2
A01/3

The first reason is so that the business knows that it is going to borrow the correct amount, if the figures were inaccurate when working out the amount needed it may end up borrowing too much, which will result in it paying back more interest on money it doesn't need, or it will not borrow enough, which will waste the business time trying to get the loan changed at a later date.

reason 3
A01/3

The second reason is that if the bank discovers the records are not correct it may refuse the loan as it will think you have something to hide. If the business is refused a loan when it needs it this could lead to serious financial problems, or threaten future investments such as expansion.

reason 4
A01/3

If Sally decides that she wants to set up a website with a delivery service for her school uniforms she may require some extra finance to get her started. If her friends or family can't support her financially to do this then she will have to go to a financial institution to obtain this money, such as a bank. A bank would want to see all of Sally's financial records before they offer her a loan as they will need to

reason 5

asses the risk of lending Sally money. If the bank finds the records to be incorrect this will reflect very badly on Sally and may jeopardise her chance of getting a loan. The bank may feel that lending money to Sally is risky as they might think she is trying to hide something, this could seriously affect Sally in the future as she feels the current size of her shop is restrictive, she may need to borrow a large loan so she can expand her business premises.

reason
A01/3

Business expansion is a major and expensive decision, especially for a small business such as Sally Smalls. Its financial records will have a key role in deciding if it will expand or not. If financial records are not accurate the owner may be led into thinking that either the business does not have enough money to expend, when it actually does. Or on the other hand it may think it has enough money when it doesn't. If Sally makes these mistakes it could ruin her business as she will need to expand in the future as she feels the current size of her business is restrictive.

reason
A01/3

The consequences of Sally's business if its financial information is found to be inaccurate:

The Companies Acts 1985 and 1989, which are concerned with the preparation and publication of financial statements, states that public limited businesses are annually required to submit a copy of their accounts to the Companies House. Business that then have a turnover over £1million are required to have their accounts independently audited. The auditors, who are appointed at the general meeting, examine the books and accounts and create a report on the accuracy of the accounts so they can decided whether they give a true picture of the financial state of the business. The results from this are given to the shareholders at the annual general meeting.

As well as Companies House wanting a copy of the businesses accounts the Inland Revenue also needs to receive a copy so that it can calculate how much

corporation tax is due to be paid. If a business fails to submit its accounts to the Inland Revenue they will try to chase them up, if this fails or can't be done then they will be fined and could be prosecuted for non-compliance, this would look bad on the business from the public's point of view and also if the business wants to borrow money from a bank in the future it could jeopardise its chances if they know about the incident as it makes them look unreliable.

consequences

A01/3

If Sally, or any other business submits accounts that it knows are wrong then they are committing fraud, if they get caught then the business will receive a fine and could be prosecuted. However if the business simply made a mistake then it is likely just to receive a fine for late payment and be charged on the outstanding tax liability. If Sally did this it would weaken her business, but of course depends on the size of the fine.

consequences

A01/3

If a business fails to keep accurate records it will not know exactly how much money it has available to spend. This may result in it spending money that it does not have. As well as this it will not know how many debtors and creditors it has. These two points can have serious financial implications on the business because spending money it hasn't got will get the business in debt and by not knowing creditors the business will probably not be aware of when they have to pay them back, which can lead to a bad reputation and having to pay interest on top of the sum owing. For small businesses like Sally's this is a very risky thing to do, as she is a sole trader and she has unlimited liability, which means that if her business gets into debt then she will have to sell off her personal possessions in order to cover the amount if her business can't afford it.

consequences

A01/3

A business can encounter cash-flow problems if it incurs a high tax bill or a fine for criminal action, this could be if the business failed to declare accurate accounts. If it is found just to be a mistake then the business will just have to pay a fine and any outstanding interest, however if the business is found to have committed fraud then it will face prosecution, this will then cost the business a lot

A01/3

more not only in money, but it could also cost it its reputation, customer base and its shareholders.

consequences

The shareholders of a business are the people who invest money in the company in order to receive an annual dividend. Shareholders are important to businesses as they are a source of finance, however if a business is found to not be keeping accurate financial records then they are likely to do one of two things. The first option would be to sell their shares so they have nothing else to do with the business and invest elsewhere, however, if the shares are at a lower value than to what they brought them at they will probably take the second option, this would be to vote in a new board of directors, this way the share holder can either wait for their shares to hopefully increase in value under the new plans of the directors, or keep with the business and the directors

consequences

The only way the public is likely to discover that a business has been not been keeping accurate records is if it is reported in the media, for small business like Sally's this is not much of an issue it is unlikely television or national newspapers are going to be interested in her business activities, however it might be printed in the local papers if it is bad enough. For bigger businesses the sensation media creates could have a damaging effect on the business by giving it a bad public image and therefore have internal and external consequences. The external consequences of this happening would be shareholders selling their shares as they would not want to be associated with that business, and customers also withdrawing from the business. The internal consequence would be employees becoming concerned about their job prospects/safety and so may decided to start looking for work elsewhere. A bad public image would be bad for Sally's shop, however Elmshide Girls College uniform can only be purchased from Sally's shop, and at the present time Sally's shop is the most convenient school shop for most of the schools in that area. Therefore if Sally did get herself a bad reputation it is likely to still have some business, and time to re-gain her reputation before the supermarket would be built.

consequences

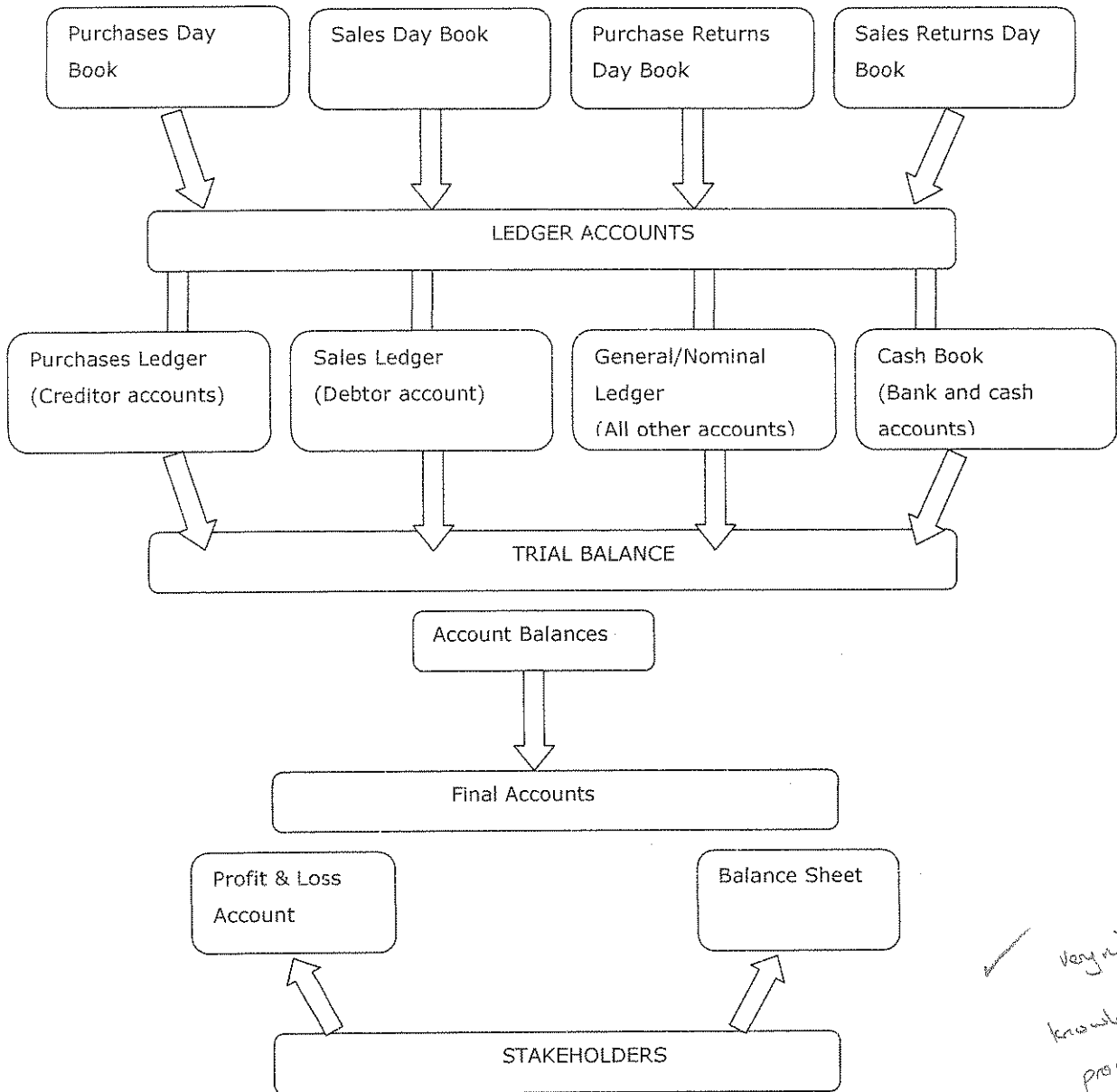
If Sally had a larger business like a private limited company and was experiencing bad publicity then there would probably be a change in management structure in order to try and resolve the problem. Limited companies are run by a board of directors on behalf of the shareholders, so that when the business is doing badly the shareholders have the option of voting in a new board of directors of whom they think will get the business back on its feet. For very large businesses though there are thousands of shareholders and so it is difficult to get people to vote in order for change to take place.

can be by other way

ADU/3.

Different Types of Income and Expenditure Which Are Included In a Set of Final Accounts:

Business documents i.e credit notes, invoices, cheques and paying-in-slips, are all sources of accounting records, all these documents are organised into day books, the diagram below shows how the creation of the day books leads to the stakeholders being able to see the profit and loss account and the balance sheet.



Very nice knowledge/process. Aol/S

When a business records its financial transactions its splits its accounts into four different 'ledgers' these are the sales ledger, purchase ledger, the general ledger and the journal. The sales ledger contains all the accounts of debtors who have yet to pay for the products or service they have received. The purchase ledger is

similar to this but it contains the accounts of the creditors who the business has to pay at a later date. The general ledger records the value of sales/sales returns and purchases/purchase returns. It also contains the records of money spent on expenses, and the cashbook, which records the cash flow of the business. The last ledger is the cash book; it contains the bank and cash accounts. When the accounts have been balanced these can then be put into the trial balance. If the trial balance balances the final accounts can then be created, which means that the profit and loss account and the balance sheet can be created. ✓

knowledge
A01/3

The money or items invested in a business by an owner to start up a business is the opening capital. For example if someone opens a business and puts in £1000 and a car that's worth £650 into their business this will become its opening capital:

Bank	£1000
Car	£650
Opening Capital	£1650

Add these two figures together to get the opening capital

The closing capital is the net worth of the business after it has been trading for a full year, the net worth of this business below is £5450 after its first year of trading.

Opening Capital	£1650
Add Net Profit	£34 500
Less Drawings	£30 700
Closing Capital	£5450

Opening capital ADD net profit
SUBTRACT drawings =
CLOSING CAPITAL

The closing balance of the first year will then be the opening balance of the second year.

knowledge
A01/3

For limited companies the capital is different. The capital for limited companies is worked out by multiplying the number of shares sold by the value at which they were sold. The capital for limited companies also includes any reserves that the business may have created from retained profits. If Sally becomes a limited company she will need to be aware of these changes.

knowledge

One of the most common external sources of finance is a bank loan, most business will need one through some point of the life of their business normally either for starting up or to expand. When borrowing money from a bank there will be an agreed pay back plan, this will include the date on which all the money needs to be paid back by and the interest rate the business chooses. There are two interest rates that a business can choose from; fixed or variable. A fixed interest rate will be slightly higher than the current base rate but will not be subject to interest fluctuations. A variable rate of interest is subject to change as interest rates do, a business could be lucky and have to pay back its money when interest rates are low, or it could be unlucky and pay them back when they are high, or get a mixture of the both. This could cause the business problems as the amount they have to pay back will change each month, so these fluctuations have to be considered when forecasting or budgeting.

knowledge
A01/3

There are two types of assets a business may own, fixed assets and current assets. Its current assets would be the stock the business has, debtors and cash in the bank. A businesses fixed assets are the items that it needs in order to run the business efficiently every day. These assets have a life expectancy of a year or more and are usually expensive; examples of these assets are its premises, vehicles, machinery and office equipment. As these assets are expensive the business may have to take out a loan so they are able to buy the asset, as the loan would be likely to last over a period of five years this would be classed as a long-term liability in the accounts of the business.

knowledge
A01/3

A short term liability of the business would be when it buys items on credit. Small businesses like Sally's often do this especially when they are starting up as they can receive the stock and pay for it at a later date; this gives them a chance to sell some of the stock to cover the cost for when they have to pay the money back. Businesses often offer a discount for businesses that pay for their goods straight away as they don't have to wait for their money.

knowledge
A01/3

The stock that Sally buys to sell on in her shop is an expense. If Sally purchases these items on credit she will have to show this by opening up an account for them in double entry accounting, she will also have to do this when customers buy products from her on credit. All the transactions of sales and purchases, whether brought on credit or not need to be recorded in double-entry accounts.

knowledge
A01/3

There are many expenses involved within a business in order for it to be able to run. When a business is starting up there is likely to be more expenses as the owner will need to purchase assets such as equipment, and will also need to train any employees. Other expenses can be broken down into fixed and variable costs. Variable costs are items that prices will change on a weekly/monthly bases, for example if the demand for a product is low then less raw materials will be needed to make it so the business won't buy as much. This will also affect the amount of electricity needed, less production means less electricity needed as the machines wouldn't be running for as long, therefore the cost would have changed. Fixed costs are expenses that stay at the same price for a long period of time like the re-payment of a loan or the payment of wages. Sole traders like Sally record their wages under the bank and drawings account in double-entry accounting.

knowledge
A01/3

Information that needs to be put into the final accounts can be found from different sources within the business for example credit notes and bank records. Once all the relevant information has been collected a set of final accounts can start to be created. There are many stages and processes involved in creating

the final accounts and the system of double entry and the trial balance have a key role in the construction of the final accounts. ✓

Double-entry is based on the principle that each transaction has to be entered twice, and therefore has an impact on two accounts. To record transactions in double entry accounting 'T-line' accounts are drawn up, these are shown in the examples below: ✓

*knowledge
A01/3*

The name of the account is shown at the top of the account so it is clear what account it is. For each transaction that takes place the date, amount and a description of where the money came from/went has to be recorded. ✓

DR		Bank Account		CR	
Date	Description	Amount (£)	Date	Description	Amount (£)
1/03	Capital	2 500			

This is the debit side of the account; this is shown via the DR. The debit side records the goods, services or money the business receives. ✓

This is the credit side of the account; this is shown via the CR. The credit side records the goods, services or money the business gives. ✓

*knowledge
A01/3*

For every transaction that takes place it will increase the value of one account and decrease the value of another.

DR		<u>Capital Account</u>		CR	
Date	Description	Amount (£)	Date	Description	Amount (£)
			1/03	Bank	2 500

The bank account has received £2 500 from the capital account, therefore the value of this account has increased by £2 500. ✓

The capital account has paid out £2 500 to the bank account, so now this account has £2 500 less, therefore the value of this account has decreased. ✓

DR		<u>Bank Account</u>		CR	
Date	Description	Amount (£)	Date	Description	Amount (£)
1/03	Cash sales	2 500			

 If the transactions are not entered accurately then when the business creates its trial balance it will not balance. Before the trial balance can be created the business needs to balance off all its accounts.

Accounts are balanced off at the end of each month so that the business can bring forward its 'opening balance,' this is how much money is in each account at the beginning of the month. Balancing the accounts allows the business to see its financial position as a whole once the trial balance is completed after the accounts have been balanced, but it also allows the business to look at specific financial areas. For example it will be able to see the value of the months sales

knowledge
A013

knowledge
A013

and compare it to past performance to look for any trends, it can identify how much money it has spent on purchases and expenses, and also how much money its owes its creditors and debtors.

There are three stages involved in balancing the accounts, shown in the examples below;

Stage 1: To add up each side of the account and identify the highest total.

DR		Bank Account		CR	
Date	Description	Amount (£)	Date	Description	Amount (£)
1/03	Opening Balance	3 500	1/03	Rent payable	500
3/03	Sales account	1 600	14/03	Royal Wordsley	50
16/03	Sales account	3 450	23/03	D K Ties & Badges	1 500
			26/03	Rates account	500
	total	8 550		total	2 550

These totals come from adding up all the figures in the column above them on their side. The total on the debit side of the account can be identified as the highest total.

Stage 2: To work out the difference between the totals.

DR	Bank Account	CR
total	8 550	total

As the total on the debit side was the highest you then have to subtract the credit total from this:

$$£8\,550 - £2\,550 = \underline{£6\,000}$$

The result from this, £6 000, is called the balance.

bracketed & clear understanding shows through diagrammatical information

Apr 13

Stage 3: Putting the 'balance' on the account

DR		Bank Account		CR	
Date	Description	Amount (£)	Date	Description	Amount (£)
1/03	Opening Balance	3 500	1/03	Rent payable	500
3/03	Sales account	1 600	14/03	Royal Wordsley	50
16/03	Sales account	3 450	23/03	D K Ties & Badges	1 500
			26/03	Rates account	500
			30/03	Balance c/d	6 000
	total	8 550		total	8 550
	Balance	£6 000			

The balance is placed on the debit side as this was the side with the highest total, it has to be put on this side so the balance can be brought forward for the next month on the correct side.

This is the difference between the two totals to bring the credit side up to the same total as debit side so that the two sides balance.

Once all the accounts have been balanced like the one above the trial balance can then be constructed.

The Trial Balance and Errors

The trial balance is the method that is used to check the accuracy of the double-entry accounting. If there is a mistake in the double-entry accounts this will show in the trial balance as the sides will not balance. The trial balance also brings to the attention of management outstanding debtors and creditors and can also be used to check against fraud if it is a big business and lots of different people contribute to the data in the accounts.

A business can't construct a trial balance until it has balanced off all its accounts as all that is needed for the trial balance is the individual balances of each

knowledge.
10/13

knowledge
10/13

account. Once the business has these balances they are then put into a table like the one below: ✓

Type of Account	Debit (£)	Credit (£)
Capital		6500.00
Bank	774.00	
Cash in hand	4000.00	
Purchase	943.00	
DK Ties and Badges (CR)		619.00
Sales		1835.00
B. Smale Account (DR)	1544.00	
Rent	300.00	
Discounts allowed	26.00	
Electricity	167.00	
Drawings	1200.00	

These are all the accounts that were brought forward, the amount that was brought forward is placed on the relevant row either under 'debit' or 'credit' depending on which one they were brought down under. ✓

process part 3 ✓

All the figures in the debit side of the account need to be added up and totalled at the bottom of the table, as does the credit side.

Type of Account	Debit (£)	Credit (£)
TOTAL	8954.00	8954.00

As the two sides balance this more than often means that the accounts are accurate. However it is possible that there are some errors in the accounts, the

trial balance only shows what is on the surface, it does not provide a thorough detailed look into the accuracy of the accounts, so although it gives a good indication as to if there are any errors it does not prove it.

There are different types of errors that can occur in accounts which can cause the trial balance to appear correct. An omission error happens when an entry has not been recorded on both the debit and credit side. This error is easily corrected as all the business needs to do is to enter the invoice into the accounts.

*Demonstration
of methods
of errors that
occur & how
to rectify
them.*

A01/3

Compensating errors are slightly more complicated as this is when two separate errors of the same amount happen, as one occurs on the credit side and the other on the debit side the errors cancel each other out which is why the trial balance appears correct. To correct this error the accounts would need to be credited and debited with the missing entries.

Errors of principle are caused by entries being put into the wrong account, for example when cash received from a debtor is debited to the debtors account and credited to the cash account rather than the other way around. This is corrected by balancing out the error in the account and entering it correctly.

Bibliography

'Business Studies' third edition: Dave Hall. Rob Jones. Carlo Raffo.

A2 Level for OCR Applied Business: Catherine Richards, Rob Dransfield, Neil Richards and Karen Hough.

*well written - demonstrating
a clear & comprehensive
grasp of many of the
concepts involved in producing
financial records.*

CONSTRUCTING A FINANCIAL STRATEGY UNIT 14

Task B,C,D

Task B (1)

Below I have entered the relevant data in order to balance off Sally's accounts at the close of trading on 1st May 2006. I have then brought down the balances ready for trading to commence on 2nd May 2006.

DR		L. Hill Account (Debtor)				CR	
1/5	Opening Balance	✓ 190	00	1/5	L. Hill (cheque)	98	00
	Sales invoice #4	✓ 127	00	1/5	Discount Allowed	2	00
				1/5	Balance c/d	217	00
		✓ 317	00			✓ 317	00
2/5 ✓	Balance c/f	217	00	✓			

DR		S Branson Account (Debtor)				CR	
1/5	Opening Balance	✓ 326	00	1/5	Balance c/d	412	00
1/5	Sales invoice #3	✓ 86	00				
		✓ 412	00			✓ 412	00
2/5 ✓	Balance c/f	✓ 412	00				

DR		DK Ties & Badges Account (CR)				CR	
1/5	Purchases returns	89	00	1/5	Opening Balance	✓ 1092	00
1/5	Bank (cheque)	955	00	1/5	Purchase invoice #2	✓ 691	00
1/5	Discounts Received	45	00				
1/5	Balance c/d	✓ 694	00				
		✓ 1783	00			✓ 1783	00
				2/5 ✓	Balance c/f	✓ 694	00

DR		B. Smale Account (Debtor)				CR	
1/5	Opening Balance	✓ 294		1/5	Sales Returns #6	20	00
				1/5	Bank (cheque)	250	00
				1/5	Discount Allowed	24	00
		294	00	✓		✓ 294	00
				✓	2/5 Balance c/f £0.00		

DR		Royal Worldsley Account (Creditor)						CR	
1/5	Purchases Returns #5	✓	162	00	1/5	Opening Balance ✓	4948	00	
1/5	Bank		1400	00	1/5	Purchase invoice #1	652	00	
	Discount Recieved		28	00					
1/5	Balance c/d		4772	00	1/5	Purchase invoice	762	00	
			✓	6362	00		✓	6362	
					2/5 ✓	Balance c/f ✓	4772	00	

DR		Sales Account						CR	
1/5	Balance c/d		117215	00	1/5	Opening Balance ✓	✓	116735	
					1/5	Invoice 4(L. Hill)	127	00	
					1/5	Invoice 3(SBranson)	86	00	
					1/5	Cash Sales	267	00	
			117215	✓			✓	117215	
					2/5 ✓	Balance c/f	✓	117215	

DR		Purchase Account						CR	
1/5	Opening Balance ✓		78310	00	1/5	Balance c/d	80415	00	
1/5	Invoice2(DK Ties)		691	00					
1/5	Invoice1(Royal Wordsley)		652	00					
1/5	Invoice (Royal Wordsley)		762	00					
			✓	80415	00		✓	80415	
2/5 ✓	Balance c/f		✓	80415	00				

DR		Cash in Hand Account						CR	
1/5	Opening Balance		✓	38	00	1/5	Balance c/d	38	
							✓	38	
2/5	Balance c/f ✓		38	00					

DR		Bank Account				CR	
1/5	Opening Balance ✓	4369	00	1/5	D K Ties & Badges (cheque)	955	00
1/5	B Smale	250	00	1/5	Royal Wordsley	1400	00
1/5	Cash sales	267	00	1/5	Rent payable	250	00
1/5	L Hill	98	00	1/5	Rates account (connalton council)	1800	00
				1/5	Balance c/d	✓579	00
		✓4984	00			4984	00
2/5 ✓	Balance c/f	✓579	00				

DR		Rent Payable				CR	
1/5	Opening Balance ✓	2500	00	1/5	Balance c/d	2750	00
1/5	Bank (cheque)	250	00				
		2750	00			2750	00
2/5 ✓	Balance c/f ✓	2750	00				

DR		Discounts Allowed Account				CR	
1/5	Opening Balance	✓354	00	1/5	Balance c/d	380	00
1/5	L. Hill	2	00				
1/5	B.Smale	24	00				
		✓380	00			✓380	00
2/5 ✓	Balance c/f	✓380	00				

DR		Discounts Received Account				CR	
1/5	Balance c/d	225	00	1/5	Opening Balance ✓	152	00
				1/5	Royal Worldsley	28	00
				1/5	DK Ties	45	00
		✓225	00			✓225	00
2/5 ✓	Balance c/f					225	00

DR		Purchases Returns Account				CR	
1/5	Balance c/d	2695	00	1/5	Opening Balance ✓	2444	00
				1/5	D K ties & badges	89	00
				1/5	Royal Worldsley	162	00
		✓ 2695	00			✓ 2695	00
				2/5 ✓	Balance c/f ✓	2695	00

DR		Rates Payable Account				CR	
1/5	Opening Balance ✓	1200	00	1/5	Balance c/d	3000	00
1/5	Cheque (Bank)	1800	00				
		3000	00			✓ 3000	00
2/5 ✓	Balance c/f ✓	3000	00				

DR		Sales Returns Account				CR	
1/5	Opening Balance	✓ 107	00	1/5	Balance c/d	127	00
1/5	B Smale	20	00				
		✓ 127	00			✓ 127	00
2/5	Balance c/f ✓	127	00				

Excellent work,
well laid out
in appropriate clear
format
A02/3

Task C

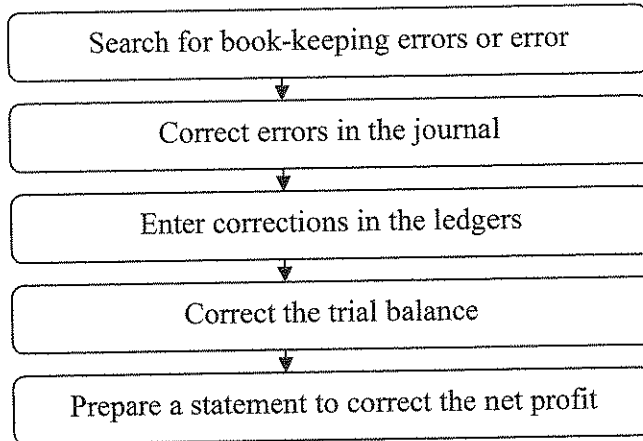
(i) The following balances have been taken from Sally's books to produce a trial balance as at 15th May 2006;

	Debit (£)		Credit (£)	
Sales			122 496	00
Purchases	81 869	00		
Stock at 1 st June	41 082	00		
Wages	4 471	00		
Fixtures and fittings at cost	11 500	00		
Provisions for depreciation fixtures and fittings at 1 June 2005			2 450	00
Bad debts	32	00		
Provision for doubtful debts at 1 June 2005			10	00
General expenses	5 184	00		
Rent payable	2 750	00		
Drawings	1 533	00		
Sales returns	164	00		
Purchase returns			2 973	00
Loan interest	600	00		
Capital			19 555	00
Telephone expenses	1 244	00		
Loan at 12% per annum			10 000	00
Cash in hand	139	00		
Rates	2 675	00		
Light and heat	2 069	00		
Bank	3 284	00		
Discounts allowed	388	00		
Discounts received			218	00
L Hill (debtor)	399	00		
S Branson (debtor)	593	00		
B Smale (debtor)	408	00		
Royal Wordsley (creditor)			4891	00
DK Ties and Badges (creditor)			743	00
Carriage inwards	2 204	00		
Carriage outwards	572	00		
	163 160	00	163 336	00

The trial balance I have constructed for Sally's business for 15th May did not balance. As the totals are mathematically accurate and the entries are on the correct sides of the accounts, (either debit or credit side) this shows that there are errors in the entries of the accounts themselves. Therefore I am going to open a 'Suspense account' with the balance of £176 as this is the difference between the two totals of Sally's trial balance. A suspense account is opened because if Sally is unsure where to post an item, then the suspense account will hold the figure until she has identified where it should be.

A02/3

So for example, if Sally received a payment for goods she supplied but it is not clear who sent the money to her, then the suspense account can be credited with the amount. When she finds out who sent the money she can put her accounts right and credited the customer's account. A more important reason for opening a suspense account is when there is a difference on the trial balance, as you can see on the trial balance I made, that cannot be found quickly and corrected. The above trial balance resulted in the difference of £176 between the total debits and the total credits. There is usually a procedure that is followed to try and clear the suspense account as soon as possible. This is shown in the diagram below:



A02/3

I wont need to prepare a statement because we have not got the net profit in our figures but I will prepare a corrected trial balance. The £176 is written on the debit side of the suspense account as shown below:

DR	Suspense Account						CR
15/2	Balance	176	00				

Now that I have created a suspense account for Sally, I am going to produce a 'Journal' were the identified adjustments will be entered, each adjustment must be entered twice as it has to follow the rules of double-entry accounting.

(ii) I have identified all the errors and entered them in the Journal further down. Below are statements containing the information of the error and how it has been corrected.

Error 1: A cheque for £100, received from S Branson was credited to B Smale's account. The error here was that a cheque was credited into the incorrect account, B Smale's. To correct this I had to reduce the amount in B Smale's account by £100 this was done by debiting his account, then I had to credit S Branson's account with £100 to amend the error fully.

A02/3

Date	Details	DR(£)		CR(£)	
15/2	B Smale Account	100	00		
15/2	S Branson Account			100	00

Error 2: The second error that occurred was that £120 paid of general expenses had been correctly entered into the cash book, but had also been credited to the general expenses account. Sally should have debited the general expenses account, so I had to take the entry out once, post in the entry again and then credit it, this corrected the suspense account. To correct the rest of the error I had to debit the general expenses account with £240 and credit the suspense account also with £240.

Date	Details	DR(£)		CR(£)	
15/2	General expenses account	240	00		
15/2	Suspense account			240	00

Error 3: In this error a £14 discount allowed had been correctly entered in the debtors account but had been debited to the discounts received account. To correct this error I debited the discounts allowed account with £14 and then credited the discounts received account with £14.

Date	Details	DR(£)		CR(£)	
15/2	Discounts allowed account	14	00		
15/2	Discounts received account			14	00

Error 4: The fourth error was a £20 standing order for general expenses which had been omitted from her accounts. Crediting the bank account with £20 and then debiting the general expenses account with £20 corrected this omission error.

Date	Details	DR(£)		CR(£)	
15/2	Bank account			20	00
15/2	Suspense account	20	00		

Error 5: The last error Sally made was when a telephone expense paid by cheque for £32, was debited to both the cash book account and the telephone expenses account. By taking it out once and then posting it again and then crediting it, corrected the suspense account. Finally I credited the cash book with £64 and debited the suspense account with £64, which corrected this error.

Date	Details	DR(£)		CR(£)	
15/2	Cash book account			64	00
15/2	Suspense account	64	00		

Well done
102/3

Description	Ledger Balances		Adjustments (from Journal)	
	Debit (£)	Credit (£)	Debit (£)	Credit (£)
Sales		122 496		
Purchases	81 869			
Stock at 1 st June	41 082			
Wages	4 471			
Fixtures and fittings at cost	11 500			
Provisions for depreciation fixtures and fittings at 1 June 2005		2 450		
Bad debts	32			
Provision for doubtful debts at 1 June 2005		10		
General expenses	5 184		240	
			20	
Rent payable	2 750			
Drawings	1 533			
Sales returns	164			
Purchase returns		2 973		
Loan interest	600			
Capital		19 555		
Telephone expenses	1 244			
Loan at 12% per annum		10 000		
Cash in hand	139			64
Rates	2 675			
Light and heat	2 069			
Bank	3 284			20
Discounts allowed	388		14	
Discounts received		218		14
L Hill (debtor)	399			
S Branson (debtor)	593			100
B Smale (debtor)	408		100	
Royal Wordsley (creditor)		4891		
DK Ties and Badges (creditor)		743		
Carriage inwards	2 204			
Carriage outwards	572			
Suspense account	176		64	240
	163 160	163 336	438	438

I then took all of these figures and placed them in the correct columns in the journal.

The Journal					
Date	Details	DR (£)		CR (£)	
15/2	B Smale Account	100	00		
15/2	S Branson account			100	00
15/2	General expenses account	240	00		
15/2	Suspense account			240	00
15/2	Discounts allowed account	14	00		
15/2	Discounts received account			14	00
15/2	Bank account			20	00
15/2	General expenses account	20	00		
15/2	Cash book account			64	00
15/2	Suspense account	64	00		

Now I have worked out the errors and the accounts they should be in I will make another trial balance with adjustments columns and put the figures above in the adjustments column next to the appropriate descriptions.

Unit14: Constructing A Financial Strategy

(iii) The corrected trial balance as at 15 May 2006

Both the adjustments columns now balance and these adjustments can be put into the debit and credit columns of the trial balance to make them balance. I will now add the adjustments to the debit and credit columns to correct the trial balance. For example, as there were two changes to the expenses account and it had to be debited for the two errors I added the £240 and the £20 together and entered this as £260. I entered the £176 alongside suspense account in the description. This was the amount I needed to enter to balance the columns. General expenses of £5184 plus £260 = £5444, and so on.

	Debit (£)	Credit (£)
Sales		122 496
Purchases	81 869	
Stock at 1 st June	41 082	
Wages	4 471	
Fixtures and fittings at cost	11 500	
Provisions for depreciation fixtures and fittings at 1 June 2005		2 450
Bad debts	32	
Provision for doubtful debts at 1 June 2005		10
General expenses	5 444	
Rent payable	2 750	
Drawings	1 533	
Sales returns	164	
Purchase returns		2 973
Loan interest	600	
Capital		19 555
Telephone expenses	1 244	
Loan at 12% per annum		10 000
Cash in hand	139	
Rates	2 675	
Light and heat	2 069	
Bank	3 200	
Discounts allowed	402	
Discounts received		232
L Hill (debtor)	399	
S Branson (debtor)	593	
B Smale (debtor)	408	
Royal Wordsley (creditor)		4891
DK Ties and Badges (creditor)		743
Carriage inwards	2 204	
Carriage outwards	572	
TOTAL	163350	163350

It now balances.

*Well done
A02/3*

grid?

TASK D

(I) SALLYS EXTENDED TRIAL BALANCE AS AT 31st MAY 2006

	<u>Trial Balance</u>		<u>Adjustments</u>		<u>Profit and Loss</u>		<u>Balance Sheet</u>	
	DR (£)	CR (£)	DR (£)	CR (£)	DR (£)	CR (£)	DR (£)	CR (£)
Sales		£127,625.00 ✓				£127,625.00 ✓		
Purchases	✓ £85,429.00				£85,429.00 ✓			
Stock at June 2005	✓ £41,082.00				£41,082.00 ✓			
Wages	✓ £4,665.00				£4,665.00 ✓			
Fixtures and fittings	✓ £11,500.00						£11,500.00 ✓	
Provision for depreciation fixtures and fittings		£2,450.00 ✓		£1,725.00 ✓				£4,175.00 ✓
Bad debts	✓ £35.00				£35.00 ✓			
Provision for doubtful debts		£10.00 ✓		£38.00 ✓				£48.00 ✓
General expenses	✓ £5,667.00				£5,667.00 ✓			
Rent payable	✓ £2,750.00		£250.00 ✓		£3,000.00 ✓			
Drawings	✓ £1,600.00						£1,600.00 ✓	
Sales returns	✓ £171.00				£171.00 ✓			
Purchases returns		✓ £3,102.00				£3,102.00 ✓		
Loan interest	✓ £600.00				£600.00 ✓			
Capital		✓ £19,555.00						£19,555.00 ✓
Telephone expenses	✓ £1,407.00				£1,407.00 ✓			
Loan at 12% per annum		✓ £10,000.00						£10,000.00 ✓
Cash in hand	✓ £41.00						£41.00 ✓	
Rates	✓ £2,675.00			£1,050.00 ✓	£1,625.00 ✓			
Light and heat	✓ £2,104.00				2104 ✓			
Bank	✓ £4,735.00						£4,735.00 ✓	
Discounts allowed	✓ £419.00				£419.00 ✓			
Discounts received		✓ £351.00				£351.00 ✓		
Debtors	✓ £960.00						£960.00 ✓	
Creditors		£5,644.00 ✓						£5,644.00 ✓
Carriage inwards	✓ £2,300.00				£2,300.00 ✓			
Carriage outwards	✓ £597.00				£597.00 ✓			
Depreciation - fixtures and fittings			✓ £1,725.00		£1,725.00 ✓			
Bad debts			✓ £38.00		£38.00 ✓			
Prepayments			✓ £1,050.00				£1,050.00 ✓	
Stock (balance sheet)							£35,263.00 ✓	

Stock (profit and loss)						£35,263.00		
Accruals			✓	✓				✓
Net Profit/Loss			£250.00		£15,477.00			£250.00
								✓
								£15,477.00
Totals	£168,737.00	£168,737.00	£3,063.00	£3,063.00	£166,341.00	£166,341.00	£55,149.00	£55,149.00

This would have been
 preferably on one
 page - but well
 done, you are showing
 a clear understanding here
 of how to use accounts
 a prepayment. 102/3

TASK D SALLY'S TRADING PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING 31 MAY 20

	£	£
Sales		£127,625.00
Less: sales returns		£171.00
		£127,454.00
Less cost of sales		
Opening stock	£41,082.00	
Purchases	£85,429.00	
Less Purchase returns	£3,102.00	
	£123,409.00	
Plus: carriage in	£2,300.00	
	£125,709.00	
Less: closing stock	£35,263.00	
Cost of sales		£90,446.00
GROSS PROFIT		£37,008.00 (This is profit made before expenses)
Add discounts received		£351.00
		£37,359.00
Less: expenses		
Wages		£4,665.00
Bad debts		£73.00
General expenses		£5,667.00
Rent		£3,000.00
Laon interest		£600.00
Telephone		£1,407.00
Rates		£1,625.00
Lighting and heating		£2,104.00
Depreciation of fixtures and fittings		£1,725.00
Discounts allowed		£419.00
Carriage out		£597.00
		£21,882.00
NET PROFIT		£15,477.00

This is the figure shown on the extended trial balance so I know it must be right.

Well done.

Aoz/3

All I did was move the profit and loss figures from the extended trial balance to create Sally's Trading Profit and Loss account as at 31 May 2006

(iii) SALLY'S BALANCE SHEET FOR THE YEAT ENDING 31 MAY 2006

	DR (£)	CR (£)
FIXED ASSETS		
Fixtures and fittings	£11,500.00	
Less: depreciation		£4,175.00
		£7,325.00
CURRENT ASSETS		
Stock	£35,263.00	
Debtors	£960.00	
Prepayments	£1,050.00	
Cash	£41.00	
Bank	£4,735.00	
		£42,049.00
Less: Doubtful debts		£48.00
		£42,001.00
Less: Current Liabilities		
Creditors		£5,644.00
Add Accruals		£250.00
		£5,894.00
Working capital (CL-CA)		£36,107.00
		£43,432.00
Long Term Liabilities		
Loan		£10,000.00
Net Assets (FA-CA-CL-Long term loan)		£33,432.00
Capital		£19,555.00
Add: Net profit		£15,477.00
		£35,032.00
Less Drawings	£1,600.00	
Capital Employed (Net assets - drawings)		£33,432.00

*Well done
A02/3*

All I did was move the balance sheet figures from the extended trial balance to create Sally's Balance Sheet as at 31 May 2006

Dear & comprehensive understanding of how to draw up financial accounts - clear understanding of the accounts

Task D

Additional Information

1. Stock figure £35,263 = Credit column on profit + loss account
= Debit column on balance sheet

2. Rent = £250 per month. $£250 \times 12 = £3000$
paid £250 to much - month ahead. Have to put £250 in
adjustments under accruals credit side.

3. Loan goes on the balance sheet as its long term
liability to Sally, goes on credit side.

4. Closing debtors = £960.

Provision for doubtful debts 5%

5% of £960 = £48

Already £10 on trial balance = £38 to go on adjustment
column on credit side.

5. $£1800 \div 12 = £150$

only has 7 months pay for

$£150 \times 7 = £1050$

6. $£11500 \times 15\% = £1725$ adjustment column.

✓ workings

CONSTRUCTING A FINANCIAL STRATEGY UNIT 14

Task E,F

Task E

(i) Possible Templates and Layouts

As businesses need immediate access to their financial records, commercially produced accounts packages allow this provided that the information is entered correctly. These packages are produced to use on a computer and make the whole process simpler for the person using the software. The benefit of having computerised accounts is that they look more professional if the business has to show a bank manager, for example if Sally had to meet with a bank manager in order to gain finance for her expansion, it would look much better on her if she had a neat printed copy of her accounts rather than numerous pieces of paper with her accounts on. Also, they allow her to carry out what if situations so that she can see at a glance what would happen if she changed any of the figures. Another advantage is that if a transaction has been entered correctly the error can be corrected on the computer and it will automatically correct any totals or balances that may have been affected. This saves a lot of time because once a formula is put in then calculations take place automatically when Sally changes these figures. So she can see what would happen if say, for example, she cut down her expenses. It will show the effect this would have on her profits. I would advise Sally to carry out some research into small business computerised packages that would suit her business, as once she has purchased one of these packages, it will save her a lot of time in completing her accounts, and it will let her check her accounts at different times of the year to make sure that they are correct and to identify any errors that are made, as well as clearly showing her what her debtors and creditors figures are.

A03/3

When choosing an accounting package there are several factors that the owner would need to consider, firstly she would need to consider the short and long term use of each package to her business and if it will be appropriate to Sally's performance, for example an accounting package that only works with ten employees may be suitable for the short term but when the business employs more people they will have to purchase another package. So it is important that Sally thinks carefully about the reasons she wants the package and the different ones there are available so she can choose the one that suits her business the most. If she decides to purchase a package she has to think about the computer she has. Is it ok for her to use with the package. It could mean that she might have to invest in another type of computer, or if she

A03/3

hasn't got one then buy one for this purpose. Another important point to consider is which package the businesses accountant uses, this probably will not be an issue for Sally as she has not received much financial advice so far, but for other business if they are using the same or similar package to their accountant then they can transfer their accounts to a disk and just give the accountant the accounts at the ends of the year to prepare the yearly accounts, this will also cost the business less in paying for an accountant.

A03/3

There are three main accounts packages I have identified that are specifically aimed at small businesses. The first is MYOB which costs from £195, this comes with a free download trial so Sally can try the package out and see if it suits her business. The second package I researched is Sage which costs from £99. This is a well known package and it is aimed at business with ten employees or less and also has a support infrastructure. Also from an extra £85 the business can get cover that allows them to have contact with experienced Sage advisors for a year, so that if they have any problems with the package they can sort it out straight away. This is a very important consideration for Sally as she will need to know that there is someone she can ask if she is having any trouble. A further package I researched is TAS which is the cheapest I could find and costs from £69, and this has had the biggest impact on accounting in the UK in the last two years.

A03/3

gathered data

A03/3

(ii) Legal Requirements

As Sally is a sole trader there were no legal formalities she had to undertake when setting up her business, unlike other businesses such as a limited business which have to register their business with Companies Houses. However Sally was required to inform the government that was going to be self-employed. Apart from this Sally as a sole trader Sally started trading straight away as she required no licences for her business to run unlike other businesses which sell products such as alcohol who require a licence to sell it. However she has some legal responsibilities now that her business is established. Sally must pay two types of tax, the first is income tax. The amount of income tax a business has to pay is dependant on the tax band its income falls into. The table below shows the bands and limits:

A03/3

<i>Income Tax Band</i>	<i>Income Tax rate on earned income</i>
£1 to £2,230	10%
£2,231 to £34,600	22%
£34,601 and above	40%

In Sally's case this is £15,477.00, falling in to the 22% tax band. It is also required for Sally to pay National Insurance contributions from the profits earned, the Inland Revenue assesses how much Sally's business will have to pay.

Sole traders have unlimited liability and therefore if the business gets into debt then the owner will have to cover the costs, in some cases this can lead to owners having to sell their homes to pay of a business debt. The best way for Sally to avoid this is by keeping accurate records, this will help as she will be able to see from her accounts, (such as the profit and loss account) how her business is performing. Also Sally has to keep her final accounts accurate as she will have to send them off to the Inland Revenue for VAT at some point, if any errors are found or if it appears that the accounts are misleading on purpose Sally could face a fine.

Businesses are not automatically VAT registered as they are not required to pay VAT until their turnover reaches a certain limit over a period of a year, currently the 'VAT threshold' is £64,000 for the tax year 2007/2008. When Sally is at the threshold of £64,000 turnover, it is legally required for her for her to register for VAT and send the Inland Revenue her accounts, failure in Sally being fined, and also possibility of facing further legal action. It is important then that Sally keeps an eye on her figures to make sure that she doesn't go over the VAT threshold without knowing. Some businesses will try and operate just below the VAT figure so that they do not have to be registered.

Sally also needs to be aware of legal obligations that may affect her in the future when developing her business. For instance Sally feels that the current size of her shop is restrictive and therefore may want to expand, if this is the case then Sally should understand that she would have to gain planning permission. After expanding it is likely that Sally will need to employ other staff. If Sally decides to do this she will

have to comply with all the health and safety legislation and employment legislation. She might also find that her insurance increases when she takes on more staff or expands and its important for her to think about the extra costs to her business of doing this.

A03/3

Ideas from research
are brought together
into a complex whole &
demonstrate clear
understanding.

Task F

I have calculated ratios for Sally's business ending the year on 31st May 2006, I have used the final accounts from this year to assist with working out these ratios. Below are the ratios, their formulas and how I worked out each one in context of Sally's business.

1. Gross Profit Percentage

Formula:
$$\frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \text{Gross Profit Percentage}$$
 ✓

Working:
$$\frac{£37,008.00}{£127,625.00} \times 100 = 29.27\%$$
 ✓

2. Net Profit Percentage

Formula:
$$\frac{\text{Profit before Tax}}{\text{Sales}} \times 100 = \text{Net Profit Percentage}$$

Working:
$$\frac{£15,477.00}{£127,625.00} \times 100 = 12.13\%$$
 ✓

3. Return On Capital Employed

Formula:
$$\frac{\text{Profit before Tax}}{\text{Capital Employed}} \times 100 = \text{Return On Capital Employed}$$

Working:
$$\frac{£15,477.00}{£33,432.00} \times 100 = 46.29\%$$
 ✓

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4. Debtor Collection Period

Formula:
$$\frac{\text{Final Debtors}}{\text{Credit Sales}} \times 365 = \text{Debtor collection period}$$

Working:
$$\frac{£960}{£127,62.50} \times 365 = 27.45 \text{ days}$$

5. Creditor Payment Period

Formula:
$$\frac{\text{Final Creditors}}{\text{Credit Purchases}} \times 365 = \text{Creditor Payment Period}$$

Working:
$$\frac{£5,644.00}{85,429.00 \div 100 \times 95 = 81157.55} \times 365 = 25.38 \text{ days}$$

6. Current Ratio

Formula:
$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

Working:
$$\frac{£42,049.00}{£5,894.00} = 7.13:4$$

7. Acid Test Ratio

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

Working:
$$\frac{£42,001.00 - 35,263.00 = £6738.00}{£5,894.00} = 1.14:3$$

1.14:3

8. Stock Turnover

Formula:
$$\frac{\text{Average Stock}}{\text{Cost of Sales}} \times 365 = \text{Stock Turnover}$$

Working:
$$\frac{41,082.00 + 35,263.00 \div 2 = 38172.5}{90,446.00} \times 365 = 154.05 \text{ days}$$

I have put the calculations of my ratios into a table alongside the ratios provided for the previous two years of Sally's business; I have grouped the information according to the type of ratio, i.e. profitability, solvency and performance. This means that I can see at a glance the changes in the different types of ratio.

	Year Ended 31 st May 2004	Year Ended 31 st May 2005	Year Ended 31 st May 2006
<u>PROFITABILITY RATIO</u>			
Gross Profit Percentage	34.78%	40.12%	29.27%
Net Profit Percentage	12.65%	18.23%	12.13%
Return On Capital Employed	23.78%	45.11%	46.29%
<u>PERFORMANCE RATIO</u>			
Debtor Collection Period	44 days	53 days	27 days
Creditor Payment Period	18 days	22 days	25 days
Stock Turnover	105 days	139 days	154 days
<u>SOLVENCY</u>			
Current Ratio	6.53:1	6.95:1	7.13:1
Acid Test Ratio	0.58:1	0.89:1	1.14:1

Now that Sally's business has been trading for three years she can use the ratios to compare them to previous years, this is a useful tool to assess how her business is performing. Sally has focused on three main types of ratios, these are profitability, performance and solvency.

It is usually preferable for a business to have a high and increasing gross profit as this shows the stakeholders such as employees or potential investors that the business is performing well, and that it has control over the cost of its purchases. Sally's gross profit percentages for the latest year 2006 is 29.27%, this is down 10.85% from the

A03/3

previous year, 2005. It is better for businesses to have higher gross profit margins than lower ones. To determine whether her gross profit margin is good Sally should think about comparing this with other similar business. Her figures also show that her stock turnover is slower which has probably contributed to this lower figure because usually the quicker the turnover of stock the lower the gross profit margin will be. For Sally, the aim of her business for the first three years is survival and as a result profitability has not been a main focus for Sally. This may be a reason why her gross profit has fallen and not stayed steady during her first three years of trading. Improving her profitability is important because she will then be in a better financial position to think about expansion.

A03/3
analysis/int

Sally's net profit percentage has also dropped from 18.23% in 2005 to 12.13%, this is a 6.1% decrease. Similar to gross profit, higher net profit percentages are usually preferred. The net profit helps Sally to measure how well she can control her overheads. The fact that Sally's net profit has decreased shows that she does not have control over her overheads. In the next financial year 2007 when Sally plans to change her strategic aim to improve her profitability Sally will need to plan a method of ensuring she has control over her overheads otherwise her net profit will continue to decrease.

analysis/int

A03/3

The last profitability ratio Sally uses for her business is 'return on capital employed', this shows the relationship between the capital invested into the business and the net profit of the business. The percentage rate for Sally's business has increased continually through her three years of trading. It has increased from 23.78% in 2004, to 45.11% in 2005 and to 46.29% in 2006. Although these figures have increased, the amount increased from 2005 to 2006 was only 1.18%, compared to the 21.33% increase from 2004 to 2005. This smaller increase is due to the net profit decreasing by 6.1% from 2005 to 2006, therefore the return on capital employed is not going to be as great an increase as previous years. Stakeholders in the business will be able to see that although there has been a slight increase in the ROCE it is not as great as the year before. Therefore, Sally needs to address this issue.

analysis/int

A03/3

As Sally wants to expand her business in the future it is important that her profitability ratios are high so she has a better chance of not only having the

opportunity to expand, but also of attracting investors interest in her business, as a higher net profit and return on capital employed will reflect positively on the business.

The 'debtor collection period' measures the efficiency of Sally's credit control system. It calculates the average number of days it takes Sally (or any other business) to collect the debts from her customers. Sally's business has improved massively through her three years of trading, going from 53 days in 2005 to nearly halving it in 2006 with an average of 27 days. This indicates that Sally must have an effective system of credit control. This is beneficial to Sally as 95% of her shops purchases are brought on at least one month's credit, as it takes her an average of 27 days to receive her money from customers, it is unlikely she will experience cash-flow problems as she is receiving money to help pay off her suppliers in time.

analysis: /inter
A03/3

The number of days it takes for Sally to receive payment from her debtors has improved but her time for paying for her purchases has increased slightly from 18 in 2004, to 22 days in 2005 and finally 25 days in 2006. From the 'debtor collection period' ratios it appeared that Sally could collect the money owed to her in time to pay off her creditors, however from the results of this ratio it appears that this is not the case. This highlights one of the limitations of ratios, that they do not give reasons to justify the ratios. Sally needs to monitor her payments because if this time continues to increase and she is not aware of this, then it could lead to difficulties for her. It is possible that if her creditors are not paid on time, then she may not be able to continue using the credit system. Also, it does not give her a good reputation. Furthermore, if Sally misses the time she is allowed to gain discounts, then this will increase her outgoings.

analysis /
eval.
A03/3

Stock turnover calculates the number of days it takes a business to sell its stock. In 2006 Sally's 'stock turnover' was 154 days. Since she started trading in 2004 this amount of days has risen from 105 days in 2004 to 154 in 2006. This may explain why Sally's 'creditor payment period' is increasing as it is taking longer for Sally to sell her stock. This will impact on Sally's profit, for example in 2005 Sally's net profit was 18.23% with a stock turnover of 139 days, whereas in 2006, with a stock turnover of 154 days, Sally is making 12.13% net profit. Businesses with a higher stock turnover can earn their profit on the sale of stock quicker.

interp.
analysis

eval.
A03/3

The ratios for 'stock turnover' don't take into account that the demand for Sally's uniforms is not going to be in high at all times, it will have peak times in August and September when parents are purchasing their children's uniform for the new school year, but there will be times when demand is low, for example in October demand will be lower as the majority of people will already have new uniforms. If the council's planning committee goes ahead and builds a supermarket Sally's stock turnover will be further affected as uniform will be available there and some parents may find it convenient to buy uniforms whilst buying their groceries.

Analysis

The overall performance, according to ratios, is quite negative as the time it takes her to pay creditors back is increasing as is stock turnover. Although Sally can collect her debtor payments increasingly quickly she is not selling her stock quick enough to pay back creditors quickly enough, this will lead to serious financial problems in the future.

analysis

It is essential that Sally (and any other business) has enough 'liquid assets' to pay any immediate bills that may appear. Liquid assets include cash and assets that can be quickly turned into cash like stock and debtors. 'Current ratios' use the current assets and a current liability to calculate if a business has sufficient 'liquid' resources. Sally's current ratio stands at 7.13:4 in 2006, increased from 6.32:1 in 2004 and 6.95:1 in 2005. It appears that Sally has too much money tied up in stock, as it is suggested anything over 2:1 is 'tied up' it can't generate any return compared to it being in the bank. As Sally's 'stock turnover' is high it re-instates the point that money is tied up in stock, this is money that Sally could leave in the bank herself and earn interest on or invest it in something else for instance her online and telephone sales system.

analysis

The acid ratio test is also to measure liquidity but is more severe, and because stock is not guaranteed to be sold, they are removed from this ratio. The purpose of this is to check whether or not a business such as Sally's will still have sufficient liquidity (without stock) to pay off immediate debts. It indicates as to whether or not a business may find it hard to pay its current liabilities on time. Stock is not always guaranteed to

interp

be sold, although as a school outfitter Sally should not find stock left on her shelves due to changes as would some other clothes retailers. School uniforms are usually stable. There are variations in industry as to what figures are best but generally retailers who have a strong cash flow will find that they can operate effectively with an acid test ratio of less than 1. However, when the liquidity is higher then businesses like Sally need to think about problems of having surplus cash.

analysis

Ratios are a very useful tool for analysing different financial aspects of the business, profitability, performance and solvency. However, although they are useful they are only of any use when there are previous ratios to compare them with, or if comparing with competitors, their ratios. Ratios can only be compared to other businesses if they have a similar business, for instance if Sally wanted to see how her ratios compared to other business she could only do this with another school outfitter as they are in the same business and are likely to operate in a similar way. Ratios are based on information from final accounts and documents, mainly the closing profit and loss account and the balance sheet for that particular year, therefore they rely on the fact that the documents are correct. Even if these accounts are correct then there may still be factors that can affect the quality of the financial information, for instance if there is a change in the value of money due to inflation, prices will rise which might cause asset values and turnover to increase in money terms. However when these figures are adjusted from the inflation there might not be an increase in real terms. As ratios do not show this, this may distort comparisons between different periods of time. As ratios are based on quantitative information, any qualitative information is ignored. For instance if there had been inflation and it may appear that the value of the fixed assets and turnover has increased, there will be no explanation in the ratios for the sudden increase, as far as stakeholders would be aware this increase could have come simply from a good year of business. Sally's business is currently facing indirect threat of a proposed supermarket store that would sell some school uniforms, Sally's increasing stock turnover may in the future be a result of customers shopping at other places like the supermarket, ratios don't take into account possible constraints Sally may have such as being situated in a bad area where there is a lot of competition. In order to evaluate and analyse a businesses performance effectively, both quantitative and qualitative reasons needs to be considered.

analysis
interpret

A03/3

interp.

A03/3.

Well done - clear understanding ✓
of ratios analysis which
you have discussed in the
context of Sally's business

Bibliography

- 'Business Studies Third Edition' – Dave Hall, Rob Jones, Carlo Raffo
- 'A2 Level for OCR Applied Business' Catherine Richards, Rob Dransfield, Neil Richards and Karen Hough.
- Business Accounting – Rob Jones
- www.bytestart.co.uk
- Plus other websites to try and find information on accounting packages

CONSTRUCTING A FINANCIAL STRATEGY UNIT 14

Task G

Task G

Sally's strategic aim for her first three years of trading was to survive, she has achieved this. Now into her fourth year of business Sally has changed her aim to improve the profitability of her business. The current state of Sally's profitability is more negative than positive, because from 2005 to 2006 both net profit and gross profit has decreased, net profit by 6.1% and gross profit by 10.85%. The only part of Sally's profitability that has improved is the return on capital employed. To meet her new aim of improving profitability there are a number of different things Sally can do through different areas of her business.

Sally's solvency ratios (liquidity ratios) assess the ability of her business to pay its bills. They focus on the short-term assets and liabilities of her business. If Sally wishes to apply for a loan for the expansion that she would like, then the bank would be interested in her liquidity ratios to help them make their decisions. Her suppliers are also interested in these figures as they can help them to decide whether her business is good for credit. Sally herself will use them to make sure that her business has enough liquid resources (money flowing around the business) for her to operate efficiently. Sally's liquidity ratios are good and show that she is running her business efficiently and that she can meet her bills. She has enough funds to pay the day to day bills such as wages and invoice due for payment of materials. It is also important that she has enough liquid assets, such as stock, to make sure that her business runs well and that any orders or requests can be given to customers on time. Sally's is a small business and she needs less working capital than a large business. I worked out the working capital on Sally's balance sheet. The current ratio is high at 7.13:1 as it is said that current ratio should be between 1.5:1 and 2:1. If Sally had a low figure then this could indicate that she runs the risk of running out of liquid assets and this would mean that she might find herself in a position when she cannot pay her bills. For a figure to be more than 1:1 you could say that she has too many current assets and she could put those assets to better use which would help her to improve her profit. She could run her stock levels down, or reduce her debtors or even buy more equipment for her business.

The acid test ratio of 1.14:1 is a more realistic figure that shows her liquid assets without stock. Stock is the most difficult liquid asset to change into cash at short

2020/2021

404/3

notice, and by excluding stocks the acid test ratio gives a better measure of her short term liquidity than her current ratio. This sort of figure gives her sufficient liquidity to run her business efficiently and paying her bills on time. ✓

As her liquidity ratios are too high then it proves that she has too much liquidity. She could have too much cash and would be advised to invest some of this excess cash in either cost saving equipment to help her earn higher profits. This is a reason why she should invest in technology and creating web pages for her business. Sally has not many debtors but it is always wise to make more effort to collect debts on time. ✓

A04/3
part

As Sally's stock turnover is high, this means that she is hanging on to her stock too long and she should be selling this at a faster rate. Stock turnover is very important because the quicker her stock is used up the faster the stock turnover and the more efficiently the business will be using its resources. Sally's turnover of stock is slow and means that she has money tied up in this, which she could be using elsewhere, for example, she could use some of this money to pay off her loan, which will then reduce her expenses. Although some businesses turn stock over quickly Sally's school uniforms are more or less seasonal, and there is an upturn in her sales in the summer months up to September. If Sally can focus on increasing sales, and this can be achieved through the marketing campaign I have suggested and the introduction of selling on-line, as well as maintaining the same level of stock, her stock turnover will improve. ✓

A04/3

Given the current external influences on Sally's business I think that the next option is the most suitable for Sally. Sally's business is situated in an area which has bad public transport, this stops more customers purchasing their uniform from her. As well as this Connalton High School, which is a large school, is considering to change its uniform to be less restrictive, to a polo shirt and jumper, this could result in a considerable decrease in the demand for items such as school trousers and shoes, this would have a direct effect on profit and stock turnover as less of these items would be sold compared to before. I have already shown that Sally needs to turn her stock over more quickly, and because of the changes externally she might consider stocking more general uniform, although she cannot price this as cheaply as the large companies can, but her reputation and personal service is always attractive to customers. This is because the most important external factor is that the local

A04/3

council's planning committee is planning to build a supermarket just seven miles away from Sally's business, the supermarket would also stock school uniform. This is a serious threat to Sally as many parents lead busy lives and so may find it more convenient to purchase their child's uniform whilst they are also doing their food shop.

Considering these threats and the fact that Sally aims to improve her profitability, I think Sally would be advised to think about a marketing campaign. This would get her business recognised by more of her target market and persuade them that they should buy their uniform from her shop, therefore increasing profit. Sally has already got a good reputation as she has started to gain customers from a primary school in a nearby village, as they have heard about the high quality of clothing that Sally provides, as this is what her target market seems to want she should emphasise this in her marketing campaign.

Sally's policy of selling high quality clothes at a low mark up could be having an influence on the fact that it is taking her longer to pay back her creditors, as she is selling the products at a low price she is not making as much profit as she could be, and therefore is finding it difficult to pay them back. Sally should research into finding new suppliers that offer a similar quality but at a cheaper price. If she can't find this she should try and find creditors with a longer payment period. However if Sally's marketing campaign is successful then her stock turnover will increase as will the gross profit which will mean that she can pay back suppliers quicker. This will increase Sally's net profit as she will be able to get trade discounts which will decrease her overheads.

Sally feels that the current size of her business is restrictive, as she is already paying off a loan of £10,000 which is costing her £600 a year in interest. Sally should try to avoid taking out another loan whilst she is paying off this one as she will have to pay back more interest which will increase her expenses and then decrease her net profit. Whilst Sally is focusing on increasing her profits I think that she should start saving some of her profit to put towards expanding her business physically as in the size of her shop. She can however expand her business in other ways which will increase her profit. Sally should consider getting her partner Sunil Shah involved in her business

Consider have
cd pay of
her loan
or decrease
her exp.

A04/3.

A04/3.

as he is a web designer he could create Sally a professional website on which people can place orders, this may be more convenient to her target market and also attract people who wouldn't usually buy from Sally's shop due to the area they live in i.e. a long distance from the shop. Part of her marketing campaign could be to target the local schools. She should get in touch with these schools and propose that she sells her uniform not only on parents evenings and new intake evenings, but also supplying the schools with some bulk uniforms so that they are always available for parents when they want them. She could also offer an ordering service straight from the schools. She could produce leaflets to give out at new intake evenings and other special evenings at school, and also distribute these in the local community. She could also place an advert in the local free papers. By doing this Sally will not only generate more interest in her business, and get herself more known, she will also generate more profit and a bigger customer base without actually expanding the physical size of the business. This is important because she hasn't the room for extension in the shop. It could be that she needs to redesign her shop to make use of all the available space she has.

A04/3

Sally's new objective should be to focus on increasing her profits for the next three to four years, after this she should focus on physically expanding her business by either making her shop bigger or by opening another shop in a different area, this decision will depend on how well she manages to improve her profit by. Failure to expand her business in this way will mean that her business will be restricted to its current size and won't be able to get bigger and will continue to be under threat from the supermarket and other large retailers. As well as this if Sally's orders from either the internet, by phone or from school becomes popular Sally will not have enough room in her shop to stock her orders and her current stock to sell in the shop, this will mean that she will have to eventually (if she does not expand) rent storage space which will then mean more overheads and therefore less profit.

I think that the most effective way for Sally to improve her profit in the future is by investing excess money in marketing as she is facing a lot of external threats, therefore she needs to build up her customer base even more, as she has a good reputation this will work in her favour, as will her being able to collect money from her debtors quickly. If she continues to collect the money from her debtors quickly and

she makes an effort to reduce her expenses, and her sales increase due to the marketing campaign, this will mean that Sally will be able to pay back her suppliers quicker, benefiting from trade discounts. More sales will also mean that there is higher stock turnover, this is good for Sally's business as she is selling school uniforms certain elements of them like for example school trousers tend to change as fashion does, this means that if Sally's stock is turned over at a faster pace she is not keeping the clothes for too long and therefore is not keeping out dated clothes. If she had out dated clothes she would have to reduce them and sell them in a sale, this would reduce profits as Sally is losing money on her stock this is the danger of leaving excess money tied up in stock.

In conclusion, Sally's solvency is good, although there is wastage here and she can put her liquid resources to better use. Performance ratios show that she can improve the efficiency of her business, by reducing her stock turnover time so that unwanted uniforms are not left on the shelf. Her business is efficient and she has reduced her debtors collection period, although she is taking slightly longer to pay her creditors.

Well written
reasoned & logical
conclusions

A04/3