

Thursday 24 January 2013 – Morning

A2 GCE BUSINESS STUDIES

F294/01/RB Accounting

RESOURCE BOOKLET

To be given to candidates at the start of the examination

Duration: 2 hours



INSTRUCTIONS TO CANDIDATES

- The information required to answer questions 1–6 is contained within this Resource Booklet.

INFORMATION FOR CANDIDATES

- The information contained within this Resource Booklet is based on one or more real businesses.
- This document consists of **8** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER/INVIGILATOR

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Bag of Tricks Ltd (BOTL)

Holly and James formed Bag of Tricks Ltd (BOTL) in 2010. They each hold 50% of BOTL's issued share capital. They met whilst working as designers for a major international outdoor activities product manufacturer, Matterhorn plc.

Whilst working for Matterhorn plc, Holly and James specialised in the design of rucksacks. Although the work was challenging and well paid, the couple were regularly frustrated by the restrictions placed on the design team. Specifically, Holly and James could not agree with Matterhorn plc's strict financial controls, how these negatively affected their scope for creativity and the quality of the final product.

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With the re-location of their employer's UK head office from Norfolk to Edinburgh, Holly and James, with no desire to leave their idyllic rural home, decided that it was time to set up their own business designing and producing innovative and high quality rucksacks.

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In addition to these aims, the couple wanted to support their village community and set out to employ local people who could make BOTL's products from their homes. Ten secondhand industrial sewing machines were acquired by BOTL for the sum of £20000 in order for the workers to make the products. Each worker is responsible for the entire production of a rucksack and is paid a piece rate of £30 per finished rucksack. Other business operations such as research and development, packaging and storage are carried out from Holly and James' cottage and outbuildings.

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BOTL has a range of three types of rucksack. In the first year of trading sales were limited to direct purchases by members of rambling clubs and other serious walkers. Sales growth was slowed down by ongoing issues with the inconsistent quality of the rucksacks produced by BOTL's home workers. This problem meant that BOTL had difficulties keeping up with the level of demand. Sub-standard products accounted for all of BOTL's closing stock at the end of its first year of trading (December 2010). However, in January 2011 there was an order to sell all these rucksacks most of which would be sold at heavily discounted prices to a local retailer. BOTL's auditors made the necessary adjustment to the final accounts based on the information provided to them (see Table 1).

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Table 1 – Summary of sub-standard closing stock year ending 31 December 2010

Rucksack style	Quantity in stock	Full cost per rucksack	Amended price per rucksack
A	15	£49	£50
B	12	£67	£60
C	8	£82	£70

Despite quality issues, the rucksacks' innovative design and use of natural materials received positive feedback from its customers. In March 2011 a national television programme, featuring BOTL's rucksacks, led to an increase in demand for its products. Several upmarket national retailers began to stock the range but only after Holly and James had offered significant discounts. At the end of its second year of trading, Holly and James sat down with BOTL's auditors to compare the financial performance of 2010 with that of 2011 (see Tables 2 and 3).

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Table 2 – BOTL's Profit and Loss Accounts (Income Statements) for the years ending 31 December 2011 and 2010

	2011 £	2010 £
Revenue	78 755	40 214
Cost of sales*	48 197	20 872
Gross Profit	30 558	19 342
Administration costs, including Holly and James' wages	22 000	16 000
Research and development costs	4 000	2 000
Marketing and distribution costs	3 322	1 049
Net Profit	1 236	293
 *Cost of sales breakdown		
Direct labour	21 960	11 310
Materials	26 237	9 562
Total cost of sales	48 197	20 872

Table 3 – BOTL's Balance Sheets as at 31 December 2011 and 2010

	2011		2010	
	£	£	£	£
Fixed (non-current) Assets		22 650		22 000
Current Assets				
Stock	4230		2015	
Debtors	4013		577	
Total Current Assets		8243		2592
Current Liabilities				
Trade creditors	1826		845	
Bank overdraft	5538		1454	
Total Current Liabilities		7364		2299
Net Current Assets		879		293
Long term borrowings		0		0
Net Assets		23 529		22 293
Equity				
Issued Ordinary Share Capital (£1 Nominal value)		22 000		22 000
Reserves		1529		293
Total Equity		23 529		22 293

As well as carrying out this assessment, Holly and James looked to the future of BOTL's promotional strategy. They acknowledged that the focus on product development had come at the cost of neglecting the promotion of the products using online techniques. Even friends and customers pointed out that BOTL's website was embarrassingly basic for a business claiming that its products are innovative and stylish. Holly and James knew that the development of the promotional strategy would be a significant investment (£15 000) and one which they could not support through further personal investment. In addition to this issue, seven of the ten sewing machines were proving to be very unreliable and subject to regular breakdowns which required costly repairs. Reluctantly, Holly and James recognised that these machines would have to be replaced in the very near future and at a cost 50% higher than the original cost. They wondered what funding options were feasible for such a recently formed private limited company. 35 40

The good news for the business was that its order book was growing; however, this positive position was likely to put severe strain on BOTL's capacity to produce enough rucksacks. James was also worried that his drive to improve the level and consistency of the quality of the products would suffer. Indeed, coupled with the problems with the sewing machines, he was having second thoughts about their decision to use home workers to manufacture the rucksacks. Apart from the quality problems, the workers often proved to be unreliable in terms of meeting deadlines – personal problems were often the excuse made by workers for the late completion of orders. 45 50

James now knew why his ex-employer had adopted such a strong culture of operational control and financial management. He contacted an ex-colleague who had been responsible for sub-contracting production to companies in Vietnam and other Asian countries. The information, in terms of sub-contracting BOTL's production to a company in Vietnam, was certainly worth further consideration. James realised that he would face strong objections from Holly and so carefully researched the case for his proposal (see Fig. 1). 55

Fig. 1 – Key points in favour of sub-contracting manufacture to Vietnam

- 40% savings in direct costs
- Vietnamese company has a proven high quality standard record
- flexible production methods, would easily adapt to any new products developed by BOTL
- lead times on the completion of orders would match current production methods

Where James was less comfortable with his proposal was in the aspect of what he thought of as 'unknown circumstances' or external influences. Holly was bound to use these factors as one of her main reasons to reject his idea.

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