GCE

Business Studies

Advanced GCE **2875**

Further Accounting and Finance

Mark Scheme for June 2010

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1 (a) (i) The debtor repayment period for CBL. **[2]**

Debtors days= $\frac{\text{debtors}}{\text{Sales}}$ *x 365* **(1)**

$\frac{£216,985}{£1,198,900}$ *x 365=66 days* **(1)**

(ii) The stock turnover ratio for CBL. **[2]**

Stock turnover= $\frac{\text{cost of goods sold}}{\text{Stock}}$ **(1)**

$\frac{£822,200}{£99,642}$ *= 8.25 times per year* **(1)**

(iii) Analyse one implication for CBL of having a stock turnover ratio which is different to the industry average.

[6]

The stock turnover ratio is significantly above the industry standard and must be a cause for concern. The perishable nature of the stock is likely to lead to high shrinkage levels and other stockholding costs such as storage space. On the other hand CBL is well positioned to respond to sudden increases in demand and its stock policy may well suit the JIT needs of its customers.

Level 3	Candidate demonstrates analysis of stock turnover issues for CBL	**(6-5)**
Level 2	Candidate demonstrates understanding of stock turnover position for CBL	**(4-3)**
Level 1	Candidate demonstrates knowledge of stock turnover	**(2-1)**

(b) By the end of the next financial year Bruce aims to have reduced variable costs by 3% at CBL. Discuss how the introduction of a standard costing system would help him to achieve this objective. **[10]**

Standard costing assists management teams in monitoring and controlling production costs. In this case all the functional teams would benefit from the information created by a standard costing system.
From the evidence available, it would appear that there are no systems in place to monitor costs.
A standard costing system assesses volumes and costs such as materials, energy and labour against target volume and cost levels. Variance analysis allows management teams to identify causes for variance from targets.
The nature of CBL's production and products lends itself to reasonably accurate standard costing.
Bruce will have to ensure that sufficient resources are employed to guarantee the system is successfully implemented. For example, training of staff and the development of information technology systems to support the vast flow of information. Just as important is the need to develop a culture where use of data is widely embraced.
Candidates who adopt a holistic approach beyond the boundaries of accounting should be highly rewarded.

Level 4	Candidate evaluates based upon analysis of the standard costing proposal and consideration of other relevant factors for CBL	**(10-9)**
Level 3	Candidate demonstrates analysis of information using appropriate criteria relevant to CBL	**(8-6)**
Level 2	Candidate demonstrates understanding of the concept of standard costing relevant to CBL	**(5-3)**
Level 1	Candidate demonstrates knowledge of the concept of standard costing	**(2-1)**

(c) Emma feels that the business 'performs well and is in quite a strong financial position' (lines 28-29). Evaluate the accuracy of her assessment of CBL's financial performance. [16]

<u>Profitability</u>

	1999	*2004*	*2009*
% Gross Profit	*41.4*	*34.2*	*31.4*
% Net Profit	*14.2*	*9.1*	*5.5*

These results indicate a dramatic decline in performance over the last decade, in the same period sales have risen by 289% but net profit has risen by only 52%.

<u>Investment</u>
Emma may be confused by the ROCE that in 2009 was 18.4%. Is this figure being inflated by low balance sheet values and/or is CBL using leasing to access plant and machinery?
Gearing is low at 15.4% but would rise if the proposed investment were made.
<u>Liquidity</u>
Current ratio=1.20:1
Acid test ratio=0.84:1
These ratios are slightly below normal standards but must be viewed in light of the industry CBL operates in. Demand for bread and related products is steady and one can expect regular daily sales.
However there could be concern over the dependency on one customer and whether stock is vulnerable to shrinkage
<u>Efficiency</u>
Fixed Asset utilisation=3.59 times
Net Assets=3.32 times

In conclusion, the ratios indicate a mixed picture but Emma should take Bruce's views seriously as the profitability position is in sharp decline. Does the decline reflect industry trends and competitive forces?
Without previous balance sheets and industry comparisons it is difficult to draw any firm conclusions.

Level 4	Candidate evaluates based upon analysis of data and consideration of other factors for CBL	**(16-10)**
Level 3	Candidate demonstrates analysis of information using appropriate criteria for CBL	**(9-6)**
Level 2	Candidate demonstrates understanding of performance of CBL	**(5-3)**
Level 1	Candidate demonstrates knowledge of the concept of performance	**(2-1)**

2 (a) Analyse two sources of finance for the proposed investment in new machinery. [6]

There are insufficient internal sources of finance to support the investment, even if debtors and stock levels could be reduced. However better stock management would contribute to the investment and reduce the amount required to be externally sourced.
In terms of external sources of finance, CBL could look to increase its loan and/or prepare a new share issue. The loan route depends upon CBL's relationship with its bank e.g. what was the original size of the existing loan? Have CBL a good repayment record? How does its bank regard the falling trend in profitability? What is the bank's current attitude to risk? How good a business proposition has Emma created?
The share capital issue depends upon the personal wealth of the family. £285,000 is a large investment and so the business may have to look towards a new investor. Could the new equipment be acquired through leasing?

Level 3	Candidate demonstrates analysis of source of finance relevant to CBL	**(6-5)**
Level 2	Candidate demonstrates understanding of source of finance relevant to CBL	**(4-3)**
Level 1	Candidate demonstrates knowledge of source of finance	**(2-1)**

(b) Recommend whether CBL should make the investment in the new machinery. Justify your view. [16]

DCF Appraisal

Year	***Net Cash Flow***	***DCF 15%***	***NPV***
0	*(285)*	*X 1.000*	*(285)*
1	55	X 0.870	*47.85*
2	*65*	*X 0.756*	*49.14*
3	*75*	*X 0.658*	*49.35*
4	*75*	*X 0.572*	*42.90*
5	*75*	*X 0.497*	*37.275*
6	*75*	*X 0.432*	*32.40*
			(26.085)

So the investment marginally misses Bruce's criterion of 15% and, on this basis, should be rejected.
On the other hand, the payback criterion of 6 years or less is achieved in 4 years and 2.4 months.
Much depends on the quality of the cash flow projections including CBL's ability to quantify the efficiency savings. One assumes that market research has been carried out to establish the demand for new products. What are the implications for existing production levels? Will there be significant disruptions. Has training been factored into the cash flows?
Does the investment rely too heavily on the relationship with PP and the possibility of a contract for continental breads?
Should Emma be devoting her time and energy to resolving the other issues faced by the business i.e. poor profitability/credit control/stock management?

There is also the issue how the project will be funded. If funded through a bank loan, has there been a contingency built in for increases in interest rates?
What is the shareholders' attitude to risk? Gearing would increase if the project were funded through borrowing.

Level 4	Candidate evaluates based upon analysis of the investment proposal data and consideration of other factors for CBL	**(16-10)**
Level 3	Candidate demonstrates analysis of investment proposal for CBL using appropriate investment appraisal technique(s) e.g. payback/DCF	**(9-6)**
Level 2	Candidate demonstrates understanding of investment decisions for CBL	**(5-3)**
Level 1	Candidate demonstrates knowledge of investment decisions	**(2-1)**

Assessment Objectives Grid

Question	AO1	AO2	A03	A04	Total
1 (a) (i) (ii)	2	2	-	-	**4**
1 (a) (iii)	2	2	2	-	**6**
1 (b)	2	3	3	2	**10**
1(c)	2	3	4	7	**16**
2 (a)	2	2	2	-	**6**
2 (b)	2	3	4	7	**16**

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