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Oxford Cambridge and RSA

June 2015**A2 GCE APPLIED BUSINESS****F253/MS** Constructing a Financial Strategy**MARK SCHEME FOR ACADEMIC YEAR 2014–2015****SERIES 9****This stimulus material must be used for the June 2015 examination session.****OCR supplied materials:**

None

Other materials required:

- A calculator may be used

**INSTRUCTIONS TO TEACHERS**

- This stimulus material provides a vocational context for the internally assessed unit: F253 – Constructing a Financial Strategy.
- Each year **one** scenario will be released on OCR's website which will provide an authentic vocational context for candidates' subsequent investigations.
- It is imperative that this material is used for the **June 2015** examination session. New stimulus material (**Series 10**) will be issued for the academic year 2015–2016.
- There are no separate marking criteria with this stimulus material. A solution will, however, be provided for **Series 9** in the **Principal Moderator's report for June 2015**.
- Please bear in mind that, due to the nature of this unit, candidates will have many opportunities to revisit their figures and you need to be able to ensure that the work of each candidate is their own. Therefore, it may be that **Tasks B–G** of this unit are supervised to ensure that individual, authentic evidence is produced.

INFORMATION FOR CANDIDATES

- This stimulus material has been created to provide you with a vocational context for the internally assessed unit: F253 – Constructing a Financial Strategy.
- If you have any questions regarding the stimulus material, you must consult both your teacher and the unit specification.
- It is anticipated that, where necessary, you use an approved calculator to complete the **Tasks** as outlined in the stimulus material.
- This document consists of **20** pages. Any blank pages are indicated.



**A calculator may
be used for this
paper**

Applied Business F253 Mark Scheme**TASK A – suggested responses**

- (i) In report form accurate financial records are needed in the following areas:
- calculate profit and loss, to allow for planning and control, particularly with the proposed financing of asset acquisition and replacement and possible purchase of premises. It will be important to ensure the information is correct for tax calculations and to provide bankers/financiers with accurate information when seeking additional finance for *Byyte Solutions Limited*. Accuracy of financial records is very important to all businesses irrespective of the size of the business or the size of the transaction, thus enabling decisions to be based on reliable figures.
 - meet legal requirements, to ensure that the correct information is provided to shareholders, Companies House, tax authorities, lenders, etc, to avoid potential damaging legal action for misrepresentation.
 - show the assets and liabilities of *Byyte Solutions Limited* to assist in the planning of, for example, the replacement of equipment, to maintain sufficient stock levels, to monitor debtor collection and to ensure payment of creditors on time.
 - compare the financial results of *Byyte Solutions Limited* to the prior year results, enabling the shareholders to have a clear view of the company's success and to plan.
 - prepare accurate budgets/forecasts for future years, to quantify what *Byyte Solutions Limited* is able to achieve. This will also highlight limiting factors and provide an indication of the extent to which the business is able to achieve its objectives over specific periods of time. *Byyte Solutions Limited* will need to be careful in the timing of expansion plans and the possible purchase of premises as this will have a significant impact on their cash-flow.
 - obtain additional finance, *Byyte Solutions Limited* will need to provide information about its past and forecast profitability, liquidity, asset worth, etc when applying for additional finance.
 - plan any future expansion, by quantifying the resources available and indicating the impact on resources, if expansion goes ahead.
- (ii) Consider the following consequences for *Byyte Solutions Limited* if problems arise from:
- criminal action, potential fines or removal of key personnel from the business which would cause delays to the business and mean that the focus was on the criminal proceedings rather than the business. Bad publicity could potentially lead to the decline or failure of the business.
 - cash-flow problems from a high tax bill or criminal action which could lead to business failure and hinder the ability of the business to expand. Poor cash-flow would also limit the ability of the business to borrow and would worsen the liquidity of the business.
 - shareholders may lose confidence and decide to invest elsewhere. At present the main two shareholders are Kieran and Maryum who are committed to the success of *Byyte Solutions Limited*, but if they were to look to new shareholders to help finance the purchase of new premises for instance, then any new shareholder may seek more immediate financial stability and returns.

- bad public image, bad publicity could lead to a loss of customers and employees may feel vulnerable and leave the business. Reputation is important to all businesses and so it is vital that *Byte Solutions Limited* maintains the quality of service it has established.
- changes to management structure, in a small organisation such as *Byte Solutions Limited*, where personal contacts are made through Kieran and Maryum, a change to this structure could be very damaging to the business and could significantly affect its success. While there is no hint that Kieran or Maryum wish to leave change may be forced upon them through, for example, illness of Kieran or Maryum.

(iii) The following should be explained to Kieran and Maryum in a form suitable for non-accountants:

- capital and bank loans
- assets such as premises and vehicles, including items bought on credit
- expenses for running a business, e.g. wages and electricity
- items/services purchased for resale, including those bought on credit
- items /services sold, including those sold on credit
- invoices
- credit notes
- bank records, e.g. direct debits and till receipts.

A matrix style answer may be effective in producing this part of the report.

(iv) Continuing the report. (Answers could be in a written format or as a diagram or flowchart). Explanation showing understanding of each of the following processes:

- double-entry transaction recording
- accurately balancing off of the accounts
- the division of ledgers
- the creation of a trial balance.

Including understanding of the types of error which can occur when preparing accounts with examples including:

- omissions
- compensating errors
- errors of principle.

Applied Business F253 Mark Scheme for Tasks B, C, D, E, F and G

TASK B

LEDGER ACCOUNTS

Dr		Palmer, Plumb and Greenwell Solicitors (Debtors)				Cr
2014	Details	£	2014	Details	£	
1 April	Balance b/d	1 250	1 April	Bank	1 225	
1 April	Sales	731	1 April	Discount allowed	25	
			1 April	Balance c/d	731	
		<u>1 981</u>			<u>1 981</u>	
2 April	Balance b/d	731				

Graygables Hotel and Conference Centre (Debtors)					
2014	Details	£	2014	Details	£
1 April	Balance b/d	925	1 April	Bank	925
1 April	Sales	90	1 April	Balance c/d	90
		<u>1 015</u>			<u>1 015</u>
2 April	Balance b/d	90			

Dr		Kneller & Brooke Accountants (Debtors)				Cr
2014	Details	£	2014	Details	£	
1 April	Balance b/d	400	1 April	Bank	392	
1 April	Sales	132	1 April	Discounts allowed	8	
			1 April	Balance c/d	132	
		<u>532</u>			<u>532</u>	
2 April	Balance b/d	132				

Dr		Brook Laine Garage (Creditor)				Cr
2014	Details	£	2014	Details	£	
1 April	Bank	291	1 April	Balance b/d	191	
1 April	Discount received	9	1 April	Motoring expenses	109	
		<u>300</u>			<u>300</u>	

Dr		Nuitparts (Creditor)				Cr
2014	Details	£	2014	Details	£	
1 April	Purchase returns	35	1 April	Balance b/d	1 185	
			1 April	Purchases	320	
1 April	Balance c/d	1 475	1 April	Carriage inwards	5	
		<u>1 510</u>			<u>1 510</u>	
			2 April	Balance b/d	1 475	

Dr			The Gadget Hatch (Creditor)			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance c/d	1735	1 April	Balance b/d	1735			
1 April		<u>1735</u>			<u>1735</u>			
			2 April	Balance b/d	1735			

Dr			Sales			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance c/d	238250	1 April	Balance b/d	237126			
			1 April	PPG Solicitors	731			
			1 April	Kneller & Brooke	132			
			1 April	Graygables Hotel	90			
			1 April	Cash sales	151			
			1 April	Cash sales	20			
		<u>238250</u>			<u>238250</u>			
			2 April	Balance b/d	238250			

Dr			Purchases			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance b/d	54197						
1 April	Nuitparts	320	1 April	Balance c/d	54517			
		<u>54517</u>			<u>54517</u>			
2 April	Balance b/d	54517						

Dr			Rent and rates			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance b/d	13476	1 April	Balance c/d	14599			
1 April	Bank	1123						
		<u>14599</u>			<u>14599</u>			
2 April	Balance b/d	14599						

Dr			Carriage inwards			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance b/d	132	1 April	Balance c/d	137			
1 April	Nuitparts	5						
		<u>137</u>			<u>137</u>			
2 April	Balance b/d	137						

Dr			Motoring expenses			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance b/d	6725	1 April	Balance c/d	6904			
		109						
1 April	Brook Laine Garage	70						
1 April	Brook Laine Garage							
		<u>6904</u>				<u>6904</u>		
2 April	Balance b/d	6904						

Dr			Purchase returns			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance c/d	367	1 April	Balance b/d	332			
			1 April	Nuitparts	35			
		<u>367</u>				<u>367</u>		
			2 April	Balance b/d	367			

Dr			Insurance			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance b/d	672	1 April	Balance c/d	726			
1 April	Bank	54						
		<u>726</u>				<u>726</u>		
2 April	Balance b/d	726						

Dr			Bank interest received			Cr		
2014	Details	£	2014	Details	£			
1 April	Balance c/d	21	1 April	Balance b/d	21			
		<u>21</u>				<u>21</u>		
			2 April	Balance b/d	21			

Dr					Cash Book					Cr
2014	Details	Disc £	Cash £	Bank £	2014	Details	Disc £	Cash £	Bank £	
1 Mar	Balance b/d	27	30	38327	1 Mar	Balance b/d	263			
1 Mar	Cash sales			151	1 Mar	Brook Laine Garage			70	
1 Mar	Cash sales		20		1 Mar	Brook Laine Garage	9		291	
1 Mar	Kneller & Brooke	8		392	1 Mar	Rent and rates			1123	
1 Mar	Graygables Hotel			925	1 Mar	Allova Insurance			54	
1 Mar	Palmer, Plumb & Greenwell	25		1225	1 Mar	Balance c/d		50	39482	
		60	50	41020			272	50	41020	
2 Mar	Balance b/d		50	39482						

OR

Dr			Bank			Cr
2014	Details	£	2014	Details	£	
1 April	Balance b/d	38327	1 April	Brook Laine Garage	70	
1 April	Cash sales	151	1 April	Brook Laine Garage	291	
1 April	Kneller & Brooke	392	1 April	Rent and rates	1123	
1 April	Graygables Hotel	925	1 April	Allova Insurance	54	
1 April	Palmer, Plumb & Greenwell	1225	1 April	Balance c/d	39482	
		41020			41020	
2 April	Balance b/d	39482				

Dr			Cash Account			Cr
2014	Details	£	2014	Details	£	
1 April	Balance b/d	30				
1 April	Cash sales	20	1 April	Balance c/d	50	
		50			50	
2 April	Balance b/d	50				

Alternative approach for discounts

Dr			Discounts received			Cr
2014	Details	£	2014	Details	£	
1 April	Balance c/d	272	1 April	Balance b/d	263	
			1 April	Brook Laine Garage	9	
		<u>272</u>			<u>272</u>	
			2 April	Balance b/d	272	

Alternative approach for discounts

Dr			Discounts allowed			Cr
2014	Details	£	2014	Details	£	
1 April	Balance b/d	27				
1 April	Kneller & Brooke	8				
1 April	Palmer, Plumb and Greenwell	25	1 April	Balance b/d	60	
		<u>60</u>			<u>60</u>	
2 April	Balance b/d	60				

TASK C

(i)

Byyte Solutions Limited
Trial Balance as at 18 April 2014 (before adjustments)

	£	£
Sales		283 684
Purchases	60 426	
Ordinary share capital @ £1 each		4 000
Retained profit		1 653
Motor vehicles (cost)	24 760	
Provision for depreciation of motor vehicles		7 428
Equipment (cost)	8 610	
Provision for depreciation of equipment		2 150
Discount received		482
Discounts allowed	9	
Rent and rates	14 399	
Purchase returns		445
Telephone	630	
Electricity	420	
Insurance	1 635	
Advertising	460	
Carriage inwards	198	
Bad debts written off	152	
Wages	121 688	
Sundry expenses	167	
Interest received		29
Stock at 1 May 2013	8 837	
Bank (Dr)	46 186	
Cash	50	
Motoring expenses	7 978	
Creditors		2 348
Debtors	2 155	
Dividends paid	3 000	
Suspense	459	
	302 219	302 219

10

(ii) Journal

Error			£	£
1	Discount allowed	Dr	163	
	Discount received	Dr	163	
	Suspense	Cr		163
	Suspense	Cr		163
2	Rent	Dr	200	
	Suspense	Cr		200
3	Purchase	Cr		29
	Purchase return	Cr		29
	Suspense	Dr	29	
	Suspense	Dr	29	
4	Telephone	Dr	17	
	Insurance	Cr		17
5	Suspense	Dr	9	
	Motoring expenses	Cr		9

Dr		Suspense				Cr
2014	Details	£	2014	Details	£	
18 April	Balance b/d	459	18 April	Discount allowed	163	
18 April	Purchases	29	18 April	Discount received	163	
18 April	Purchase returns	29	18 April	Rent	200	
18 April	Motoring expenses	9				
		<u>526</u>			<u>526</u>	

TASK C

(iii)

Byyte Solutions Limited
Trial Balance as at 18 April 2014 (After Adjustments)

	£	£
Sales		283684
Purchases	60397	
Ordinary share capital @ £1 each		4000
Retained profit		1653
Motor vehicles (cost)	24760	
Provision for depreciation of motor vehicles		7428
Equipment (cost)	8610	
Provision for depreciation of equipment		2150
Discount received		319
Discounts allowed	172	
Rent and rates	14599	
Purchase returns		474
Telephone	647	
Electricity	420	
Insurance	1618	
Advertising	460	
Carriage inwards	198	
Bad debts written off	152	
Wages	121688	
Sundry expenses	167	
Interest received		29
Stock at 1 May 2013	8837	
Bank (Dr)	46186	
Cash	50	
Motoring expenses	7969	
Creditors		2348
Debtors	2155	
Dividends paid	3000	
	302085	302085

TASK D

(i)

Byyte Solutions Limited
Trading, Profit and Loss and Appropriation Account for the year ended 30 April 2014

	£	£	£
Sales			291 252
Stock at 1 May 2013		8 837	
Purchases	62 622		
Carriage inwards	219		
Less purchase returns	474	62 367	
		<u>71 204</u>	
Closing stock at 30 April 2014		9 714	
Cost of sales			<u>61 490</u>
Gross profit			229 762
Discount received			319
Interest received			35
			<u>230 116</u>
Discounts allowed		172	
Rent and rates	14 599		
Less prepaid rent and rates	1 123	13 476	
Wages	62 688		
Add accrued wages	4 106	66 794	
Directors' remuneration		60 000	
Motoring expenses		7 978	
Telephone		720	
Electricity		610	
Insurance		1 850	
Advertising	460		
Add accrued advertising	140	600	
Sundry expenses		219	
Depreciation – vehicles (30% x (24760-7428))		5 200	
Depreciation – equipment (20% x 8610)		1 722	
Bad debts written off (152+237)		389	
Doubtful debt provision (5% x 2204)		110	159 840
Net profit			<u>70 276</u>
Retained profit b/d			1 653
			<u>71 929</u>
Ordinary share dividend – paid		3 000	
proposed		50 000	53 000
Retained profit c/d			<u>18 929</u>

TASK D

Byte Solutions Limited
Balance Sheet as at 30 April 2014

	£	£	£
	Cost	Accumulated Depreciation	NBV
FIXED ASSETS			
Motor vehicles	24 760	12 628	12 132
Equipment	8 610	3 872	4 738
			16 870
CURRENT ASSETS			
Stock		9 714	
Debtors	2 204		
Less provision for doubtful debts	110	2 094	
Prepaid rent and rates		1 123	
Bank		49 674	
Cash		50	
		62 655	
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Creditors	2 350		
Accrued wages	4 106		
Accrued advertising	140		
Proposed dividend	50 000	56 596	
NET CURRENT ASSETS			6 059
NET ASSETS			22 929
CAPITAL AND RESERVES			
Ordinary share capital (4000 shares @£1 each)			4 000
Retained profit			18 929
			22 929

NOTE: The new International Accounting terminology and style for final account preparation is acceptable.

TASK E

Different formats for company accounts are required by law and amended by the accounting standards as appropriate. Different sizes of companies have different demands on them and a relatively small private company such as *Byte Solutions Limited* may produce final accounts in less detail and prescriptive form to that required by large listed public companies and groups.

Nevertheless, all companies are subject to the Companies Acts which call for specific formats and elements of disclosure both on the face of the financial statements and within notes to the accounts. In addition a directors' report is commonly produced and the accounts are audited within current legislative requirements.

Comparison with summary financial statements should highlight the way summary statements are driven more by perceived user needs, financial literacy and clarity, as opposed to legislative requirements. For example, in summary statements rounded figures highlight profits, asset values and earnings and dividend related information are provided. The rounding is there to simplify the financial information, making it more understandable and comparable, though in so doing it raises concern with materiality in mind.

TASK F

Ratio	Year ended 30/4/2013	Year ended 30/4/2014	
Gross Profit percentage	81%	$229762/291252 \times 100$	78.89%
Net Profit percentage	24%	$70276/291252 \times 100$	24.13%
Return on capital employed (different measures are acceptable)	495%	$70276/((22929+5653)/2) \times 100$	491.75%
Expenses as a percentage of net sales	n/a	$159840/291252 \times 100$	54.88%
Current ratio	1.69:1	$62655/56596$	1.11:1
Acid test ratio	1.10:1	$(62655-9714)/56596$	0.94:1
Stock turnover	91 days	$((8837+9714)/2)/61490 \times 365$	56 days
Fixed asset turnover	n/a	$291252/16870$	17.26 times
Debtor collection period	2 days	$(2204/(291252 @ 90\%)) \times 365$ $(2094/(291252 @ 90\%)) \times 365$	3.07 = 4 days 2.36 = 3 days
Creditor payment period	18 days	$(2350/(62622-474)) \times 365$	13.80 = 14 days
Earnings per share	£18	$70276/4000$	£17.57
Dividend cover	3 times	$17.57/(53000/4000)$	1.33 times

Analysis and interpretation of ratios

Gross profit margin has decreased. The business was earning 81p for every £1 of sales in 2013, but this had decreased to just under 79p by 2014. While the reduction is quite small it would suggest that either the selling price has reduced (perhaps to compete in the recession) or that it is not passing on to its customers increases in purchase costs.

The net profit has increased very marginally from 24% to 24.13%. Therefore, the reduced gross profit may have been absorbed through an overall reduction in expenses.

The return on capital employed is very healthy and is producing a return way above any other form of investment that might be found, and demonstrates that with a relatively small investment a good level of profit can be made. However, it has decreased between 2013 and 2014 by 3.25 percentage points; nevertheless this business would make a very attractive investment opportunity.

The current ratio decreased quite significantly from £1.69 being available to pay every £1 of debt to £1.11. Some text books would suggest that this should be nearer to £2 for every £1 of debt, so this is on the low side; that said a better measure is the acid test. Ideally this should be £1 available for every £1 of debt. This has fallen from £1.10 to just 94p which means that the business is unable to cover its debts, leaving it 6p short in every £1 owed. This is not ideal, and could be a sign that the business is overtrading.

The stock turnover has decreased from 91 days to 56 days a year. This is a good sign, but perhaps could reflect the fact that the business is only able to carry a limited stock due to a lack of space, which means frequent replenishment of stock is necessary.

The debtor collection period has increased from two days to four days. This reflects the fact that most of its customers are paying it on a monthly fee basis, set up as a direct debit. However, the fact that there has been some bad debts this year might suggest the business is not carrying out credit checks on its customers and the increase in the collection period should be closely monitored to ensure that debtors pay quickly.

The creditor payment period has decreased from 18 days to 14 days. While it is preferable for the business to have as long as possible before paying its suppliers, the debtor collection period is still a full 10 days shorter, which means that money is coming into the business before it has to be paid out to suppliers.

Earnings per share have dropped slightly between the two years (43p per share), but the dividend cover has fallen more significantly from three times to 1.33 times. This represents the ease with which the business is able to cover the dividend from distributable profits. This could suggest that the dividends paid are too generous, stripping the business of vital profit retention and, potentially, causing liquidity problems.

There are limitations to ratio analysis:

- it only measures the historical financial health of the business
- it does not take into consideration non-financial happenings
- it does not take into consideration wider economic trends
- it does not take into account the 'goodwill' of a business (such as skills, service uniqueness, etc).

Overall *Byyte Solutions Limited* is making very healthy profits, though the liquidity of the business is a little on the low side. This is largely being caused by the level of dividends proposed to the shareholders which if paid will leave the business short of cash. It would, therefore, be worth considering whether such a high dividend was necessary or prudent.

TASK G

In report form this should consider what financial strategy should be adopted using the information obtained from the scenario, the accounts and the ratios.

The following points can be brought out:

- The relative advantages/disadvantages of property purchase versus rental and a basic mortgage rate comparison as against rental cost would be a good starting point, but things such as building maintenance should also be considered. Would the business be in a position to take out a mortgage? What can it offer as security? Would the banks view the business as too risky? Could more shares be created to help with the funding of expansion? The shares do not need to be repaid and there is no need to pay dividends, though shareholders are likely to expect some return on their investment. However, it is usual that shareholders have voting rights and a say in the company's operations. Unless many shares are issued Kieran and Maryum would still maintain control; however, even a minority shareholder could cause conflict.
- Location considerations – the property to purchase is in a more rural location. This may provide new opportunities, and as the premises are larger than needed, this could be useful if the business expands still further. Alternatively the additional unused space could provide a rental income opportunity for the business. Downsides of purchasing the property being considered might include, for example, travelling to its current customers which may end up costing more in fuel and maintenance of the vehicles (additional 15 miles away) and cut down the hours available to work with clients due to time lost to travelling. How reliable are the vehicles? Will they need replacing? Depending on its location the opportunity to stock more consumable items may be lost as this will only work where there are other businesses which need those supplies. Have Kieran and Maryum checked out competition in the area being considered for property purchase?
- Expansion will also involve other costs – new equipment is also mentioned – how will this be paid for?
- There is no mention in the case study of any labour problems but clearly this too is a consideration – *Byte Solutions Limited* will need reliable trained staff, how easy will it be to find new staff with the right qualifications. Any future changes to employment legislation will also have an impact on the business (for example, pension schemes).
- While the business is making good profits and has a healthy bank account, the liquidity ratios raise a few concerns. It may be better to retain more profits than pay out high dividends, which would enable expansion to take place in a more planned, controlled way. As the main shareholders are Kieran and Maryum their dividends, together with directors remuneration, are quite excessive.
- Debtor collection periods and creditor payment periods are not significant and apart from the credit control which should be carried out there is no further action needed.
- Stock levels are not a significant part of the business but if space allowed there may be financial savings in buying stock in larger quantities which might attract discounts. This, therefore, has the potential to allow profits margins to increase.
- Overall the business appears successful but a planned expansion utilising retained profits, where possible, would appear to make better financial sense. Therefore, it should be recommended that all the shareholders discuss this as a strategy. It should also be recommended that the options are fully explored and budgets produced before *Byte Solutions Limited* embarks on any expansion plans.

The above are only an indication of aspects which the candidates may explore. This answer is not meant to be exhaustive and any other valid, alternative suggestions should be duly rewarded.



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