

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced GCE

BUSINESS STUDIES

2875

Further Accounting and Finance

Thursday **26 JANUARY 2006** Morning 1 hour 30 minutes

Additional materials:
8 page Answer Booklet

Candidates may use calculators in this examination.

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.
- 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 3 printed pages and 1 blank page.

Upton Furniture Company Ltd. (UFC)

“Business is getting tough,” said Nigel Upton, Managing Director of Upton Furniture Company Ltd (UFC). UFC is a family run limited company specialising in the production of office furniture. One of the company’s best selling products is an office chair (model BX10). “Even sales of this are falling,” said Nigel. “Customer loyalty is not what it used to be and people buy largely on the basis of price not quality. We are only operating at 75% capacity in the BX10 department.” 5

Nigel was looking at some financial data produced for him by the company’s financial accountant (see Table 1).

Table 1

Financial Data for Office Chair model BX10 (2005)		10
Sales volume	150,000 units (chairs)	
Unit selling price	£134	
Material cost per unit	£50	
Labour cost per unit	£30	
Allocated overheads	£5m	15

The sales volume of these chairs was expected to fall by 5% in 2006, while direct costs were expected to rise by 5%. No selling price increase was anticipated, neither were changes to allocated overheads. UFC allocates overheads equally between all the product lines manufactured by the business.

Nigel was interested in an enquiry from Poland for BX10 office chairs. A potential customer from Krakow had contacted UFC and said that he was prepared to place a one-off order for 200,000 chairs at a non-negotiable price of £125. All the chairs would have to be delivered by the end of 2006. UFC’s accountant was still looking at the implications of the order but estimated that an additional £100,000 distribution cost would be incurred by its acceptance. What was certain was that the acceptance of the order from Poland would have an impact on UFC’s existing UK contracts. 20 25

For a number of years UFC had been troubled by cash shortages. Nigel had been in discussion with his financial advisors and the outcome was that a strategy of raising finance had been agreed. This, however, had increased the gearing ratio of the business. Nigel was not sure that he fully understood the implications of this, although he was aware that UFC’s costs had increased. However, the strategy had provided much needed funds to help modernise production in parts of the factory. 30

The production manager has requested that a Computer Aided Design [CAD] system be purchased at a cost of £2m. It has an expected life of four years with a residual value of £0.4m. Annual cost savings of £0.6m are forecasted. However, cost savings are always difficult to forecast. Furthermore, if the CAD system were to be purchased, other improvements to production line methods would have to be delayed. UFC has an investment requirement of a 10% return on capital. The financial accountant has been asked to carry out a full investment appraisal of the CAD system before any decision is made. 35

Table 2 gives the future values of cash flows discounted at different interest rates.

40

Table 2

Present day values of £1				
Year	1	2	3	4
10%	0.9091	0.8264	0.7513	0.6830
14%	0.8772	0.7695	0.6750	0.5921

45

Answer **all** questions.

- 1 (a) If the order from Poland is **not** accepted, calculate the break even volume for Chair model BX10 in **2006**. [4]
- (b) Assess the usefulness of break even analysis in helping the management of UFC in making business decisions. [10]
- (c) Analyse the basis by which UFC's management allocates overheads. [6]
- (d) Should UFC accept the order from Poland? Justify your answer. [16]
- 2 (a) Analyse the implications for UFC of an increase in its gearing ratio. [6]
- (b) Using both quantitative and qualitative information, advise UFC whether to proceed with the purchase of the CAD system. [16]

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