

**ADVANCED GCE UNIT
BUSINESS STUDIES**

Further Accounting and Finance

FRIDAY 26 JANUARY 2007

2875

Morning

Time: 1 hour 30 minutes

Additional materials: Answer Booklet (8 pages)

Candidates may use calculators in this examination



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 document consists of **4** printed pages.

Dreamwater Hotel

Henry and Rita manage the Dreamwater Hotel in the South West of England. Rita looks after the financial side of the business and Henry focuses on the day to day operations and marketing. The Hotel is part of a group owned by Beerhead plc. Beerhead's management at Head Office have been setting tougher financial targets of late and Rita, in particular, has felt under great stress. She and Henry are analysing the latest set of figures (Table 1) regarding the Hotel's finances for the last 12 weeks of 2006 and the data does not make for happy reading.

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Table 1

Dreamwater Hotel Financial data Last 12 weeks 2006	
	£
Turnover	100,800
Cost of Sales	60,000
Gross Profit	40,800
Overheads	36,000
Depreciation	10,000
Net profit	(5,200)

10

15

A footnote from the accountant stated that depreciation of capital expenditure on assets, such as hotel furniture and equipment, was on a straight line basis.

The Dreamwater Hotel is a small hotel which can only accommodate 60 people. Over the last 12 weeks of 2006 the average occupancy rate was 25% and the charge is £80 for Dinner, Bed and Breakfast per person, per night. As well as residents, the Hotel also attracts outside customers to its restaurant and bar, although in the winter months these outside customers do not generate any net income.

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Henry and Rita then looked at the budgets that Head Office had sent them covering the same 12 week financial period. Head Office had set them a target of 40% occupancy and a gross profit margin of 45%. The shortfall in profit did not look good, despite the fact that the budgeted overheads and depreciation came in on budget.

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Head Office had also told them that in future the overall performance of the Dreamwater Hotel should be assessed in terms of profit centres. The profit centres are to be the accommodation, the restaurant and the bar. Rita had always looked at the business as a whole and had never analysed performance in greater detail. She was worried about what the change might mean.

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The management of Beerhead plc had been seeking to improve the profitability of its business for some time. They had decided that much tighter financial control had to be implemented over the management of its hotel and restaurant outlets. Targets for a whole range of variables such as occupancy rates, sales turnover, and return on net assets had been set and they believed that this would aid financial performance. They believed that these changes were needed in a group with such a diverse range of business activities, including a number of large city centre hotels, as well as small individual hotels such as Dreamwater. The changes had created a number of problems initially but Beerhead's senior management believed that they were only short term difficulties. Only time would tell. What is certain is that Rita is getting very agitated with the centrally imposed Head Office targets. 35 40

Henry and Rita had recently put a proposal to Head Office for a substantial renovation of the whole Hotel. Their proposal would mean an investment of £2m. Head Office had been unimpressed. "Unless you can increase the return on net assets significantly, we will not finance this scheme," had been the response. "Currently you are falling well below it. You have to demonstrate that the potential for much greater profitability is there." 45

Henry had been planning a few new initiatives to boost profits and to demonstrate to Head Office that sales could be improved. He showed Rita some costings that he had done for a two night themed weekend in Spring 2007. 50

Table 2

Financial Data for themed weekend	
Customers per weekend	60
Price per weekend break per customer	£150
Contribution per customer	£80
Specific overheads	£3,000

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"I am planning to hold six such weekends throughout 2007 and I'm sure that they will be popular," he said.

Rita was not easily impressed. "What do you have in mind?"

"1960's themes with rock bands and the like," he replied.

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"Profit equals guess work, while cash is fact," she said. "We will have to pay the bands in advance and the extra overheads, including advertising, while our customers pay in arrears. Anyway what if the events are not popular? We could even end up losing money. What is our breakeven figure?"

Henry admitted that he had not done much research but still felt that the themed weekends were a good idea. 65

Answer **all** the questions.

- 1 (a) (i) Calculate the budgeted gross profit target set by Head Office for the 12 week period for the Dreamwater Hotel. [4]
- (ii) Analyse possible reasons why the Dreamwater Hotel was below the gross profit target set by Head Office. [6]
- (b) Assess the usefulness of profit centre analysis in helping the management of the Dreamwater Hotel in making decisions. [10]
- (c) Using both qualitative and quantitative information, evaluate the proposal to hold theme weekends at the Dreamwater Hotel. [16]
- 2 (a) Analyse the accuracy of the statement “profit equals guess work, while cash is fact”. [6]
- (b) Discuss the value to the management at Head Office of setting financial targets for the hotels in its group such as the Dreamwater. [16]

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