

Centre Number						Candidate Number				
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Other Names										
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For Examiner's Use	
Examiner's Initials	
Question	Mark
1	
2	
3	
TOTAL	



General Certificate of Education  
Advanced Level Examination  
June 2014

# Applied Business

# BS15

## Unit 15 Financial Accounting for Managers

Monday 23 June 2014 9.00 am to 10.30 am

**For this paper you must have:**

- a calculator.

### Time allowed

- 1 hour 30 minutes

### Instructions

- Use black ink or black ball-point pen.
- Fill in the boxes at the top of this page.
- Answer **all** questions.
- You must answer the questions in the spaces provided. Do not write outside the box around each page or on blank pages.
- Do all rough work in this book. Cross through any work you do not want to be marked.

### Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- Questions 1(c), 2(c) and 3(b) should be answered in continuous prose. In these questions you will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.



J U N 1 4 B S 1 5 0 1

Answer **all** questions in the spaces provided.

1 Read **Item A** and then answer the questions that follow.

**Item A**

**Bingham Machinery Ltd**

Bingham Machinery Ltd (BM Ltd) produces baggage-handling equipment for airports, which loads passengers' bags onto aeroplanes. As well as selling the equipment to airports, it provides a maintenance service for the equipment. In 2013, BM Ltd's baggage-handling equipment was used in over 80% of UK airports. However, during the first quarter of 2014, BM Ltd had a 20% fall in the value of purchase orders received for equipment compared with the same quarter in 2013.

Even though net profit has increased during the past 5 years, BM Ltd's Managing Director, Duncan Read, is worried about the profitability of the business. He is very concerned about BM Ltd's increasing reliance on maintenance contracts, especially given the cost figures shown below in the extracts from the accounts (**Figure 1**).

**Figure 1: Extracts from BM Ltd's accounts for 2008 and 2013**

	£ million	
	2013	2008
Equipment sales	10.3	7.2
Maintenance contract sales	6.8	1.9
Total sales	17.1	9.1
Equipment manufacturing costs	6.0	4.0
Maintenance contract costs	5.0	1.2
Total cost of sales	11.0	5.2
Gross profit	6.1	3.9
Expenses and overheads	4.9	3.2
Net profit	1.2	0.7

Duncan thinks that entering the European market is the obvious way for the company to improve its profitability. This market has 10 times as many airports as the UK, and he thinks that BM Ltd could double its 2013 equipment sales by 2015. To achieve this increase in sales, the business would have to invest £12 million in a new factory in France. Duncan has assumed that BM Ltd would achieve the same profit margin on equipment sales as in 2013.

Li Yang, BM Ltd's Financial Director, has raised serious concerns about Duncan's plan. BM Ltd would need to borrow 80% of the money required for the expansion and Li estimates that total interest payments would amount to £5 million for a 20 year loan. Li has identified a much larger German competitor whose baggage-handling equipment is already popular in the European market. She thinks that this competitor would fight hard to keep its market share. For example, the German competitor might react by charging up to 10% less than BM Ltd for baggage-handling equipment. Li has recommended that BM Ltd does not enter the European market. She believes that BM Ltd should make a greater effort to control its costs and should investigate the potential for equipment sales within the UK.



**1 (a)** Using **Item A**, explain why BM Ltd might be concerned by a fall in the value of purchase orders received for equipment.

**[4 marks]**

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2 Read **Item B** and then answer the questions that follow.

**Item B**

**A potential new UK market**

BM Ltd is still considering the decision to expand into Europe. However, it recognises that 'doing nothing' is a risky option, especially if sales of baggage-handling equipment to airports continue to decline.

Li Yang, BM Ltd's Financial Director, has undertaken market research which shows that the same technology BM Ltd uses to move bags in airports could be adapted for use in supermarket warehouses to make up internet orders for home delivery. The project has been called 'faststack' and uses technology based on trays and an automatic stacking machine to reduce the manual handling that supermarket warehouse staff have to do. The machine then assists in the loading of the internet orders into the supermarket's vans for delivery to people's homes.

**Figure 2: Key figures for the faststack system**

Item	£
Sales revenue received from each faststack system sold	400 000
Parts and materials costs per system	150 000
Production and installation costs per system	165 000

The faststack project would require an initial investment, in January 2015, of £800 000 for a new production line. The production line would last 10 years and have a scrap value of £50 000. Overheads for the faststack project would amount to £305 000 per year.

Duncan Read, BM Ltd's Managing Director, is interested in the faststack system's potential and would like to develop this new market. A large supermarket chain is keen to buy the system and has said that it would buy 5 units initially. It has 50 warehouses suitable for the faststack system.

The supermarket has offered to pay a deposit, in January 2015, of 20% with its order. The remaining 80% would be paid once BM Ltd has installed all of the 5 units. This is scheduled to be completed by January 2016.

The supermarket's deposit will help to fund the new production line, but Duncan is concerned that BM Ltd will have to borrow the rest of the money to complete the order for the first 5 systems.





2 (a) Calculate the profit that BM Ltd could expect to make in the **first year** (January 2015 to January 2016) if it invested in the faststack system and sold 5 units.

[5 marks]

	£	£
Sales revenue (5 faststack systems)		2 000 000
Cost of sales:		
– parts and materials	750 000	
– production and installation	825 000	
Gross profit		
Depreciation of new production line		
Share of company overheads	305 000	
Total expenses		
Net profit		

Calculations .....

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**2 (b)** Analyse the possible impact on BM Ltd's cash flow of investing in the faststack system. **[8 marks]**

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**3** Read **Item C** and then answer the questions that follow.

**Item C**

**Cycling Adventure Tours Ltd**

In 2011, Rachel Limb earned £28 000 as a sports teacher. Her sister, Sara, worked in the finance department of a leisure centre and earned £22 000 a year. In January 2012, the sisters quit their jobs and established Cycling Adventure Tours Ltd (CAT Ltd) to provide cycling holidays in Wales. Each sister owns £12 500 of shares, and £20 000 of their capital was used to buy 20 high specification bikes. The business has no other fixed assets.

CAT Ltd made its first profit in 2013 and the sisters decided to expand the business. In January 2014, they:

- bought an additional 20 bikes which, due to inflation, cost £22 000
- used £14 300 in CAT Ltd's bank account, and part of its £15 000 overdraft facility, to finance this purchase
- increased their annual salaries from £10 000 to £25 000
- hired two part-time staff to run extra holidays and to carry out bike repairs.

Sara forecasted that, if they doubled CAT Ltd's sales, they would be able to increase their salaries and still make a small profit (see **Figure 3** below).

**Figure 3: Key figures from CAT Ltd's accounts for 2013 and 2014 (forecasted)**

	2014 £	2013 £
Holiday sales	160 000	80 000
Expenses:		
• Salaries	70 000	20 000
• Accommodation and meals for guests	64 000	35 000
• Depreciation	6 200	4 000
• Overheads	19 000	15 100
Total expenses	159 200	74 100
Profit	800	5 900

In May 2014, Rachel and Sara visited their accountant, Brian Palma, to review CAT Ltd's progress. Brian said that CAT Ltd was on target to double its sales. However, he commented on a change in the accounting policies used by Sara. According to her forecast, the bikes purchased in 2014 were depreciated, using the straight line method, at 10% per year. However, the original bikes were depreciated at 20% per year using the straight line method.

Brian also said that, if sales and expenses remained at the levels shown in Sara's 2014 forecast, CAT Ltd would have accumulated £12 600 cash by the end of 2016. By then, some of the bikes would be 5 years old. Could CAT Ltd afford to replace all of the older bikes? Sara replied that, if CAT Ltd used its overdraft facility, the business could afford to replace the 20 oldest bikes at the end of 2016. She also thought that CAT Ltd's finances could be improved by increasing the prices charged for its holidays.

However, Rachel was uncertain that CAT Ltd would ever provide the salary she used to earn as a teacher. Last week, a competitor offered to buy CAT Ltd for £50 000. Rachel calculated that the bikes, if they were all depreciated at 20% per year, were worth about £30 000. Perhaps they should accept the offer.



3 (a)

Using **Item C**, analyse why Brian Palma might be concerned about the accuracy of CAT Ltd's 2014 forecasted accounts.

**[9 marks]**

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**END OF QUESTIONS**



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