



ADVANCED GCE

BUSINESS STUDIES

Further Accounting and Finance

2875

Candidates answer on the Answer Booklet

OCR Supplied Materials:

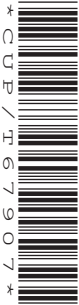
- 8 page Answer Booklet

Other Materials Required:

- Calculators may be used

**Tuesday 27 January 2009
Morning**

Duration: 1 hour 30 minutes



INSTRUCTIONS TO CANDIDATES

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- If you use additional sheets of paper, fasten the sheets to the Answer Booklet.

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** pages. Any blank pages are indicated.



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

Celtic Enterprises Ltd (CEL)

Ceri and Rhiannon Hughes are the joint owners of Celtic Enterprises Ltd (CEL). They established the venture ten years ago. Previously, Ceri had farmed the land but had become increasingly unhappy with the financial returns generated. So, he and his wife, Rhiannon, decided to convert their farm into a vineyard.

The vineyard covers 30 acres and currently produces between 15,000 and 25,000 bottles of quality white wine annually, depending on the weather. The wine is sold largely to restaurants where it is in great demand – whenever ‘Wales or Welshness’ is being celebrated. On average, a bottle is priced at £8.50 by CEL.

CEL has developed over the years. In 2000 it converted the old farmhouse into bed and breakfast accommodation. It has four double rooms to let and charges £70 per room per night. As Rhiannon said, “This produces an income stream as we operated, on average, at 40% capacity in 2008, although this part of the business is seasonal.”

In 2002 CEL also opened a café. It sells snacks and light lunches. In 2008 it generated an average weekly turnover of £2500.

Ceri and Rhiannon are now planning their next venture. The focus of their attention lies on an unused barn. They are assessing how best to use this space and two possible options have been identified:

- Option A – convert to self catering units;
- Option B – convert to a restaurant selling gourmet food.

Ceri has investigated these two options and produced the estimated figures shown in Table 1.

Table 1 – Financial Forecasts

	Option A	Option B
Set up costs	£600,000	£350,000
Average weekly sales revenue	£4000	£4200
Average weekly direct costs	£600	£2300
Annual overheads	£7000	£3000

“Are you sure you have included all the extra costs in your calculations?” said Rhiannon. “Won’t purchasing additional fixed assets have an effect on the depreciation figures that we show in our annual accounts? That will surely have an impact on our cash flow and declared profits.”

Funding of either of the options might be a problem. CEL already has a ten year variable interest rate bank loan of £400,000. It also runs an average overdraft of £50,000, which is needed in such a seasonal business. At present, as was the case last year, the interest charges on CEL’s debt are 6% p.a. on the bank loan and 5.5% p.a. on the overdraft. Rhiannon is worried that it might be difficult to raise the extra capital needed as the gearing ratio is 60% (calculated as long term debt/capital employed). She is also worried about the need to service the increased debt. “I have heard rumours that interest rates might rise next year by up to 2%,” she said. “What if the options don’t prove very popular? You know that we always look for a return of at least 10% p.a. over a 5 year period with our investments (see Table 2) and I’m not sure that either of these options will achieve this.”

Table 2

Future value of money
Discount table at 10%

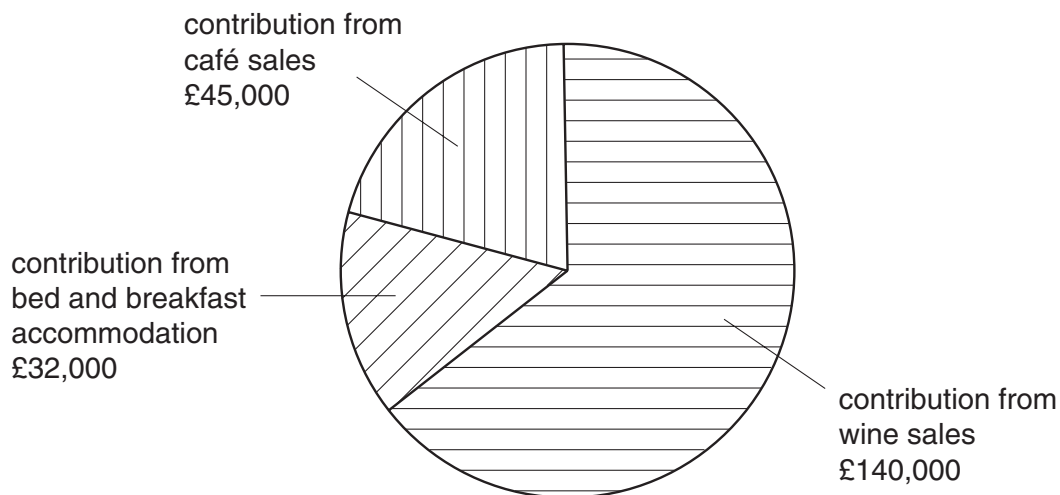
Year	0	1	2	3	4	5
Discount factor	1	0.91	0.83	0.75	0.68	0.62

Ceri was more confident arguing that you have to take calculated risks to make money. Rhiannon responded by suggesting that it would be a good start to ensure that the current business was professionally managed. "I think we should split up the business into profit centres to see exactly where we stand. I also think we should produce cash flow forecasts so that everything becomes much clearer." Ceri was in agreement with this and started to give some serious thought to the accounts of the business. He looked at some financial data for 2007 as shown in Fig. 1.

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Fig. 1

Financial data CEL 2007
Contribution Chart



CEL's accountant has just produced the provisional accounts for 2008 and Table 3 shows its profit and loss figures for the year. 40

Table 3
Profit and Loss Account
CEL
Year ending 30 November 2008

Sales	339,200
Cost of sales	149,200
Gross profit	190,000
Overheads	80,000
Net profit before tax and interest	110,000
Interest	26,750
Net profit before tax	83,250

Footnotes to the accounts showed the following:

- Sales of wine = 20,000 bottles
 - Average selling price per bottle of wine £8.50
 - Direct costs of wine production averaged £3.00 per bottle
 - Bed and breakfast accommodation open for 350 days per year
 - Direct cost of bed and breakfast for the year was £9200
 - The café was open for 52 weeks and direct costs of sales were £80,000
- 45

“Have you noticed that overheads have risen by £5000 in 2008? Last year (2007) CEL's return on capital was 17.3% and I'm sure that this year we didn't achieve that. Perhaps 2008 hasn't been a great year after all. We really do need to develop our business if we are going to get our profits back on track,” said Ceri to Rhiannon. 50

Answer **all** the questions.

- 1 (a) With reference to Table 3 and the footnotes, calculate the total contribution generated by sales of wine in 2008. [4]
- (b) Discuss the usefulness of profit centres as an aid to the management of CEL. [10]
- (c) Analyse the effect that the depreciation on any purchase of fixed assets will have on CEL's cash flow **and** profits. [6]
- (d) Should CEL proceed with either of the two options (A or B) investigated by Ceri? Justify your answer. [16]
- 2 (a) Analyse the impact on CEL's costs if interest rates rise by 2%. [6]
- (b) Evaluate the performance of CEL in 2008 using both quantitative and qualitative data. [16]