ADVANCED GCE **2875**

BUSINESS STUDIES

Further Accounting and Finance

FRIDAY 25 JANUARY 2008 Morning

Time: 1 hour 30 minutes

Additional materials (enclosed): Answer Booklet (8 page)

Additional materials (required):
Calculators may be used

CUP/T46473

INSTRUCTIONS TO CANDIDATES

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

INFORMATION FOR CANDIDATES

- The number of marks for each question 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.

Sheer Indulgence Ltd (SIL)

Sheer Indulgence Limited (SIL) was established in 1980 by Esther Wright and Jermina Wellington. It manufactures high quality chocolates and other confectionery aimed at the premium end of the market. The business was originally set up as a partnership but it converted to a private limited company in 1992. Esther is in charge of the marketing and product side of the business, while Jermina deals with human resource issues.

The factory and its administrative offices are based in Marlow, Buckinghamshire. The company has been extraordinarily successful but its success is now starting to cause problems. Production is now at capacity with no scope for further increases. Future growth, therefore, seems constrained.

At SIL's most recent fortnightly Board meeting a number of issues were raised by the Financial Director. He began by stating that he wanted to change the method of depreciating fixed assets as shown on the balance sheet. At present a straight line method is used to write off the book value to zero, usually over a five year period. He proposed using a 35% declining balance method, which he stated would give a more accurate valuation of the assets. However, he did point out that this would have some impact on declared profits. Both Esther and Jermina were confused by this. Jermina said, "All I look at is the bottom line and I assume that it is accurate. If you think we should change, then I'll go along with that".

The Financial Director then raised the issue of investing in new machinery. He told the Board that some of the machines needed replacement, in particular a blending machine as it was causing numerous problems. Table 1 gives details of two possible replacement blending machines X and Y.

Table 1

Data for Blending Machines

	X (£000's)	Y (£000's)
Capital cost	160	220
Projected annual cost savings	50	70
Anticipated residual value	0	25
Anticipated economic life	4 years	6 years

The Financial Director told the Board that the usual minimum return criterion that the company used was 8%. Jermina told him to carry out an investment appraisal and to report at the next Board meeting.

Table 2

Present Value of £ receivable at end of year at 8%

Year	1	2	3	4	5	6
Value	0.926	0.857	0.794	0.735	0.681	0.630

Esther then told the meeting that sales in 2007 had risen by 40% from last year's figure of £120m. She understood that overheads were £50m and that direct costs represented 35% of the total sales revenue. "Yes," said the Financial Director, "but I think that we need to look again at the way we record the profit for individual product lines. Look at this," he said, producing information about the company's two highest selling products (see Table 3).

Table 3

Financial Data 2007

	Mint Cremes (£m's)	**Strawberry Delight** (£m's)
Sales	35	90
Direct costs	13	32
Allocated overheads	12	12

"I propose that overheads are allocated as a percentage of the value of the product to the total sales of the business." Everyone agreed that this was sensible.

The meeting then turned its attention to future strategy issues. Esther told everyone that a representative of a major supermarket chain had approached her a few weeks previously with a provisional order worth £120m. Current capacity would be unable to meet this, so Esther proposed building a new factory. This would entail increasing capacity by 150%, with an increase in overheads of 75%. The major stumbling block appeared to be raising the capital of £70m needed to finance it (see Table 4).

Table 4

Extract from accounts 2007 – SIL

	£m's
Long term liabilities	80
Share capital	20
Reserves	15

Answer **all** the questions.

1 **(a)** Calculate the net profit made by SIL in 2007. [4]

(b) Analyse the impact on the recorded profit of Mint Cremes if overheads were allocated as a percentage of sales value. [6]

(c) If Esther and Jermina chose to expand the business by building a new factory, discuss ways the business could finance this expansion. [10]

(d) Should SIL accept the provisional order from the major supermarket? Justify your answer. [16]

2 **(a)** Analyse the impact on the profit and loss account and balance sheet of the business if it were to change its depreciation policy. [6]

(b) Justifying your recommendation, advise SIL whether to purchase either of the machines X or Y. [16]