OCR
RECOGNISING ACHIEVEMENT

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced GCE

BUSINESS STUDIES 2875

Further Accounting and Finance

Wednesday **26 JANUARY 2005** Morning 1 hour 30 minutes

Additional materials:
Answer Booklet

TIME 1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Write your name, Centre number and candidate number in the spaces provided on the answer booklet.
- Answer **all** questions.
- Write your answers on the separate answer booklet provided.
- If you use extra sheets of paper, fasten these sheets to the answer booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [ ] at the end of each question or part question.
- The total number of marks for this paper is 60.
- You will be awarded marks for the quality of written communication where an answer requires a piece of extended writing.

This question paper consists of 4 printed pages.

SP (CW/SLM) S83895/2

[Turn over

Dream Ski Shops (DSS) plc

Adam Birtwistle opened his first shop in 1998. His concept was a ski equipment and clothing shop selling specialist and fashionable leisure wear. Since then the business has grown significantly and now comprises 20 stores throughout the country, with more being planned. Adam set two basic targets for the business to achieve:

- a rate of return on capital employed of 20%;
- annual sales turnover growth of 15%.

The company went public in 2000. However 2004 was a difficult trading year. Turnover continued to grow largely because of the opening of four new stores, but for the first time the company did not enjoy a similar growth in operating profits. Table 1 shows the most recently published profit and loss accounts for the company.

Table 1
Dream Ski Shops plc Consolidated Profit and Loss Account
Year ending 31 December [£000s]

	2004	**2003**
Turnover	**17,800**	**14,162**
Cost of sales	(9,100)	(7,500)
Gross Profit	**8,700**	**6,662**
Administration overheads	8,000	5,100
Operating Profit	**700**	**1,562**
Tax on profits	287	640
Net Profit after tax	**413**	**922**
Earnings per share	**7.5p**	**15.2p**
Dividends per share	**6p**	**11p**

Table 2 provides a summary of the balance sheet for the company.

Table 2
Dream Ski Shops plc Summary Balance Sheet
as at 31 December [£000s]

	2004	**2003**
Fixed Assets	**4,280**	**2,824**
Current Assets	4,957	4,032
Current Liabilities	4,900	3,257
Net Current Assets	**57**	**775**
Net Assets	**4,337**	**3,599**
Long term liabilities	**2,600**	**1,999**
Shareholders funds	**1,737**	**1,600**
Capital Employed	**4,337**	**3,599**

Stock was valued at £2,500,000 on 31 December 2003 and at £3,755,000 on 31 December 2004

The notes to the accounts of the company also contained the following:

- stock is valued at the lower of cost or net realisable value;
- depreciation of fixed assets is calculated at the rate to write off the costs, less estimated residual value, evenly over their expected useful life as follows:

    1. Land/buildings over lease term;
    2. Fixtures between 5 and 15 years;
    3. Motor vehicles over 5 years.

At the recent AGM a number of shareholders had been critical of the performance of the management. They based their criticism in part on the evidence shown in Fig. 1.

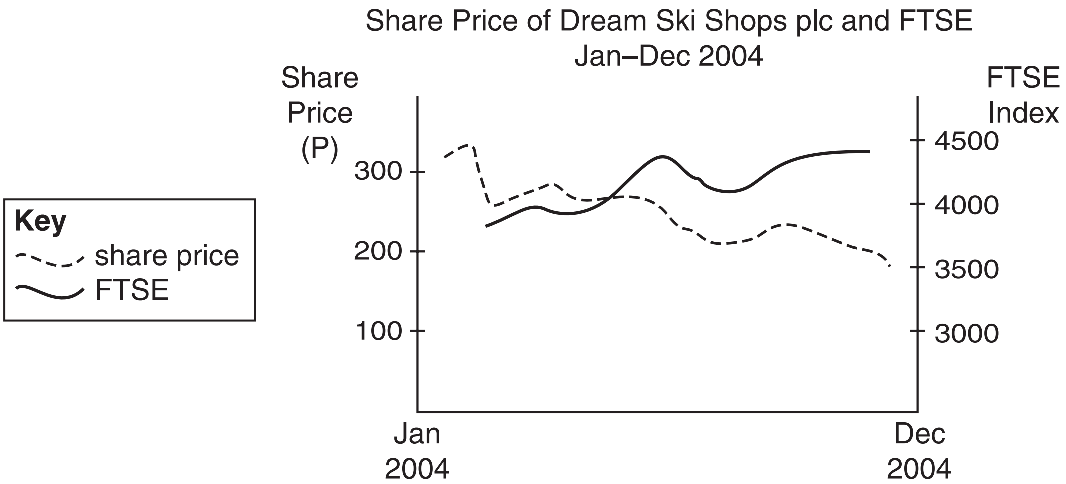

Fig. 1

Adam is examining ways of improving company performance. He has recently introduced a new management reporting system designed to monitor stock turnover rates. Table 3 is an extract from the system piloted at the Leicester branch.

Table 3

Oct – Dec 2004 [£]

	Target Sales	Actual Sales
Ski equipment	55,000	24,000
Ski wear	95,000	60,000
Leisure wear	200,000	130,000
Accessories	19,000	25,000
Total	369,000	239,000

Adam is aware that certain stock lines are not selling well. This is particularly true of some leisure wear products. He knew that competition in these product lines was particularly severe and had resulted in problems of stock build ups that had prompted a strategy of substantial price discounting with only limited success. His management advisors suggested that he should use variance analysis to help assess the situation.

Adam has also been looking carefully at the criteria used to justify new shop developments. Two proposals are being considered regarding the opening of new stores in Newcastle and Wolverhampton. The company does not have the funds to proceed with both, so a choice has to be made. A partial investment appraisal for both stores has been carried out and provisional results are shown in Table 4.

[Turn over

Table 4

	Newcastle	Wolverhampton
Initial cost	£900,000	£550,000
Annual Running costs	£650,000	£475,000
Projected annual cash inflow	£950,000	£700,000
Pay Back [years]	3 years	2 – 3 years
Net Present Value	?	+ £222,200

DSS plc has investment criteria which state that the return on capital must be a minimum of 14% and that projects must be profitable within 4 years. Table 5 gives the discount factors at 14% for 5 years.

Table 5

Year	D.F. @ 14%
0	1
1	0.877
2	0.769
3	0.675
4	0.592
5	0.519

Answer all questions.

1 DSS plc owns 10 vehicles. Its policy is to keep them for 5 years. These vehicles were bought for £20,000 each and have an estimated residual value of £5,000.

(a) Calculate the total annual depreciation on the 10 vehicles owned by DSS plc. [4]

(b) (i) Analyse the performance of an investment in the shares of DSS plc from the view of a shareholder buying 2000 shares at £3.05 in January 2004. [6]

(ii) Evaluate the success of DSS plc in the financial year ending 31 December 2004 from different stakeholders' points of view. [16]

(c) Calculate the net present value of the Newcastle store and, with reference to Table 4, advise the management of DSS plc whether to proceed with either store. [10]

2 (a) Analyse why stock might be valued at the lower of cost or net realisable value on the balance sheet of DSS plc. [6]

(b) Should Adam introduce the new reporting system to help monitor stock turnover (lines 47–48)? Justify your view. [16]