BUSINESS STUDIES REVISION GUIDE

UNIT 2: FINANCE

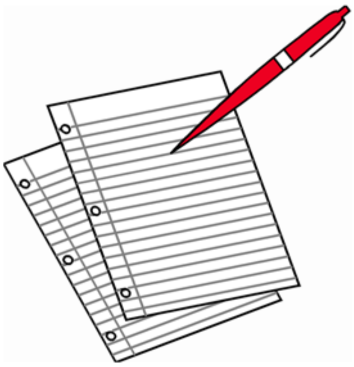
Name:

Contents

Throughout this revision guide you will find all of the topics that could appear on your final exam. Each topic will have three sections; Read, Practice and Test. Each section is explained below:

Read

The read sections of your revision guide give you definitions, explanations and key points to remember. You are advised to read and highlight the key points



Practice

The practice sections give you the opportunity to have a go at completing activities similar to the exam questions. You should use your notes to help you complete these questions

Test

The test section has exam questions for you to attempt. You should complete these questions without your notes and within a given time limit. Remember 1 minute per mark!

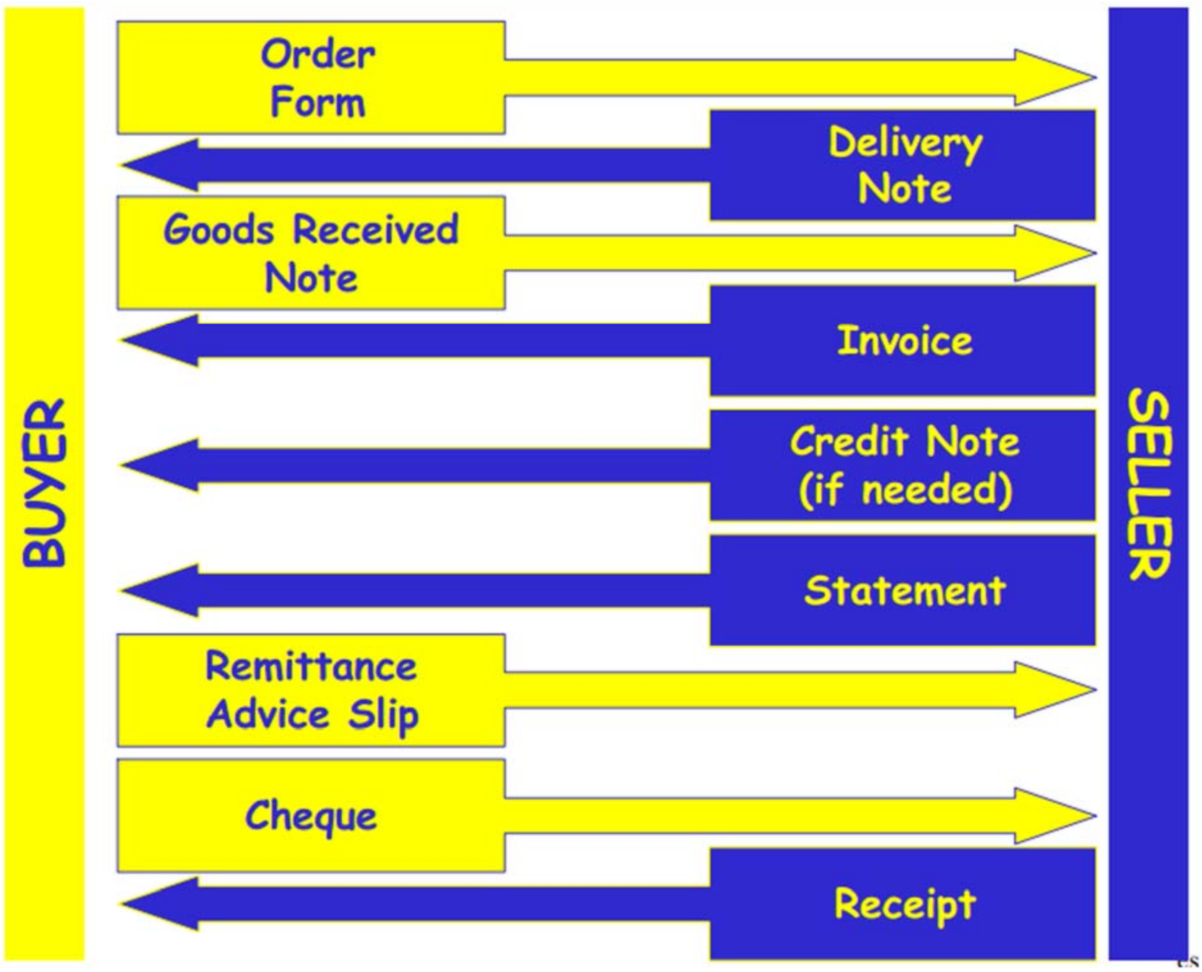
You should then use the answer booklet to check how you did or ask your teacher to mark it for you.

Contents

1) Financial Documents

There are 9 financial documents used within a single transaction between two businesses. The documents follow a particular order and have to be completed accurately otherwise it could have serious consequences for the business.

Below is a diagram to show the flow of financial documents between the customer (Buyer) and supplier (Seller). You will need to know the order of these documents and what each document is used for.



STEP 1: The PURCHASE ORDER...

Introduction – Who completes it, when:

Completed by the customer (buyer) who sends it to the supplier (seller) when they want **to buy goods or services** from the supplier.

How it is completed – a typical layout:

Name of Customer
Address of Customer

PURCHASE ORDER

Name of Supplier
Address of Supplier

Purchase Order No:
Date:

Quantity	Reference	Description	Unit Price

NB: May also include: supplier's VAT registration no. (if applicable); unique customer account number/code (issued by the supplier usually where the supplier has regular customers); total cost; any special requirements / delivery terms eg deadline date for delivery. May also be signed by the person ordering the goods / an authorised person.

Purpose / Use / Importance / Benefit(s):

- A document sent by a customer to request goods and services from a supplier.
- A record of items ordered from a supplier and how much these items cost – important for accounting purposes.
- Provides written proof of what has been ordered and when, in case of a dispute.
- Can be checked against the delivery note, (see STEP 2 below) to make sure the correct items have been sent by the supplier.
- Can be checked against the invoice (when received) (STEP 4 below) to make sure the supplier is charging the correct amount.

Importance of Accuracy: *If not completed correctly this could result in:*

- the wrong goods or services or too little or too much being supplied to the customer. This could result in too little stock to supply the customer's customers, and could lead to dissatisfied customers, if orders cannot be supplied on time. This could negatively affect the reputation of **the customer** and result in loss of repeat business and / or lost sales from new customers, and therefore, reduced / less sales revenue and, ultimately, less profit for the customer.
- increased administration costs for the customer because of the amount of time taken to correct errors, resulting in reduced / lower profit (for the customer).

STEP 2: The DELIVERY NOTE...

Introduction – who completes it, when:

Initially completed by the supplier (seller) who sends it **with the goods or services** to the customer (buyer).

How it is completed – typical layout:

Name of Supplier
Address of Supplier

DELIVERY NOTE

Name of Customer
Address of Customer

Delivery Note No:
Date:
Purchase Order No:

Quantity	Reference	Description

Please check this delivery and record any problems or actions taken in the box below.

COMMENTS:

SIGNED: ______________________________ Date: ________________

NB: Usually contains the same details as purchase order (unless goods on the order are out of stock) but does not always include the pricing information. May also include: supplier's VAT registration no (if applicable); unique customer account number/code; order date; supplier's payment terms.

Purpose / Use / Importance / Benefit(s):

- A document sent by the supplier to the customer with the goods that have actually been delivered - important in maintaining accurate stock and accounting records.
- Provides written proof of what has been delivered and when – useful in case of a dispute.
- Should be used by the customer to check off deliveries and ensure all items listed have actually been received and in good condition. If there are shortages in the delivery, items not ordered or items received in poor condition, the customer needs to make a note on the delivery note to ensure they are not charged for these items. (NB The customer has the right to return any incorrect goods received in poor condition and to obtain a credit note for them – see STEP 5 below).
- The completed form is sent back to the supplier who should use it to complete the invoice.
- The customer keeps a copy which provides a record of what has actually been delivered and can be checked against the purchase order and / or sales invoice (when received) to ensure the customer only pays for items ordered and received.
- It is used to complete the goods received note – an important document in maintaining accurate stock and accounting records (see STEP 3 below).

Importance of Accuracy:

If the delivery note is not completed correctly by the supplier this could result in:

- the wrong goods or services, too little or too much being supplied to the customer. This could result in too little stock to supply the customer's customers and could lead to dissatisfied customers as orders cannot be supplied on time. This could negatively affect the reputation of **the customer** and result in loss of repeat business and / or lost sales from new customers, and therefore, reduced / less sales revenue and profit for the customer.
- increased admin costs due to time taken to correct errors, resulting in lower profit (of the supplier).
- the supplier looking incompetent. This could lead to dissatisfied customers. This could negatively affect the reputation of the supplier and result in loss of repeat business and / or lost sales from new customers, and thus, lower revenue and profit for the supplier.

STEP 3: The GOODS RECEIVED NOTE...

Introduction – who completes it, when:

Completed by the customer (buyer) (or person authorised to receive goods on behalf of the customer) who sends it to the customer's stock and accounts departments **to maintain accurate stock and accounting records**.

How it is completed – a typical layout:

GOODS RECEIVED NOTE

GR Note No:

Name of Supplier
Address of Supplier

Delivery Date:
Delivery Note No:
Purchase Order No:

Quantity	Description

Received by:

SIGNED: ______________________________ Date: ________________

NB May also include supplier's product reference codes; comments re: condition of goods.

Purpose / Use / Importance / Benefit(s):

- A document recording items received (and accepted) from suppliers, which is sent to the purchasing firm's (ie the customer's) stock and accounting departments.
- Provides written proof of what has been received, and when, in case of a dispute.
- Important in maintaining accurate stock records.
- Important in maintaining accurate accounting records.
- Can be checked against the sales invoice (when received) to ensure the customer only pays for items received and accepted.

Importance of Accuracy:

If the goods received note is not completed correctly this could result in:

- inaccurate stock figures. This could result in insufficient orders being placed in the future to meet the buyer's customer requirements as the customer thinks there is more in stock than actually held. This would lead to dissatisfied customers and negatively affect the customer's reputation, resulting in loss of repeat business and / or lost sales from new customers and less sales revenue and, ultimately profit, for the customer.
- disputes with paying the supplier which, in the worst case scenario might lead to the supplier refusing to supply the customer in the future.

STEP 4: The INVOICE...

Introduction – Who completes it, when:

Completed by the supplier (seller) who sends it to the customer (buyer) **to request payment** for goods or services supplied.

How it is completed – a typical layout:

Name of Supplier
Address of Supplier

SALES INVOICE

Name of Customer
Address of Customer

Invoice No:
Invoice Date:
Customer No:
Purchase Order No:
Delivery Date:
Payment Terms:

Quantity	**Reference**	**Description**	**Unit Price**	**Total**
			Sub Total	
			VAT @ 17.5%	
			Total	

NB: May also include: supplier's VAT Registration Number; date goods were ordered; any discount applicable.

Purpose / Use / Importance / Benefit(s):

- A document requesting payment from a supplier for goods received by a customer.
- A document showing what the customer owes to a supplier.
- A record of what has been sold by a supplier / A record of what has been purchased by a customer.
- Can be used by the customer to check against the purchase order to make sure the supplier is charging the correct amount.
- Can be used by the customer to check against the statement of account (when this is received) to verify that the final balance shown on this document is accurate and can be paid in full.

Importance of Accuracy:

If the invoice is not completed correctly by the supplier this could lead to:

- the customer paying too little (or too much) for the goods or services supplied – ***if the customer does not detect the error.*** This could affect cash flow, and / or profit or loss of both the supplier and the customer, and could result in the wrong amount of tax being paid from incorrect profits or VAT, and thus, trouble with Inland Revenue and / or Customs and Excise involving financial penalties.

- the supplier looking incompetent. This could lead to dissatisfied customers. This could negatively affect the reputation of the supplier and result in loss of repeat business and / or lost sales from new customers, and thus, lower revenue and profit for the supplier.

- a delay in payment. This could negatively affect the cash flow of the supplier. It might mean the supplier cannot meet debts as they fall due. It might mean the supplier has to borrow money in the form of an overdraft, which would increase costs (interest payments) and lower profit.

- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the supplier.

STEP 5: A CREDIT NOTE...

Introduction – Who completes it, when:

Completed by the supplier (seller) who sends it to the customer (buyer) **to give credit** for faulty, damaged or returned goods or **to rectify mistakes** on previous invoices issued, and **prevent overpayment**.

How it is completed – a typical layout:

Name of Supplier
Address of Supplier

CREDIT NOTE

Name of Customer
Address of Customer

Credit Note No:
Date:
Customer No:
Invoice No:

Quantity	Reference	Description	Unit Price	Total
			Net	
			VAT @ 17.5%	
			Gross	

NB: May also include: purchase order number; reason for credit.

Purpose / Use / Importance / Benefit(s):

Sent by a supplier to a customer to:

- give credit for faulty, damaged or returned goods.
- reduce the amount owed on an invoice and prevent overpayment.
- rectify mistakes on previous invoices issued and prevent overpayment.
- rectify overpayment of an invoice.

The customer should check it against Goods Received Notes to ensure appropriate credit is being given.

Importance of Accuracy: *If not completed correctly this could result in:*

- too much or too little being credited for the goods or services supplied – ***if the customer does not detect the error.*** This could affect the profit or loss of both the supplier and the customer.
- the supplier looking incompetent. This could lead to dissatisfied customers. This could negatively affect the reputation of the supplier and result in loss of repeat business or lost sales from new customers, and thus, lower revenue and profit for the supplier.
- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the supplier.

STEP 6: The STATEMENT OF ACCOUNT...

Introduction – Who completes it, when:

Completed by the supplier (seller) at the end of the month who sends it to the customer (buyer) to show all the transactions over the month and **amount the customer owes / balance payable.**

How it is completed – a typical layout:

Name of Supplier
Address of Supplier

STATEMENT OF ACCOUNT

Name of Customer — Customer Account No:
Address of Customer — Date:

Transaction Date	Transaction No	Description	Debit £	Credit £	Balance £
				Amount Outstanding	

NB: May also include: statement no; supplier's VAT Registration Number; supplier's payment terms; summary of invoices outstanding from earlier trading periods; Remittance advice slip to tear off and present with payment (see STEP 7 below).

Purpose / Use / Importance / Benefit(s):

- Reminds the customer of unpaid bills.
- Assists the supplier in credit control.
- Should be used by the customer to cross check invoices and credit notes received to ensure the supplier is not over (or under) charging.
- Shows at a glance all transactions between a supplier and its customer, making it easier for the supplier to keep a check on who owes money and how much is owed, and quicker for the customer to check through, rather than lots of individual documents.
- Convenience – the customer only has to pay one rather than several separate amounts.

Importance of Accuracy: *If not completed correctly this could result in:*

- too little or too much being paid for the goods or services supplied – ***if the customer does not detect the error.*** This could affect cash flow, and / or profit or loss of both the supplier and the customer.
- the supplier looking incompetent. This could lead to dissatisfied customers and affect the reputation of the supplier, which could result in loss of repeat business and / or lost sales from new customers, and thus, lower revenue and profit for the supplier.
- a delay in payment. This could negatively affect cash flow of the supplier. It might mean the supplier cannot meet debts as they fall due and the supplier has to borrow money, which would increase costs (interest payments) and lower profit.
- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the supplier.

STEP 7: The REMITTANCE ADVICE SLIP...

Introduction – Who completes it, when:

Sent by the customer (buyer) with payment to the supplier (seller) to **show what the payment being made is for**. Issued as **proof the supplier has been paid the correct amount.**

How it is completed – a typical layout:

Name of Supplier
Address of Supplier

REMITTANCE ADVICE SLIP

Name of Customer
Address of Customer

Date:

Invoice No.	Date	Amount

Payment Method:

Total Paid:

NB May also include: Customer Account No / Code.

Purpose / Use / Importance / Benefit(s):

- Provides a record that payment has been made by / received from a particular customer, and what the payment is being made for.
- Enables the supplier to reconcile their accounts.

Importance of Accuracy:

If the remittance advice slip is not completed correctly this could result in:

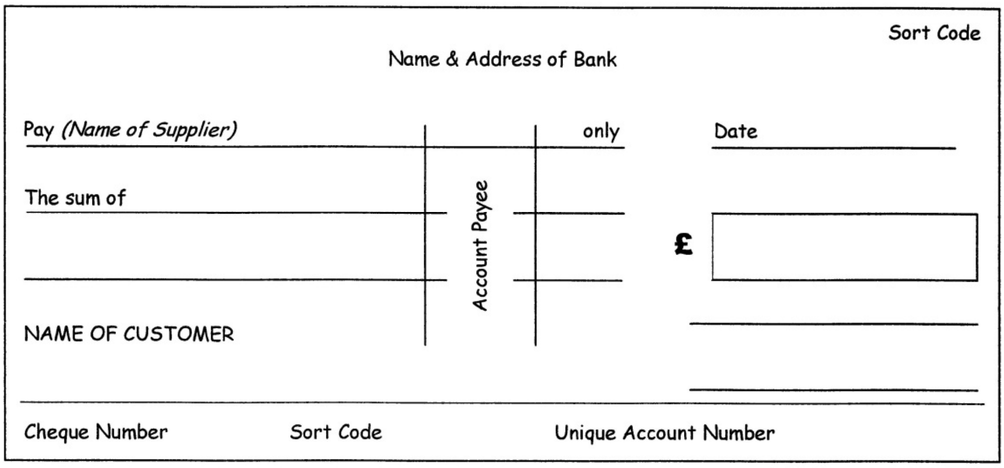
- too little or too much being paid for the goods or services supplied. This could affect the cash flow and / or profit or loss of the supplier and the customer.
- the supplier not being happy (if too little is paid) and refusing to supply any more goods or services to the customer, or asking for cash on delivery for future orders, rather than giving credit. In the worst case scenario, if mistakes keep being made by the customer, this may damage the reputation of the customer and other suppliers might refuse to supply them.
- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the customer.

STEP 8: A CHEQUE...

Introduction – Who completes it, when:

Completed by the customer (buyer) who sends it to the supplier (seller) to **pay for the goods or services supplied**.

How it is completed – a typical layout:



Purpose / Use / Importance / Benefit(s):

A relatively secure way of paying for goods and services – less risk of theft than with cash payments – addressee named on cheque and signature of addressee required. Therefore, difficult for potential thief to impersonate addressee. Also much more convenient than carrying around large amounts of cash.

(NB The advantages and disadvantages of paying by cheque in relation to other methods of payment are covered in detail in the following sub-unit).

Importance of Accuracy:

If the cheque is not completed correctly this could result in:

- too little or too much being paid for the goods or services supplied. This could affect the cash flow and / or profit or loss of the supplier and the customer.
- the supplier not being happy (if too little is paid) and refusing to supply any more goods or services to the customer, or asking for cash on delivery for future orders, rather than giving credit. In the worst case scenario, if mistakes keep being made by the customer, this may damage the reputation of the customer and other suppliers might refuse to supply them.
- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the customer.

STEP 9: A RECEIPT...

Introduction – Who completes it, when:

Completed by the supplier (seller) who sends it to the customer (buyer) **once payment has been received**.

How it is completed – example layout:

Name of Supplier
Address of Supplier

RECEIPT

Name of Customer
Address of Customer

Invoice / Statement No:
Date:

Reference	Details	Amount
	Payment Method & Amount Paid	
	Balance	

NB: May also include: supplier's VAT Registration Number; unique customer account number/code; purchase order no; order date; delivery date.

Purpose / Use / Importance / Benefit(s):

- Issued by the supplier to notify the customer that payment has been received.
- Important record for the customer to confirm that payment has been made for goods / services received.

Importance of Accuracy:

If the receipt is not completed correctly by the supplier this could result in:

- the supplier getting confused about which payment for goods and services supplied has been received from the customer.
- the supplier looking incompetent. This could lead to dissatisfied customers. This could negatively affect the reputation of the supplier and, if mistakes keep being made, in the worst case scenario, this could result in loss of repeat business and / or lost sales from new customers, and thus, lower revenue and profit for the supplier.
- increased administration costs due to time taken to correct errors, resulting in reduced / lower profit for the supplier.

Financial Documents
(Can you remember???)

Match the documents up to the correct definitions!

Remittance Advice
Sales Invoice
Delivery Note
Order Form
Cheque
Goods Received Note
Receipt
Statement
Credit Note

a) A document sent by the supplier with the goods so that they can be checked by the purchaser

b) A document used by the purchaser to order goods from a supplier

c) A document used to confirm that payment has been made

d) Used to reduce the amount of money owed by the customer

e) Shows a list of transactions and the amount owed at the end of the month

f) Shows how much is owed for an order

g) A document which is signed by the purchaser to prove that the goods have been delivered

h) Sent with a payment to help match the payment with an invoice or statement

i) A document used to transfer money from one bank account to another.

Joe Jones is the owner of a Clothes Shop called *Trendy.*

When *Trendy* orders stock a number of documents will be used. These will include:

- delivery notes
- invoices
- statements of account
- purchase orders
- remittance advice.

(a) Which document would be used in the following situations? Tick **one** box for each answer.

	Delivery note	**Invoice**	**Purchase order**	**Statement of account**	**Remittance advice**
Trendy will send this document to a supplier when they want to buy something.					
The supplier will send this document to *Trendy* to request payment for the items supplied.					
The supplier will send this document to *Trendy* at the end of the month to inform them how much is owed.					
Trendy will send this document to the supplier together with their payment.					
The supplier will send this document with the goods required by *Trendy.*					

(b) *Trendy* has received the following items from one of its suppliers:

- 10 x baseball caps – Reference CF 657
- 15 x leather belts – Reference SSM 342
- 20 x silky scarves – Reference SWL 517
- 12 pairs x gloves – DE 87

Use the information above to complete the **shaded** areas of the Goods Received Note below for *Trendy*.

GOODS RECEIVED NOTE

FROM SUPPLIER
Magic Wears
Smith Street
Manchester
M10 2RL

Order no: 57894 **Delivery Note No:** 432 **Delivery Date:** Today's date

Quality	Description	Reference
10	Baseball caps	CF 657

Received by:

Signed: .... **Date: ....**

(c) The person responsible for receiving goods at *Trendy* wrote 20 baseball caps on the Goods Received Note, instead of 10. Explain **one** possible problem **for *Trendy*** that may result from this mistake.

....

....

....

....

Task 4

June Smith sells mobile phones and mobile phone accessories. She buys most of her mobile phones and accessories from *Mobile Accessories Ltd.*

When *June Smith* buys mobile phones and accessories from *Mobile Accessories Ltd* a number of documents will be used. These will include:

- goods received notes
- statements of account
- delivery notes
- credit notes.

(a) Using the information above, identify which document would be used in the following situations. Tick **one** box for each answer.

(i) *Mobile Accessories Ltd* will send this document to *June Smith* with the mobile phones and accessories.

Goods received note	
Delivery note	
Credit note	

(ii) *June Smith* will keep this document for accounting and stock purposes *after the goods have been delivered.*

Goods received note	
Delivery note	
Statement of account	

(iii) *Mobile Accessories Ltd* will send this document to *June Smith* at the end of the month to inform her how much is owed.

Statement of account	
Delivery note	
Credit note	

(iv) *Mobile Accessories Ltd* will send this document to *June Smith* should they owe June some money.

Goods received note	
Statement of account	
Credit note	

(b) Below is the Invoice for an order that *June Smith* has made. Complete the **shaded** boxes of the Invoice for the goods received and accepted by *June Smith*.

INVOICE

From:
Mobile Accessories Ltd
90 Tele Road
Rogford
RP0 8PN

Invoice No: 5623147 **Date:** 24th May 2014

TO:

June Smith Mobile Phone Shop
478 High Street
Rogford
RP9 4RT

Your Order Number		Delivery Date		Terms	
76431		2nd June 2014		28 days net	
Quantity	**Ref. Number**	**Description**	**Unit Price**	**Total**	
				£	p
12 dozen	NC7 654	Nokia Cases	£15.00	180	00
50	SHFS 654	Samsung Hands Free Set	£20.00		
100	BS 136	Blueberry Sets	£35.00		
			Sub Total		
			VAT @ 20%		
			Total		

(c) *Mobile Accessories Ltd* has recently sent out a number of Invoices containing errors.

Explain **two** possible problems **for *Mobile Accessories Ltd*** when mistakes are made on Invoices.

Problem 1……………………………………………………………………………………………

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Problem 2……………………………………………………………………………………………

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GGJ needs to order items for the business. Below is an extract from the sales catalogue of *Gold'n'Stuff*, one of *GGJ's* suppliers.

Gold'n'Stuff
Wholesale Jewellery Supplies
Unit 3
Navigation Business Park
St Annes SX23 9NW

Details and prices

Item description	Order code	Case quantity	Case price(£) excluding VAT
30 inch 13 mm luxury 24k gold plated curb chain	30GPC	5	45.00
24 inch 4 mm 24k gold plated rope necklace	24GPR	15	56.40
20 inch 13 mm luxury 24k gold plated curb chain	20GPC	10	93.20
36 inch 6 mm 24k gold plated wheat necklace	36GPW	5	35.00
24 inch 6 mm 24k gold plated wheat necklace	24GPW	10	43.50
30 inch 16 mm giant 24k gold plated belcher chain	30GPB	5	49.45
24 inch 6 mm 24k gold plated figaro chain solid necklace	24GPF	10	37.30

Isabel has been left the instructions below.

The gold plated chains have sold very well. Could you please order the following to be delivered immediately?

15 of the 30 inch 13 mm luxury 24k gold plated curb chain
20 of the 20 inch 13 mm luxury 24k gold plated curb chain
20 of the 36 inch 6 mm 24k gold plated wheat necklace

The last order number was 2734.

Continued on next page…

3 (a) Complete the Purchase Order below.

To:

(1)

Order number:

(1)

Qty	Item description	Order code	Case quantity	Unit price excluding VAT		Total price excluding VAT		
				£	p	£	P	
3	30 inch 13 mm luxury 24k gold plated curb chain		5	45	00	135	00	(1)
2	20 inch 13 mm luxury 24k gold plated curb chain	20GPC		93	20	186	40	(1)
4	36 inch 6 mm 24k gold plated wheat necklace	36GPW	5					(2)
					Total			(1)
Delivery terms:								(1)

Mark out of 8

Sam also ordered and paid for goods from another supplier *BetterBox*. Sam has completed the Goods Received Note below.

Goods Received Note

Number: GRN635 Our Ref: BBS9238
Date: 20/12/2012

No. of boxes	Item description	Order code	Condition of goods
100	Plain Charm Box (Size 3)	PCB3	All OK
100	Plain Pendant / Charm (Size 4)	PPC4	All OK
50	Plain Pendant / Bangle (Size 6)	PPB6	All OK
50	Necklace Box - Plain Long (Size 8)	NPL8	10 boxes damaged - returned
40	Drawstring Paper Gift Bags	DPGB	Only 30 boxes sent

When Sam completed the Goods Received Note she noticed some errors with the delivery.

She has now received the following Credit Note from the suppliers *BetterBox*.

BetterBox

Credit Note

To:
Gem Gallery Jewellers
Unit 3 The Pallisades
Smethick
BM1 2WS

Reason for credit:

Damaged in transit
Shortage of goods

Your returns ref	Customer account number	Date	Invoice number	Credit note number
783	6702	02/01/2013	GGJ2730	539

Quantity	Description	Unit price		Total price (£)	
		£	p	£	p
10 boxes	Necklace box - plain long (size 8)	0	70	7	00
10 boxes	Drawstring paper gift bags	4	50	45	00
	Goods total			52	00
	VAT @ 20%			10	40
	TOTAL			**41**	**60**

Continued on next page…

(b) Outline the purpose of a Credit Note for a business such as *GGJ*.

(2)

The Credit Note *GGJ* received from *BetterBox* contains an error.

(c) Identify the error on the Credit Note.

(1)

(d) Explain the effect on *GGJ* if Isabel does not spot this error.

(4)

Mark out of 7

Isabel has asked for your help in completing the following sales invoice.

4 (a) Complete the invoice by filling in the blank boxes.

Gem Gallery Jewellers
Unit 3 The Pallisades
Smethick
BM1 2WS
VAT Reg No. 3562789

Invoice date: 3/01/2013

Invoice number: 6273

Code	Description	Quantity	Unit price (£)	£	p	
EW354	Ladies evening watch (gold plate)	1	115.83	115	83	
LOB56	Ladies 4 mm oval bangle (9k gold)	1	184.95	184	95	
			Goods total			(1)
			Discount @ 5%			(1)
			Sub total			(1)
			VAT @ 20%			(1)
			Total to pay			(1)

Mark out of 5

You have started to draw the chart below to help Kerry Ann understand the flow of financial documents.

Your chart shows the order in which documents are sent when *Simply Bake plc* buys from a supplier. Each arrow points in the direction that the document takes.

(c) Complete the chart below.

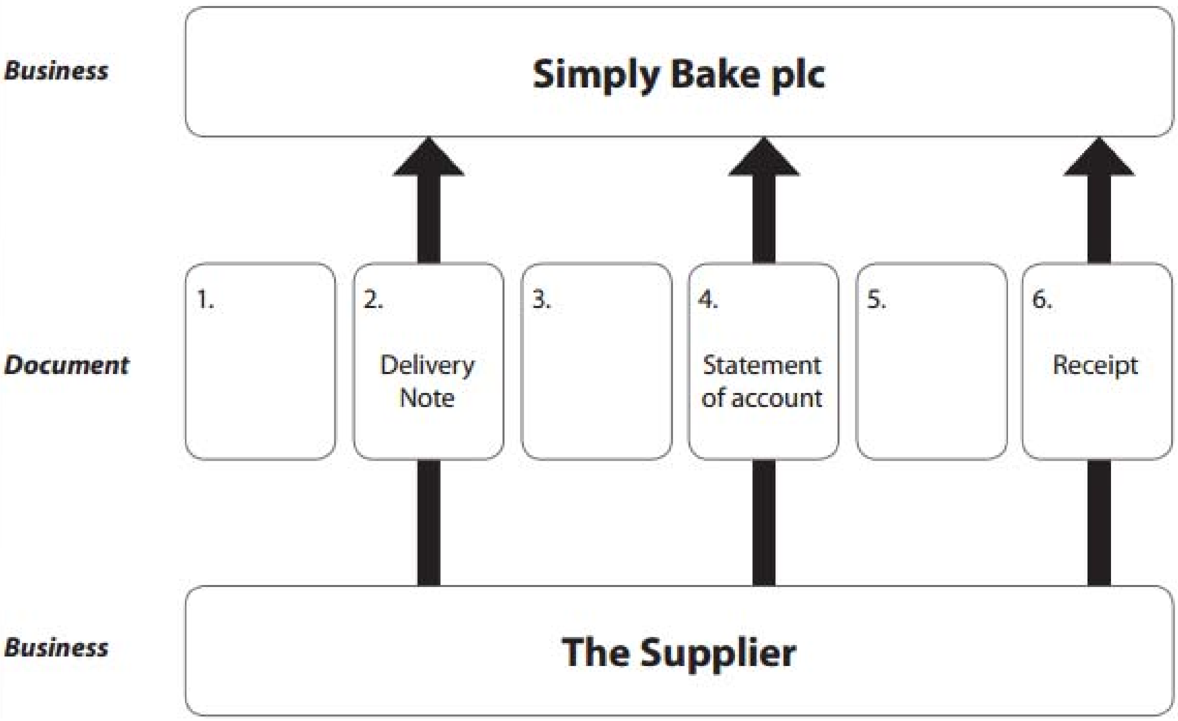
(i) In each of the three blank boxes 1, 3 and 5, write the name of **one** of the documents listed below in the correct order, from left to right.

(3)

- Cheque
- Invoice
- Purchase order.

(ii) Draw an arrow from boxes 1, 3 and 5 to show who sends the document and who receives it in light of your answer to (c) (i) above.

(3)



Mark out of 6

2) Computerised Accounting Systems

Definition: As its name suggests, “Computerised accounting” is accounting done with the aid of a computer. It involves using software to create financial documents automatically, it also allows the business to keep track of a client’s financial transactions

The Advantages and Disadvantages of <u>Computerised Accounting Systems</u> (in relation to Manual / Paper Based)

General

Computerised accounting systems cost money to purchase and maintain but should reduce costs in the long-run due to the amount of time they save producing accounting documentation, and undertaking other accounting functions eg keeping track of debtors, in comparison to manual, paper-based systems.

Computerised accounting systems are quickly and easily able to produce all the documents that pass between customer and supplier mentioned in the above sections, as well as end of year accounts and, with some systems, payroll documentation. This is because, in many instances, the accounting documentation that passes between customer and supplier contains much the same information and, unlike manual, paper-based systems, with computerised systems this information (eg suppliers’ address, product codes, product descriptions and prices) only needs to be entered once, and all related accounting documentation (eg delivery notes, invoices, receipts, statements of account, etc) are instantly updated.

Computerised accounting systems also automatically calculate totals and a file searching and sorting facility allows a business to keep close track of its debtors and creditors.

The main advantages and disadvantages of computerised accounting systems are summarised in the table below.

Advantages

Speed – automatic calculations (automated formulae), plus production, retrieval, updating / amendment of accounting information - much quicker than manual (with word processing, file searching and editing facility), therefore:

- lower admin costs and higher profit and / or admin time freed up to do other jobs;
- faster response to customer queries, resulting in more satisfied customers;
- faster payment (quicker processing and issuing of bills), improving cash flow.

Credit control – in addition to quicker processing and issuing of bills, easier to keep track of debtors – computerised systems can produce reports showing who owes the business money, therefore, improved cash flow.

Storage – less storage space required as the information is stored electronically, thus: lower fixed costs relating to storage eg rent, insurance; and / or space freed up for other uses eg revenue generating activities.

Accuracy – less opportunity for human error and (with word processing, file searching and editing facility) any mistakes can easily be put right - therefore helping to minimise / avoid:

- government penalties arising from incorrect accounts and tax (corporation tax, VAT) calculations;
- lost sales / repeat business arising from sending inaccurate documents to customers.

Presentation – more professional than handwritten, therefore improved image / reputation / status.

Greater security – can set up passwords to limit access, can save data, and quickly and easily create backups.

Overall – enhanced **organisational efficiency / productivity** – important in:

- **gaining a competitive edge** eg through lower prices; and / or
- **higher profits** as a result of lower costs.

Disadvantages

Initially:

- **Purchase cost of computer and accounting software.** (New business might not be able to afford it, might require (further) borrowing thus increasing start-up costs).

- **Cost of training** accounting staff to use the new accounting hardware and software. (Small business might not have the time / resources, might have to use outside agency, increasing costs).

- **Potential redundancies** – negatively affecting the morale and motivation of staff.

- **Changes in the way the business operates** – computerised accounting systems / packages are designed to suit most types of business – a business may, therefore, need to change the way it operates in order to suit the package.

- **Potential resistance** from accounting staff to implement the new technology or change the way they operate eg due to difficulties in learning new skills, fear of redundancies.

Ongoing issues:

- **Annual maintenance and support fees / charges** – some computerised accounts packages may require these.

- **Security** – potential for financial accounting information to be accessed by computer hackers.

- **Potential for viruses** – loss of key accounting information (unless backups taken regularly).

- **Potential system / computer failure** – loss of data (backups should be taken regularly).

- Danger of becoming **over reliant** on technology – inability to produce accounting documentation through manual means.

Billy-Bob Brannan has been told by his friend Jimmy-John Jingle that he would benefit from introducing a computerised accounting system to help him complete his financial documents. Billy-Bob isn't sure what a computerised accounting system is or what it does. Help Billy-Bob out by explaining what a computerised accounting system is and how it might help him with his business selling Banjo's. (8)

Billy-Bob likes the sound of introducing a computerised accounting system but just as he was looking to invest, Jimmy-John explains that a computerised accounting system could potentially lead to a drop in profits. Billy-Bob is confused again. Help him out again by explaining why a computerised accounting system could lead to a drop in profits (6)

ETP uses a computerised accounting system.

2 (a) Outline **one** advantage of preparing a business document using a computerised accounting system rather than a manual system.

(2)

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Mark out of 2

Sam is considering installing a computerised accounting system rather than keeping the manual accounting system she has at present.

5 (a) Explain **one** advantage to *GGJ* of introducing a computerised accounting system.

(3)

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(b) Explain **one** disadvantage to *GGJ* of introducing a computerised accounting system.

(3)

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Mark out of 6

3) Business Costs

Costs

A cost is occurred when the business has to pay for an object or service.

Business costs may include the cost of:

- purchasing / replacing premises, machinery, equipment and vehicles
- raw materials
- wages and salaries, employer's National Insurance
- rent
- gas, electricity, water rates, telephone
- advertising
- stationery, postage
- petrol
- repairs and maintenance
- interest on loans and depreciation.

Business costs may also include the costs of services obtained from outside the business to aid control or minimise the risk involved, eg: accountancy, insurance, and legal fees.

Cost information can help a business to:

- Determine **prices** required to cover costs and secure acceptable reward for investment.
- Determine whether or not sufficient **profit** is being / will be made on current / proposed business ventures, and whether it is worth continuing.
- Determine whether or not sufficient **finance** is available to meet anticipated costs, thus allowing timely decisions to be made on how to cut costs and / or raise the additional finance required.
- Compare **forecasted and actual** costs in order to take timely and appropriate action to rectify any areas of concern.

There are two types of costs; Running costs and start-up costs.

The Difference between Start-up Costs and Running Costs

Start-up Costs

Start-up costs are one -off costs incurred when you start a business or launch a new product or service. These might include:

- **Premises** eg factory, shop, office (if bought outright as opposed to rented).
- **Machinery and equipment** eg office equipment such as computers and photocopiers (if bought outright as opposed to leased or purchased on hire purchase).
- **Vehicles** (if bought outright as opposed to leased or rented).
- **Fixtures and fittings** eg carpets, curtain rails.
- **Furniture** eg desks and chairs.
- **Market research** to investigate potential demand for the new product / service and identify the marketing mix required to meet customer needs.
- **Initial recruitment, selection and training** of new staff to ensure the right number of people are recruited and trained to meet anticipated customer requirements.
- **Initial advertising of the opening** to make sure people know the business exists and encourage them to buy the product or service.
- **Initial design costs** to develop the right product or establish a company website.
- **Decorating costs.**
- **Signage** for the new premises.
- **Initial stock** for display.

Running Costs

Running costs are day-to-day costs incurred by a business in the making and selling of its products / service(s). These might include:

- **Raw materials, including any materials used in packaging.**
- **Wages and salaries** and **employer's national insurance contributions.**
- **Rent / leasing or hire purchase payments** on any buildings, machinery, equipment or vehicles rented, or leased, as opposed to purchased outright.
- **Government taxes – VAT on sales, business rates** - a charge on non-domestic premises to help fund local services provided by local authorities eg refuse collection, police.
- **Water rates.**
- **Heating and lighting.**
- **Telephone.**
- **Advertising and promotion** – once the business is established.
- **Printing, postage and stationery.**
- **Petrol.**
- **Repairs and maintenance.**
- **Legal and professional fees** including **Insurance** eg employer's liability, office, professional indemnity.
- **Bank charges** and **interest on any loans taken out.**

The Role Played by ICT in Helping to Reduce Costs

ICT stands for **Information and Communications Technology**. Numerous examples of how ICT is helping to reduce costs with reference to specific types of business, and areas within business, are provided below.

Computers and General Office Administration

Computers have impacted on general office administration with the word processing, editing function enabling speedy corrections, modifications and revisions of documents on screen, prior to printing, and there is swift access to all records held therein. This has significantly **reduced labour, printing and stationery costs.**

CAD / CAM

Information technology can be used in the design and production of products, using CAD (Computer Aided Design) and CAM (Computer-Aided Manufacture).

CAD allows a business to simulate the product on a computer screen and alter the specification, colour, features, in order to change the design, without ever having to build a prototype, thus **minimising design costs.**

CAM uses computers to control and adjust the production process. It allows firms to manufacture products in **shorter times,** with **improved quality and reliability,** and thus, **lower costs**.

EPOS, EDI and Stock Control

Modern stock control systems consist of laser scanning devices that are used to scan the bar codes of stock items arriving into a business. This information is then passed to a central computer which stores details of the stock levels held. Any items leaving the business (as sales or disposals, ie goods disposed of due to damage or going past their sell-by date) are also scanned, and the details fed back to the central computer which automatically updates the stock figures held. Furthermore, through the use of Electronic Data Interchange (EDI) information on sales and stock levels of a business can be passed to suppliers enabling orders to be generated automatically and deliveries to arrive as and when required (ie 'Just-in-Time').

The use of **EPOS** (electronics at the point of sale) systems is particularly common to **retail outlets**, in particular **supermarkets.** The familiar "beep," so frequently heard at supermarket checkouts, is now a natural part of shopping. All but the most old-fashioned retail chains have developed this technology. The **bar code** of any items sold are scanned into the till, and any items disposed of are scanned using a hand-held scanning device (rather than manually keyed in) and the details fed back to the branch computer which automatically updates sales and stock records held.

Information is also passed from the store computer to the chain's headquarters by **EDI** (electronic data exchange). This allows the centralised buyers to quickly assess demand patterns of every single product sold within the store and then to place a **bulk order** with the suppliers. In the past, managers had to perform a manual check (physically counting items held on the shop floor) and then place an order for the following week's delivery.

Such systems help reduce / minimise the following:

- **the cost of purchases** – as they enable bulk orders to be placed at discounted prices.
- **labour costs** – as they reduce the number of times stock has to be manually counted, plus more customers can be served in a shorter space of time, therefore less staff are needed.
- **stock loss and associated costs** – as greater accuracy of ordering leads to less reductions and disposals (caused by over ordering).
- **storage costs** – as up to date figures on stock levels enables faster ordering, so less buffer stock is required 'just-in-case'.
- **loss of repeat business** – as more accurate ordering helps minimise customer dissatisfaction resulting from poor availability of goods, and thus, the potential loss in sales and profits that could be caused by this.

Furthermore, more frequent deliveries (of smaller amounts), has led to a reduction in warehouse space and a consequent increase in selling space, allowing supermarkets to sell a wider range and higher volumes **without the need to invest in extra fixed capital.**

State two examples of running costs and explain how you know they are running costs

1)..
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2)..
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Running or start-up?

Cost	Start-up cost	Running cost
Rent		
Computer equipment		
Utility bills		
Staff wages		
New factory building		
Equipment Maintenance		
Initial advertising		
Annual staff training		
Delivery Vehicle		

Macy is the owner of Grandio Supermarkets. She has been told that she can reduce costs by using ICT. She has money to invest but is unsure of what to buy. Advise Macy on what she could buy and explain how this will benefit the company. (6)

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2 *Simply Bake plc* has to pay different types of costs.

(a) Using the information below, list the costs for *Simply Bake plc* as **either** start-up **or** running costs by ticking the correct column. The first one has been completed for you.

(5)

	Start Up Costs	Running Costs
A stock of flour		✓
Specialist equipment needed to make the cakes		
A monthly advert in a food magazine to promote the company's products		
Supplies of tea and coffee for clients and staff		
Staff wages		
Industrial ovens		

Mark out of 5

2 When Sam started *GGJ* she identified and listed the following costs:

- tills
- a monthly advert in the local newspaper to promote the store's products
- display cabinets for the shop floor
- stock of tea and coffee for the staff.

(a) (i) What is meant by the term **start-up cost**?

(1)

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....

(ii) Identify a start-up cost from **Sam's list above**.

(1)

....

....

(b) (i) What is meant by the term **running cost**?

(1)

....

....

(ii) Identify a running cost from **Sam's list above**.

(1)

....

....

Mark out of 4

4 Eira is considering moving the business to a purpose-built studio.

She understands that this will involve both start-up and running costs.

(a) Give an example of **one** start-up cost and **one** running cost that Eira might face.

(2)

Start-up cost ....

Running cost ....

(b) Explain the difference between start-up and running costs.

(4)

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Mark out of 6

4) Payment Methods

When a customer buys something from a business they have to make a payment for the goods or services they receive. Equally when a business pays a supplier they also have to make a payment. When making a payment they have various options to choose from.

CASH

DEBIT CARDS

CREDIT CARDS

CHEQUES

DIRECT DEBITS

CREDIT TRANSFERS (BACS)

ONLINE PAYMENT SYSTEMS
e.g.PayPal

Each payment method is defined with advantages and disadvantages on the next few pages.

Cash

How Payment Method Works

The buyer gives the seller money for the purchases, usually in a face to face situation or through some form of secured post / courier service (eg Registered Special Delivery).

The buyer should ideally be provided with a written / till receipt detailing the item(s) purchased, the cost, and VAT (if applicable), as a record that payment has been made.

Cash is more suitable for small amounts and when the seller is unlikely to give credit, eg when a buyer is new and has no credit history, or when a buyer has a poor credit rating.

Cash is frequently used by a business to pay for:

- 'Cash and Carry' sales where the buyer goes to a warehouse (like a large supermarket for traders). The buyer picks the items they want and takes them to a till where cash is handed over as payment.
- petty cash for items such as tea, coffee, postage.

Cost(s) for the Buyer

Generally none - unless additional travel is involved to make payment face to face, or, the cash is sent through some form of secured courier / postal service.

Cost(s) for the Seller

There are generally no costs for the seller, unless large cash payments necessitate investment in extra security measures.

Time it Takes

Instant.

Summary of Relative Advantages

For Buyer:

- No administration involved in filling out forms / making arrangements for payments.

- Less likely to get into to debt than other payment methods - as can see, touch and count the money, thus easy to see when you are running out.

For Seller:

- Payment is instant - assists cash flow.

Summary of Relative Disadvantages

For Buyer:

- Least secure of all payment methods as easier to steal cash than steal through other methods of payment, and if cash is lost or stolen, less likely to get it back as cash is less traceable than payment through other methods.

- Immediate affect on cash flow – no delay / period of grace between when the money leaves the business / bank, unlike majority of other methods.

- Usually has to be made face to face, or through some secured courier means (due to the potential problem of theft if sent through standard post) and, therefore, might incur travel costs (in comparison to other methods such as direct debit or other forms of credit transfer which can be made over the telephone or via the internet), which would incur delivery / postage costs.

- Possibility of being short changed.

For Seller:

- Less secure – greater risk of theft when money is handled / kept on the premises.

- Greater administration costs involved with cashing up at end of day - taking money to the bank and having to wait whilst the teller counts it is costly in terms of time and, perhaps, travel expenses.

- Possibility of giving out incorrect change – too much would obviously mean a loss for the seller.

Debit Card

How Payment Method Works

Paying by debit card is similar to paying by cheque. Instead of writing out a cheque a buyer will produce a plastic card which contains their bank account details and simply hands this (or phones the card number details through or types in the details online) to the seller. The money is then transferred from the buyer's bank account to the seller's bank account.

Cost(s) for the Buyer

- Banks may charge per business debit card purchase.

Cost(s) for the Seller

- Debit card companies (ie merchant service providers) charge the seller for using this payment collection method.

Time it Takes

- It usually takes between 1 and 3 working days for the money to be transferred from the buyer's to the seller's bank account. NB If the buyer and seller hold their account with the same bank, the money may be transferred the same day.

Summary of Relative Advantages

For Buyer:

- More secure than carrying / using cash as pin / signature required, and it is easier to trace payment.
- No admin time writing out cheque - card simply handed to seller / inserted in machine.
- More convenient to carry than cash and cheque books.
- Remote purchases possible (unlike cash/cheques) - can purchase items by phone / internet.
- Some delay before money leaves bank - may take between 1 and 3 days for money to be transferred - can ease cash flow, plus money in bank earning interest for these days (unlike cash payments).
- Eliminates possibility of being short changed - in relation to cash payments.
- Little chance of going overdrawn as balance is often checked immediately.

For Seller:

- More secure than payment by cash (or cheque) as less money is kept on the premises. Therefore, there is less risk of theft.
- Bank may be credited immediately (although it usually takes between 1 and 3 working days).
- Machine can automatically check whether or not there are sufficient funds in the account - cheques can bounce.
- Easier to cash up at end of day - fewer coins and notes and less admin time than dealing with cheques eg filling in paying in book and taking them or posting them to a bank.

Summary of Relative Disadvantages

For Buyer:

- Less secure than credit transfer and direct debit payments - card can get lost / stolen and it takes time and a bit of form filling to get a replacement.
- Easier to get into debt - as easier than cash to lose track on what you have spent.
- Open to fraud - remote use risks card details falling into the wrong hands resulting in fraudulent purchases being made on the card.

For Seller:

- Incurs costs from charges payable to merchant service providers - reducing overall profit made on purchases.
- There may be up to a 3 day delay before the money actually appears in the bank.

Credit Card

How Payment Method Works

A credit card is a plastic card which gives the credit card holder a credit limit. The cardholder is able to make purchases up to this credit limit and to pay off some, or all, of the debt incurred each month.

This type of payment method allows the buyer to purchase goods and services and pay for them later. Interest is charged if the debt is not paid in full, on any amount outstanding after a certain period of time (usually after a 55 day period). If all debt is paid off each month there is no interest. Many retail stores now have their own credit card.

Cost(s) for the Buyer

- Buyer usually gets 56 days interest free on the cost of purchases made using the card, otherwise they are charged interest on outstanding balances.
- Some companies charge an annual fee for holding such a card.

Cost(s) for the Seller

- Credit card companies charge the seller for using this payment collection method.

Time it Takes

Money may be transferred instantly but can take up to 3 working days.

Summary of Relative Advantages

For Buyer:

- More secure / safer than cash - as pin/signature required and easier to trace payment.
- More convenient to carry than cash and cheque books.
- No admin time writing out cheque - card simply handed to seller / inserted in machine.
- Can buy now pay later - useful for unexpected, larger purchases.
- Payment can be spread over time - assisting cash flow.
- Free use of funds if balance paid on time - 56 day period of interest-free credit.
- Eliminates possibility of being short changed - in relation to cash payments.
- Remote purchases possible (unlike cash/cheques) - products /services can be purchased via the internet or phone.
- Many cards offer other benefits eg insurance cover, cashback, air miles.

For Seller:

- More secure than cash (or cheque) – as less money is kept on the premises, thus, there is less risk of theft.
- Money may be in the bank the same day unlike cheques and other methods eg direct debit.
- Less admin time cashing up at the end of day due to holding fewer coins and notes.

Summary of Relative Disadvantages

For Buyer:

- Can be an expensive way of paying for goods if payment is not made within the interest free period – due to the high interest rates generally applied, especially if the minimum payment is not made on time.
- Can damage credit rating if payment is late.
- Easier to get into significant debt – easier than cash to lose track on what you have spent.
- Less secure than credit transfer and direct debit payments – as card can get lost / stolen, and it takes time and a bit of form filling to get a replacement.
- Fraud - remote use (eg over the internet) risks card details falling into wrong hands and fraudulent purchases being made using the card.
- Some companies charge an annual fee.

For Seller:

- Incurs costs from charges payable to credit card companies – reducing overall profit on purchases.
- There may be a day or two delay before the money appears in the bank.

Cheque

How Payment Method Works

Cheques come in a cheque book issued by the buyer's bank.

The buyer's money is kept in a bank account and when they want to make a purchase they simply fill in the cheque (name of payee, date, amount in words and figures, and authorised signature of buyer), and hand or post it to the seller. (NB in a face to face payment situation many cash tills / registers will print the cheque for the buyer and simply require a signature).

A cheque guarantee card may be required by the seller before they will accept the cheque as payment. This is a plastic card with a unique number. It contains details of the buyer's bank account, and has a blank strip on the back which the buyer must sign before use.

Regardless of the amount of cash in the buyer's bank account at the time, the bank will guarantee that they will honour the buyer's cheques up to the agreed limit shown on the card (usually £50, £100, or £250). The seller will examine the card to make sure the signature on the cheque matches the one on the card, and will write the card number on the back of the cheque.

Cost(s) for the Buyer

- Banks may charge for business cheques paid out.
- Banks will charge for any 'bounced' cheques, ie cheques that cannot be paid out due to insufficient funds in the account (including any overdraft agreement).

Cost(s) for the Seller

- Banks may charge for business cheques paid in.
- Banks will normally charge the seller for any cheques that are returned eg due to insufficient funds in the buyer's account, although this is much lower than the charge(s) incurred by the buyer.

Time it Takes

Usually takes a minimum of 3 working days to clear.

Summary of Relative Advantages

For Seller:

- More secure / safe than cash – less risk of theft as money not handled / kept on the premises.

For Buyer:

- More secure / safer than cash as cheque made out to specific individual / firm and signature of buyer required.
- More convenient than carrying around large amounts of cash.
- Not as easily lost as cash as cheques are easier to trace - there is a named firm / individual on a cheque who might be able to be traced if a cheque / cheque book gets lost.
- Some delay before money leaves bank - usually takes a minimum of 3 working days for cheque to clear - so no immediate affect on cash flow, money still in the bank earning interest during this time (unlike cash payments).
- Can be posted using unsecured method (unlike cash which is easier to steal) - thus minimum travel / postage costs.
- Eliminates possibility of being short changed (in relation to cash payments).

Summary of Relative Disadvantages

For Buyer:

- Admin time spent filling out cheque, and cost of postage if sent by post.
- Banks may charge for business cheques paid out.
- Less secure than credit transfer eg direct debit payments - as cheques (like cash) can get lost / stolen.
- Easier to get into debt than cash - as easier to lose track on what has been spent.
- Banks will charge fee and interest payments on any business cheques that 'bounce' / overdrawn accounts.

For Seller:

- Delay before money is cleared in the bank.
- Risk of buyer cancelling cheque after it has been presented for payment and before it is banked.
- Bank may charge for business cheques paid in.
- Admin time spent banking cheque eg filling in paying in book and posting cheque to bank - incurring postage costs, or taking it to the bank - which might incur travel expenses.

NB Buyer should make sure there is money in the bank account, otherwise the cheque will not be paid and will be returned to the seller, which might **incur bank charges for both buyer and seller.**

Direct Debit

How Payment Method Works

A direct debit is a monthly payment that goes straight out of the buyer's bank account into the seller's. Direct debits allow a business / supplier to claim payment direct from a buyer's bank account. The amount may vary from time to time. For example, a buyer may arrange for a telephone bill to be paid by direct debit. When the bill becomes due the telephone company will ask the buyer's bank for the amount due. The buyer has to complete a form to set up the scheme and agree a date on which the money will be taken from the account each month, but this can be done over the phone.

Two types of direct debit are available – fixed and variable. A fixed direct debit is where the same amount is taken out every month. This might be used, for example, to pay water rates. A variable direct debit is where a varying amount is taken out each month – usually to cover the total purchase bought / used in the period. This is often used, for example, to pay telephone bills which may vary considerably from one month to the next.

The direct debit system is only usually appropriate where regular payments to the same supplier are likely to be made throughout the year. It is particularly suitable where the amount payable is not known in advance or the amount varies from one period to the next.

Cost(s) for the Buyer

Banks may charge businesses a fee for each purchase they make using direct debit.

Cost(s) for the Seller

None.

Time it Takes

Money is usually transferred from the buyer's to the seller's account within 3 working days.

Summary of Relative Advantages

For Seller:

- Regular payment – less chance of not being paid once set up.
- More secure than payment by cash (or cheque) – less risk of theft as money is not handled / kept on the premises.
- Easier to cash up at end of day – fewer coins and notes.

For Buyer:

- One of the most secure / safest methods – no cash, cheque book or cards that can get lost or stolen. Plus buyer legally protected under 'direct debit guarantee scheme' which means that if the seller makes a mistake in obtaining payment, the buyer is refunded directly and may also be able to claim for any bank charges incurred from not having the funds in the account and, in some cases, any inconvenience caused by the error.

- More convenient than carrying around cash, cheque books and cards.

- Relatively easy to set up – can often be done over the phone – no complicated forms to fill or sign – just requires bank account details (although a mandate can be sent providing written record and requesting a signature).

- No admin time and associated costs involved once set up (compared with writing out a cheque each month / each transaction).

- Takes away the worry of remembering / eliminates risk of forgetting, and the resultant penalties.

- Helps maintain a good credit rating – important for loan or mortgage applications.

- Some companies offer a discount for businesses making payments through this method, eg utilities and phone companies, as it minimises the admin and associated costs of chasing late payments.

- Eliminates possibility of being short changed – in relation to cash payments.

- Can state the day you would like the funds to go out – ensuring payment only leaves when sufficient funds are in the account, and thus, helps to manage cash flow.

Summary of Relative Disadvantages

For Buyer:

- Less control - once set up the seller is able to access the account to obtain further payments.

- Less visible than cash - possibility of incurring bank charges through not having sufficient funds in the account.

For Seller:

- Buyer can usually dictate when payment can be taken from the account, and it may take up to 3 working days to receive the funds from this date.

Other Credit Transfers - Standing Orders and 'One-off' Bill Payments

Other forms of credit transfers include standing orders and 'one-off' bill payments.

How Payment Method Works

In both cases the buyer will provide his / her bank with the bank account details of the seller, and ask for the bank to send a specific amount of money (in payment for purchases) to the supplier's bank at an agreed date.

Standing orders (like direct debit payments) are set up to allow regular monthly payments to be made to a supplier. These payments are for a fixed amount agreed beforehand.

One-off bill payments, as the name suggests, are for one-off single purchases. However, once a payment has been made, the buyer's bank can keep the details of the transaction on file, which allows the buyer to make a payment, at another date, to the same supplier, without having to give the bank all the supplier's bank account details again.

Costs, Time, Relative Advantages and Disadvantages

Standing orders and one-off bill payments (by BACS transfer) generally share the same costs, time, and relative advantages and advantages as those listed for direct debit above.

However...

With standing orders and one-off bill payments, payment for a specific amount is made at the buyer's request.

With direct debits, the buyer hands over the right to collect payments of a varying amount from their bank account at regular intervals to the seller.

Therefore...

These methods differ in terms of who has the **power** to make / collect payments:

- with standing orders and one-off bill payments the power to make payment remains with the **buyer**.
- With direct debits the power to collect payment (each month) is passed to the **seller**.

Online Payment Systems

How Payment Method Works

Online payment systems are used as a 'middle man' to transfer payment from the buyer to the seller using the internet.

Often they are used on websites when the buyer uses the checkout option. The buyer is asked to enter their bank account and delivery details and the system processes the payment from the buyers to the sellers account.

A well known example of this system is PayPal..

PayPal allows both buyers and sellers to create an account that is linked to their bank account.

When buyers make a payment, the money is taken from their bank account by PayPal and sent to the sellers PayPal account.

The seller can then either decide to transfer this payment in to their own bank account or leave it in their PayPal account to use themselves.

Cost(s) for the buyer

Online Payment accounts are usually free to create. As a buyer you don't have to pay a fee to send a payment unless you are sending money that requires a currency conversion. This means if you sending a payment to a business in a foreign country there is likely to be a charge to process this payment.

Cost(s) for the seller

Sellers have to pay a percentage of the transaction in commission. This is usually around 4% of the overall transaction. Therefore if you were selling a product online for £50 and your customer pays through an online payment system, £2 will be deducted to process the transaction.

Time it takes

Payment is deducted instantly from the buyers account once they press the final 'Buy' button however it can take up to 3 days to be received by the seller. This is due to transaction times and security checks.

In extreme cases it can take up to 21 days before the seller is able to receive the money. This is to ensure the seller has the money available to refund the buyer if something goes wrong.

Summary of Relative Advantages

For Buyer:

- No transaction fee (Unless sending money to foreign country)
- Details of your bank account are not shared with the seller
- Can be used on smart phones
- Convenient method of payment
- Discounts are sometimes offered when paying using an online payment system

For Seller:

- Attract new customers using the Internet
- Allow sales 24 hours a day – The internet is always on!
- All of the work is done for you. No travelling to the bank
- Digital record of all of your income.

Summary of Relative Disadvantages

For Buyer:

- Cost to convert currency when sending payments abroad
- Requires signing up and creating an account which can be difficult for non-technical customers

For Seller:

- Commission has to be paid on each transaction

- Money can take up to 21 days (in extreme cases) to reach the seller. Normally takes 3 days

ALWAYS! Make sure when answering a methods of payment question you identify if You are writing about the **customer** or the **business.**

Too often marks are lost writing about the advantages or disadvantages to the wrong person.

Below is a summary of the advantages and disadvantages of each payment method to both the customer and the business. Make sure you know them!

CUSTOMER

	Advantages	**Disadvantages**
Cash	• Easy to use – Convenient. • No charges to pay by cash.	• Could be easily lost. • No record of transactions.
Credit Card	• Can buy things you want but don't have the money for immediately. • Allows you to pay back in stages rather all in one go. • Can use it online including using different currencies.	• You have to pay interest on the repayments. • Charges if you miss repayments.
Debit Card	• Can use it online including using different currencies. • No fees to make a transaction	• Have to have money in the account to be able to spend it.
Cheque	• Keeps the money in your account for 3 days whilst processing. • Allows you to keep a record of transactions.	• Can't be used online. • Not accepted everywhere, this type of payment is dying out.
Online Payment Systems	• No Fees • Allows online shopping at any time • Convenient	• Some charges to process currency conversion • Some technical knowledge needed to send payments

See the next page for the advantages and disadvantages to businesses

BUSINESS

	Advantages	**Disadvantages**
Cash	• Immediate payment – can be instantly used to buy new stock/invest elsewhere in the business. • No cost to process cash at the bank	• Not very secure as you have to keep cash on your premises. • Could lead to human error when counting up. • Has to be transported to the bank.
Credit Card	• Customers will make 'impulse' buys meaning they are more likely to spend more money. • Can take payment online/over the phone • Less cash on the premises	• Costs to process the payment • Have to invest in buying the equipment (Chip + Pin) • Delay before the money is in the business account can be up to three days.
Debit Card	• Can increase payment over the phone and online. • Keeping up with customer expectations – most want to pay by card now. • Allows overseas payment	• Cost to process the payment. • Need to purchase equipment (Chip + Pin) • Can be a delay in the money reaching your account (Up to three days)
Cheque	• Less cash on the premises if a customer pays a large amount using a cheque. • May appeal to older generation who do not trust modern technology.	• Takes 3-5 days to receive the payment from the customer and get it in to the account. • Cheques will bounce if the customer doesn't have the money in their account. • Cheques have to be processed or 'cleared' at the bank. Banks charge a fee to clear cheques.
Online Payment System	• Attracts new customers (particularly those using the internet – younger generation) • Allows 24/7 purchases • Attracts international customers	• Have to pay for each transaction (normally around 4%) • Can take time to receive the money in to your account. Normally 3 days but sometimes up to 21 days.

To be ready for your exam, make sure you can confidently explain advantages and disadvantages for both customer and businesses for each payment method!

Create your own payment methods cheat sheet

How many advantages and disadvantages can you recall?

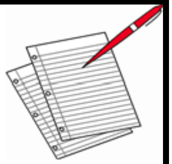
Firstly, without your notes, give at least one advantage and disadvantage for each payment method for both business and customers.

Once you have had a go, go back to your notes and fill in any you have missed

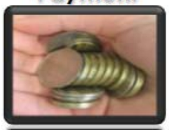
Customer/Buyer

Methods of Payment	Advantage	Disadvantage
Cash		
Credit Card		
Debit Card		
Cheque		
Credit Transfer		
Direct Debit		
PayPal Online Payment Systems		

Now try and do the same on the next page...this time from the point of view of the business/seller



Remember to give it a go without using your notes first

Methods of Payment	Business/Seller Advantage	Disadvantage
 Cash		
 Credit Card		
 Debit Card		
 Cheque		
bacs Credit Transfer		
bacs Direct Debit		
PayPal Online Payment Systems		

Practice MOP questions

Explain one advantage and one disadvantage to **Sharpe's world of knives** of allowing customers to pay using cash. (4)

Advantage

____
____
____
____
____

Disadvantage

____
____
____

The wonderful world of Wilson have recently conducted some market research and found that most of their customers prefer to pay by debit card rather than cash. Explain why some customers may prefer debit cards rather than cash (3)

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Outline one advantage to **customers** of allowing them to pay by cheque when purchasing sports cars from Carr's cars. (2)

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Outline one disadvantage to **Cooper's clothes** of allowing customers to pay by credit card. (2)

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____

Outline one advantage to **Richard's Reem Refrigerators** of allowing their customers to pay by debit card (2)

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____

____

Eira pays some of her suppliers using online payments through her bank account.

3 Explain **two** advantages to Eira of using online payments.

(6)

1 ....

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....

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2 ....

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Mark out of 6

Jen's customers can buy drum kits and accessories using credit cards.

(c) Outline **three** advantages to the **customers** of *DNS* of being able to pay using a credit card.

(6)

Advantage 1:

Advantage 2:

Advantage 3:

Mark out of 6

ETP's customers like to pay in a variety of ways.

(b) Explain why some customers may prefer to use cash rather than a card.

(3)

Mark out of 3

5) Profit & Loss Accounts

Introduction

Profit is one of the main reasons why most businesses exist and ultimately why most people decide to start their own business. It is the reward for the risk and effort involved with setting up, running or investing in a business.

Definition

Profit and Loss accounts are statements that show the income/revenue of a business and all of its costs/expenses.

It shows a business owner a breakdown of all money coming in and all money going out and how much is left over (Profit) within a certain time frame (Normally a year)

A typical layout of a profit and loss account is provided below:

Total Sales		**230 000**
Cost of Sales		150 000
Gross Profit		**80 000**
Expenses		
Rent, rates and insurance	5 500	
Wages and salaries	12 000	
Light, Heat and Power	3 500	
Telephone and Broadband	1 250	
Total Expenses		**22 250**
Net Profit		**57 750**

Constructing a profit and loss account

Let's annotate this example to try and understand what a profit and loss account is showing us:

Total Sales
Money coming in to the business from sales of products or services.

Cost of Sales
All of the costs **directly** involved in producing the goods or services.
E.G – Raw materials

Gross Profit
Total Sales – Cost of sales

Other Expenses
All other costs incurred by the business that are **not directly** involved with producing the goods or services.

Total Expenses
All of the '**other expenses'** added together

Net Profit
Gross Profit – Total Expenses

Total Sales
Cost of Sales
Gross Profit
Expenses
Rent, rates and insurance
Wages and salaries
Light, Heat and Power
Telephone and Broadband
Total Expenses
Net Profit

Remember the order:

Sales
Cost of Sales
Gross Profit
Other Expenses
Net Profit

Silly | Children | Gassed | On | Nando's

REMEMBER SCGON

Constructing a profit and loss account

So we know SCGON.

Now we need to know how to work with the numbers.

All you need to remember is start from the top and KEEP TAKING AWAY!

Step 1) Sales – Cost of sales = Gross Profit

Step 2) Gross Profit – Other expenses = Net Profit

Total Sales		**230 000**
Cost of Sales		150 000
Gross Profit		**80 000**
Less Expenses		
Rent, rates and insurance	5 500	
Wages and salaries	12 000	
Light, Heat and Power	3 500	
Telephone and Broadband	1 250	
Total Expenses		**22 250**
Net Profit		**57 750**

Minus

Minus

A profit and loss account starts by showing how much money you've made right at the top and then slowly takes away money to pay all of your costs.

The net profit is what is left. Or in other words; what's left in your net.

Hopefully this is making some sense. It's simple right?

Sales	£10
Cost of sales	£3
Gross Profit	£7
Other Expenses	£2
Net Profit	£5

Start from the top and minus your way down.

Step 1) £10 - £3 = £7

Step 2) £7 - £2 = £5

Totes simple, easy peasy!

The exam board like to make it slightly more difficult by making you work out your own sales and other expenses. Most of the time your profit and loss account will look something like this:

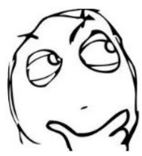
Gem Gallery Jewellers Profit and Loss Account for the year ended 31st December 2012		
	£	£
Total sales		
Gross profit		
Expenses		
Total expenses		

It's up to you to fill the gaps.

Here's the checklist of how to answer a profit and loss question perfect every time.

1) Fill in **SCGON –** Make sure if there are blanks on the left hand side you fill them in!

	£	£
Total sales		
Cost of Sales		
Gross profit		



2) Work out how much income the business makes from sales of its products:

Isabel has received a note from Sam containing information about *GGJ's* monthly sales and costs for the year ending December 2012. This information is used to calculate the profit or loss.

Sale of jewellery	35 000
Sale of watches	26 500
Repairs to customers' watches	5 750
Cost of these sales	35 200
Wages and salaries	10 000
Rent, rates and insurance	8 000
Light, heat and power	3 000
Telephone and broadband	900

Total Sales =

35,000 + 26,500 + 5,750

67,250

3) Work out **cost of sales** (Normally given to you)

	£	£
Total sales		67,250
Cost of Sales		35,200
Gross profit		

4) Work out **Gross Profit** (Sales – Cost of Sales) £67,250 – £35,200 = £32,050

	£	£
Total sales		67,250
Cost of Sales		35,200
Gross profit		32,050

Not done yet. On to the next page…

5) Now write in the other expenses from the information given to you in the exam paper. Take care with your spelling and make sure the numbers are correct!

Transport costs	4 500
Light, heat and power	1 500
Telephone and broadband	750
Insurances	1 500

Total Sales		67,250
Cost of Sales		35,200
Gross Profit		32,050
Expenses:		
Insurances	1 500	
Transport Costs	4,500	
Light, heat and power	1.500	
Telephone and broadband	750	
Total Expenses		8250

6) Now add up all of the **other expenses**:
£1,500 + £4,500 + £1,500 + £750 = **£8250**
And add this to the profit and loss account.

7) And finally work out the **Net profit** (Gross Profit – Other expenses £32,050 - £8250 = £23,800)

Total Sales		67,250
Cost of sales		35,200
Gross Profit		32,050
Expenses:		
Insurances	1 500	
Transport costs	4,500	
Light, heat and power	1.500	
Telephone and broadband	750	
Total Expenses		8250
Net Profit		23,800

And that's it! Step by step of how to complete a profit and loss account. Use these steps to answer the next few examples and then test yourself on the exam questions to see how much you know.

Profit and Loss account activities

Fill in the blanks to show the order of a profit and loss account:

Sales
Other Expenses

Complete the following profit and loss account:

Sales	£35,000
Cost of Sales	£12,000
Gross Profit	
Other Expenses	£6,000
Net Profit	

Katy has asked you to help her construct a profit and loss account using the figures below

Sales Revenue – £50,000

Electricity - £2,000

Phone Bill - £1,000

Rent - £12,000

Cost of sales – £21,000

	£	£
Total sales:		
Gross profit		
Expenses:		
Total expenses:		

Will is a farmer who sells cow's milk to supermarkets and vegetables in his farm shop. He needs help constructing a profit and loss account for 2012.

He has provided the following figures:

Sales of milk - £138,000

Electricity - £23,000

Revenue from farm shop – £24,000

Rent - £12,000

Equipment - £15,000

Cost of sales – £81,000

	£	£
Gross profit		
Expenses:		
Total expenses:		

If Will the farmer wanted to increase his Net Profit what would you recommend he does? (2)

____

____

____

____

Issac creates wooden garden furniture and sells them on his online store; www.issacswood.com. He has asked for your help creating a profit and loss account for the previous 6 months:

Here are his figures: (This one is tough – take your time)

Online Sales - £86,000
Raw materials - £37,000
Rent - £12,000
Website maintenance - £4,000
Equipment - £25,000
Petrol - £1,500

	£	£
Total sales:		
Gross profit		
Expenses:		
Total expenses:		

If you are struggling with this go back and read your definitions for each of the headings **SCGON.**

4 Jen has asked you to construct a Profit and Loss summary for *DNS*. She has supplied you with the following information.

Drumz'n'Stix figures for the last month.

Sales of:	
Drum Kits	£3 500
Accessories	£2 125
Cost of these sales	£2 225
Wages and salaries	£ 900
Rent, Rates and Insurance	£ 800
Light, Heat and Power	£ 250
Telephone and Broadband	£ 80

Use this information to construct the Profit and Loss summary for *DNS* for last month.

Profit and Loss Summary for Drumz'n'Stix

	£	£	
Total Sales			(1)
			(1)
Gross Profit			(1)
Expenses:			
		(1)	
		(1)	
		(1)	
		(1)	
Total Expenses:			
			(1)

Mark out of 8

(a) Explain to Morgan the purpose of a Profit and Loss Account.

(2)

....

....

....

....

Mark out of 2

Tess has asked you to help construct a Profit and Loss account (Income Statement) for *ETP* for 2011. She has sent you the following:

Memo

From: Tess

Here are our figures.

Admission tickets	£925 000
Food sales	£110 000
Cost of sales	£232 500
Wages and salaries	£357 000
Rent, rates and insurance	£161 900
Light, heat and power	£ 65 000
Telephone and broadband	£ 30 000

(b) Use this information to construct the Profit and Loss account for *ETP*.

Profit and Loss Account for Elmwood Theme Park 2011

	£	£	
Total sales:			(1)
			(1)
Gross profit			(1)
Expenses:			
			(1)
			(1)
			(1)
			(1)
Total expenses:			
			(1)

Mark out of 8

Complete the profit and loss account for The Kimberley Hotel for year ending 2011.

The Kimberley Hotel **Profit and Loss Account for the year ended** 31st December 2011			
	£	**£**	
Sales:			
Hotel Rooms		70 000	
Bar and Restaurant		80 000	
Conference Rooms		50 000	
Total Sales			(1)
Cost of Sales	150 000		
Gross Profit			(1)
Less **Expenses:**			
Rent, Rates and Insurance	6 000		
Wages and Salaries	9 250		
Light, Heat and Power	3 500		
Telephone and Broadband	1 250		
Total Expenses			(1)
Net Profit			(1)

Mark out of 4

Final challenge!

Create a profit and loss account using the figures below:

Online Sales - £186,000
In Store Sales – £195,000
Rent - £87,000
Equipment - £55,000
Utility Bills - £11,500
Wages - £169,000
Cost of Sales - £81,000

This isn’t an exam question so don’t worry! It will never be this tough. If you can do this then you have mastered Profit and Loss Accounts…check you out!

6) Balance Sheets

Introduction

It is important to accurately value a business and to get an understanding of what it owns and what it owes, Balance sheets show you exactly that. They are an essential document for business owners as well as other stakeholders such as shareholders and financiers.

Definitions

Balance sheets are a snapshot of a business's worth. It shows the company's financial position as well as what the business owns (assets) and what it owes (liabilities).

Before we attempt to understand the layout of a balance sheet we need to define a few key terms:

Assets – Items that belong to the business.

There are two types of assets

Fixed assets - Items that are bought to be used by a business over a long period of time (more than a year).

E.g. Property, equipment, vehicles

Current Assets - Items that are defined as short term possessions (owned for less than a year).

E.g Stock, Cash in the bank, Debtors (People who owe you money)

Liabilities – Things a business has to pay for.

Again there are two types:

Current liabilities - Short term debts that usually owed for less than a year.

E.g. Utility Bills, Staff wages, Creditors (People who you owe money to)

Long-term liabilities - Amounts that a business owes for longer than a year.

E.g – Mortgages, banks Loans

Working Capital

Current Assets – Current Liabilities

This shows how much money the business is likely to have within the next 12 months because it shows what will be left when they sell all of their current assets and then pay their current liabilities.

Capital

How much has been invested in to the business by the owners

Lots to think about but just remember if it has the word *current* it means less than 12 months.

A typical balance sheet is shown below:

Balance sheet for Smith's Superstore 1st April 2014		
	£	£
Fixed Assets		
Property		150,000
Equipment		20,000
		170,000
Current Assets		
Stock		9,000
Cash in the bank		8,000
		17,000
Current Liabilities		
Utility Bills	7,000	
Working Capital	10,000	
Net Total Assets	180,000	
Financed by:		
Capital		150,000
Profit		30,000
		180,000

On the next page we will annotate it to make sure you understand what it shows.

Breaking down Balance Sheets

Balance sheet for Smith's Superstore 1st April 2014		
	£	£
Fixed Assets		
Property		150,000
Equipment		20,000
		170,000
Current Assets		
Stock		9,000
Cash in the bank		8,000
		17,000
Current Liabilities		
Utility Bills	7,000	
Working Capital	10,000	
Net Total Assets	180,000	
Financed by:		
Capital		150,000
Profit		30,000
		180,000

Fixed Assets

This shows the value of all of the fixed assets in the business. In this example the business has £170,000 worth of fixed assets

Current Assets

This shows the value of all of the current assets in the business. In this example the business has £17,000 worth of current

Current liabilities

This shows the value of all of the current liabilities in the business. In this example the business has £7,000 worth of current liabilities (debts)

Working Capital

Current Assets – Current Liabilities

£17,000 – £7,000

Net Total assets

Fixed Assets + Working Capital

£170,000 + £10,000

Capital

How much has the owner has invested

Profit

How much money the business has made

Value of the business

How much the business is worth.

This should always match with Net Total

Balance sheets should always balance. Think of it as two separate documents. The top part (above the black line) shows the company's assets and liabilities and the bottom half shows where the money has come from to purchase the assets.

Net Total assets and the overall value of the business should always match!

Ok so balance sheets aren't easy! Luckily they won't make you create a balance sheet from scratch in the exam. You will be asked just to fill in the blanks like this:

Balance sheet for Smith's Superstore 1st April 2014		
	£	£
Fixed Assets		
Property		150,000
Equipment		30,000
Current Assets		
Stock		9,000
Cash in the bank		8,000
		17,000
Current Liabilities		
Utility Bills	7,000	
Working Capital		
Net Total Assets	190,000	
Financed by:		
Capital		150,000
Profit		40,000

Just concentrate on remembering the difference between assets and liabilities. This includes current and fixed assets and current and long term liabilities.

Also they do like to throw in a question about working capital every now and again so remember:

Current assets – Current Liabilities = Working Capital

Let's have a go at some examples

Complete the definitions

Fixed Assets: ……………………………………………………………………………………

Current Assets: ……………………………………………………………………………………

Liabilities: ……………………………………………………………………………………

Creditors: ……………………………………………………………………………………

Debtors: ……………………………………………………………………………………

Tick the appropriate box to show where each item would appear in the balance sheet.

	FIXED ASSETS	CURRENT ASSETS	LIABILITIES
Stock of Goods			
Mortgage			
Office furniture			
Premises			
Creditors			
Debtors			
Machinery			
Cash			
Shareholders funds			
Bank Overdraft			

Look at the information below and in the end column decide if the item is an asset or liability:

Item	Amount £	Asset or liability?
Cash in the till	565	
Suppliers awaiting payment	1,000	
Delivery van	5,000	
Money in the bank	8,000	
Stock	6,500	

Warehouse building	120,000	
Utility Bill	6,000	

What is the total value of current assets for this business?

____

What is the value of current liabilities for this business?

____

What is the working capital for this business?

____

Work out the following for Ice Snax LTD

Ice Snax Ltd	£
Bank	500.00
Creditors	200.00
Loan from bank	750.00
Debtors	300.00
Stock	1,000.00
Cash	250.00

Current assets =

Current Liabilities =

Working Capital =

Look at the list below.

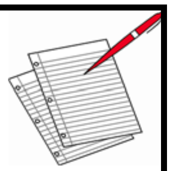
Cash in the bank; overdraft to be paid; cash in the till; advertising bill to be paid within 20 days; bank loan to be paid over five years; stock in the store room; a business van; shelving for the shop; mortgage to buy the shop; business rates to be paid within one month; tools used by the business; office furniture; tax to be paid; customers who owe the business money.

Separate the list into *assets and liabilities*

Assets	Liabilities

(d) In the table below, identify whether the liability is **current or long-term**.

Liabilities	**Current**	**Long-term**
Bank loan	☒	☒
Money owed to suppliers	☒	☒
Utility bills	☒	☒



Complete the shaded cells in the following balance sheet:
(Use your notes if you need to)

Balance sheet for Harriet's Hardware Store		
	£	£
Fixed Assets		
Property		220,000
Equipment		40,000
Current Assets		
Stock		35,000
Cash in the bank		8,000
		43,000
Current Liabilities		
Utility Bills	7,000	
Supplier Bill	24,000	
Working Capital		
Net Total Assets		
Financed by:		
Capital		200,000
Profit		72,000

CJG Photography offer photo shoots as well as selling camera equipment and accessories in their store.

(c) In the table below, identify whether the asset is **fixed or current**.

(6)

Assets	**Fixed**	**Current**
Cash	☐	☐
Camera equipment	☐	☐
Money in bank	☐	☐
Stock of DVDs and photo frames	☐	☐
Lighting equipment	☐	☐
Laptop computer	☐	☐

Overall mark out of 6

(c) State the financial term calculated using the following formula:

Current Assets minus Current Liabilities.

(1)

....

Overall mark out of 1

Kim has left the following information for you.

Assets and Liabilities for The *Kimberley Hotel* 30th April 2012	
Fixtures and fittings	**£100 000**
Money in bank	**£25 000**
Kitchen equipment	**£50 000**
Bank loan	**£80 000**
Debts owed to suppliers	**£20 000**

(c) Using the formula: Working Capital = Current Assets – Current Liabilities and the figures above, calculate the working capital for The *Kimberley Hotel*.

(2)

Show your workings.

Overall mark out of 2

....

....

....

....

Complete the shaded boxes to help Sarena complete her balance sheet

Balance sheet for Sarena's Sugary Snacks 2013			
	£	£	
Fixed Assets			
Property		120,000	
Vehicle		8,000	
			(1)
Current Assets			
Stock		15,000	
Cash in the bank		3,000	
		18,000	
Current Liabilities			
Utility Bills	7,000		
Supplier Bill	14,000		
Working Capital			(1)
Net Total Assets	125,000		
Financed by:			
Capital		112,000	
Profit			(1)
Capital Employed		125,000	

Marks out of 3

7) Solvency Ratios

Introduction

Ratios are used to analyse a company's performance and are often used to compare performance over multiple years. Solvency ratios are used to measure solvency or liquidity. In other words; how likely you are to be able to pay off debts.

Definition

There are two types of solvency ratios:

Current Ratio

The current ratio shows how many current assets a company has compared to current liabilities.

This is shown as a ratio E.g. 1.2:1.

Let's try and understand what a ratio of 1.2:1 actually means:

This shows the amount of assets the company has compared to debts. If it is 1 then it means it has the same amount of current assets as current liabilities. If it's more than 1 then they have more current assets than liabilities.

$\boxed{1.2}:\boxed{1}$

This number is always 1. This represents the current liabilities of the company

Therefore in this case the ratio shows they have 1.2 asserts to every 1 liability.

Imagine this as having £1.20 in your pocket to pay £1 worth of debt. This is ideal because you can afford it.

Acid-test Ratio

The acid test ratio is very similar to the current ratio but it doesn't take in to consideration stock.

This is because stock is not guaranteed to sell and therefore cannot be relied upon when testing to see if a business can pay debts.

Calculating Ratios

Acid Test Ratio	$\frac{\text{Current Assets – Stock}}{\text{Current Liabilities}}$
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Don't worry about memorising these as they are given to you in the exam

Ideal Values

Both ratios have ideal values that business should aim to achieve. They are:

Acid-Test Ratio	1 – 1.5
Current Ratio	1.5-2

If a business has Ratios that are higher than the ideal values this isn't a huge concern because they are clearly able to pay back their debts. However it may suggest they have too many current assets that are not being utilised.

Example

	£	**Asset or liability?**
Stock	8,000	Current asset
Cash in the bank	12,000	Current asset
Utility Bills	14,500	Current Liability

Let's work out the ratios using this information:

Current Ratio:

Current assets ÷ Current Liabilities

£20,000 ÷ £14,500 = 1.3

Or 1.3:1

Acid-Test Ratio:

Current assets - Stock ÷ Current Liabilities

£20,000 – £8,000 ÷ £14,500 = 0.8

Or 0.8:1

<u>So what does this mean?</u>

The current ratio is ideal and therefore suggests the business has enough assets to pay back its debts.

However when we take away stock and calculate the acid test ratio, we can see that the business is under the ideal value. This means the business would struggle to pay back its debts if it cannot sell its stock.

Two ideal values would mean a business is *solvent* and able to pay back its debts even if they sell no stock at all.

Have a go for yourself on the next page.

Current assets	12,000
Current liabilities	14,000
Stock	2,000

Use the following information to calculate the current and acid test ratios:

The Current Ratio:

Show your workings

What does this show?

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The Acid Test Ratio:

Show your workings

What does this show?

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………

Is this business solvent?

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………

Have another go:

Current assets	18,000
Current liabilities	10,000
Stock	4,000

The Current Ratio:

Show your workings

What does this show?

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The Acid Test Ratio:

Show your workings

What does this show?

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Is this business solvent?

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Ok one more:

FIXED ASSETS	**£155,000**
CURRENT ASSETS	**£75,000**
CURRENT LIABILITIES	**£60,000**
STOCK	**£20,000**

The Current Ratio:

Show your workings

What does this show?

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The Acid Test Ratio:

Show your workings

What does this show?

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Is this business solvent?

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If a business has a current ratio of 2.3 what does this mean? (2)

David is concerned as his Acid-Test ratio is under the ideal value. He is unsure of how to improve the ratio. Advise David on how this can be done. (6)

Ratio	2010	2009
Acid Test Ratio	1:1	0.75:1
Current Ratio	1.2:1	1:1

Jenny is considering expanding her business but is unsure if she can afford to do so. Using the solvency ratios advise Jenny on

(8)

Mark out of 8

Mohammed is unsure of what his businesses ratios actually mean. He asked his finance department to calculate the ratios and send them to you.

They have calculated some ratios to show the company's performance over two years.

	2009	2008
Current Ratio	1.6 to 1	1.3 to 1
Acid Test Ratio	1.5 to 1	1.2 to 1

Explain to Mohammed what the ratios show about the solvency of his business. (6)

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Mark out of 6

8) Profitability Ratios

Introduction

Profitability ratios are used to monitor how much cash a business is able to generate. It is often compared with previous year's performance and also competitor's figures to get an idea of how the business is performing.

Definitions

There are three types of profitability ratios:

Gross Profit Margin

Gross profit margin shows what percentage gross profit the business has generated.
(Go back and check the definition of gross profit if you aren't sure what this means)

Net Profit Margin

Net profit margin shows what percentage net profit the business has generated.

Return on Capital Employed

The return on capital employed shows what percentage return the owner has made from their investment. This allows you to see how much money the owner has received from the business compared with how much money he has put in.

Calculating Ratios

$$\textbf{Gross profit margin: } \frac{\textbf{Gross profit}}{\textbf{Sales}} \textbf{ x 100}$$

$$\textbf{Net profit margin: } \frac{\textbf{Net Profit}}{\textbf{Sales}} \textbf{ x 100}$$

$$\textbf{Return on capital employed: } \frac{\textbf{Net profit}}{\textbf{Capital}} \textbf{ x 100}$$

You would need to look through the business profit and loss account to find the necessary values to calculate the profitability ratios.

All of the three profitability ratios are displayed as percentages

Ideal Values

The ideal values of the profitability ratios are nice and simple;

The higher the percentage the better!

<u>What do the percentages mean?</u>

Gross Profit Margin Net Profit Margin	The values of these ratios show how much of every pound earned is gross or net profit. <u>Example</u> If Gross Profit was 22% it would mean for every pound the company makes from sales 22p would be kept as gross profit. If Net Profit was 4% it would mean for every pound the company makes from sales 4p would be kept as net profit.

Return on Capital Employed	The value of this ratio shows how much money the owner of the business has made compared with his investment. <u>Example</u> If an owner invests £5,000 and makes a return of £2,500 then he would have earnt a 50% Return on capital employed

That is why the higher the values the better!

Be careful though! The exam normally asks you to compare profitability ratios from multiple years to assess a company’s performance. Clearly the business would hope that profitability ratios would be rising to show the business is making more profit.

Example

Let’s work out the profitability of this company using the figures below:

Sales	230,000
Gross profit	120,000
Net profit	35,000
Capital	15,000

Always give answers to two decimal places!

	Calculation	Answer
Gross Profit Margin	£120,000 ÷ £230,000 X100	52.17%
Net Profit Margin	£35,000 ÷ £230,000 X100	15.21%
Return on Capital Employed	£35,000 ÷ £15,000 X100	233.33%

What does this mean?

It shows that this business is a profitable business and has healthy profitability ratios. The owner has made a 233% return on their investment which shows that investment could be potentially lucrative if the business continues to perform in this way.

Ok your turn:

Work out the profitability ratios for this company:

Sales	100,000
Gross profit	75,000
Net profit	11,000
Capital	5,000

Remember to show your working…and give your answer to two decimal places!

	Calculation	Answer
Gross Profit Margin		
Net Profit Margin		
Return on Capital Employed		

What does this show about the business?

Ok try this one:

	2012	2013
SALES REVENUE	**£56,000**	**£64,500**
GROSS PROFIT	**£34,500**	**£48,000**
EXPENSES	**£12,500**	**£22,550**
NET PROFIT	**£22,000**	**£25,450**

Blane the owner invested £45,000 of his own money to start this business.

Work out the profitability ratios for both years

2012

	Calculation	Answer
Gross Profit Margin		
Net Profit Margin		
Return on Capital Employed		

2013

	Calculation	Answer
Gross Profit Margin		
Net Profit Margin		
Return on Capital Employed		

Blane (the owner of the business) has asked you to explain to him what the profitability ratios show. (6)

Kim uses accounting ratios to help interpret her financial statements.

5 (a) Using the information and the formulae given below, calculate the Gross Profit and Net Profit Margins for the conference rooms of The *Kimberley Hotel* for 2010. Show your workings in the relevant section of the table.

(2)

Conference Rooms

2010	**£**
Sales	120 000
Gross Profit	42 000
Net Profit	14 400

Ratio	**Calculation**	**2010**	**2011**
Gross Profit Margin	$\frac{\text{Gross Profit x 100}}{\text{Sales}}$	%	25%
Net Profit Margin	$\frac{\text{Net Profit x 100}}{\text{Sales}}$	%	15%

(b) Explain **one** possible reason for the change in Gross Profit Margin and **one** for the change in the Net Profit Margin from 2010 to 2011.

(6)

Change in Gross Profit Margin

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Change in Net Profit Margin

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Mark out of 8

The past two years Sam's accountant worked out that the businesses Gross Profit Margin. There were as follows:

2009	2010
69%	71%

This year however Sam's account has said he 'can't be arsed' and therefore Sam has asked you to help out.
Using the following figures work out the Gross Profit Margin for 2011.

Sales	175,000
Gross profit	136,000
Net profit	95,000
Capital	125,000

Ratio	Calculation
$GPM = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$	GPM = ...

(2)

(b) Comment on the changes in the gross profit margin for *ETP* over the period 2009–2011.

(5)

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Mark out of 7

If they are feeling particularly evil the examiners can test you on both ratios together in one question. Try this one:

*6 *Simply Bake plc* has an upcoming meeting with its shareholders and wants to tell them about the **profitability** and **liquidity** of the company. The accounting department has sent you the following information taken from *Simply Bake plc* financial statements (final accounts) for 2008 and 2009.

	2009	2008
	£	£
Sales	2 175 000	1 800 000
Gross profit	653 000	540 000
Net Profit	108 750	36 000
Capital Employed	1 000 000	1 000 000

They have calculated some ratios to show the company's performance over two years.

	2009	2008
Current Ratio	**1.6 to 1**	**1.3 to 1**
Acid Test Ratio	**1.5 to 1**	**1.2 to 1**

They realise that you may need to calculate more ratios to be able to assess the financial performance of the company. They have supplied you with the following table which contains the formulas, which might be of use to you.

Ratio	Calculation
Return on Capital Employed	$\frac{\textbf{Net Profit}}{\textbf{Capital Employed}} \times \textbf{100\%}$
Net Profit Margin	$\frac{\textbf{Net Profit}}{\textbf{Sales}} \times \textbf{100\%}$
Gross Profit Margin	$\frac{\textbf{Gross Profit}}{\textbf{Sales}} \times \textbf{100\%}$

Using the above information, calculate any relevant ratios and assess the **liquidity** and **profitability** of *Simply Bake plc* compared with the previous year.

(10)

Contiuned from previous question:

Mark
out of 10

That’s a tough question!

9) Importance of financial documents to stakeholders

Overview

Each business document serves a purpose for the business. The profit and loss shows how much money is going in and out of the business. The balance sheet shows how much the business is worth. These financial documents are important for the business. But they are also important for the business stakeholders. Each stakeholder (a person who is affected by a business's decisions) will have a different interest in a business's documents.

Here's an overview:

Stakeholder	Why are they interested in the business documents?
Customer	Customers want to know how well a business is doing and therefore will look at profit and loss accounts and balance sheets to assess the businesses performance. Loyal customers want to check on how well their favourite business is doing whilst other customers who are thinking of making a purchase that they will keep for a long time (e.g. a new car) want to know that the company will still be around in a few years' time if things go wrong.
Owners	Owners are obviously interested in the documents as it helps them to keep a track of the business. It allows them to make decisions and plan for the future of the business.
Suppliers	Suppliers want to know that they can be paid on time. They will monitor a company's documents to make sure the company they are supplying is making enough money to pay back any debts.
Government	The government will assess companies documentation to make sure they are paying the correct amount of tax.
Competition	Competition will be keeping a watchful eye over other businesses documents to see how much of a threat they are to their own business.
Staff	Staff want to know if the business is doing well as they want to feel secure in their job. By looking at the documents they can

	assess the chances of them being made redundant.
Local Community	The local community would keep a check on local businesses documents to see if there is the likelihood that there may be upcoming jobs. They might even look to see if there is a chance the business might close down or go the opposite way and expand.
Financiers (Banks)	People that are about to lend money to a business clearly would want to know how the business is doing before they give them any money. Banks will always analyse the business documents to assess if they are going to be able to pay them back

Stakeholders all have different interests in the financial documents of a business, but remember a company doesn't have to publish their financial documents unless they are a Public Limited Company.

(c) Why might suppliers be interested in the **profit and loss account** (income statement) of *Simply Bake plc* and what this account shows?

(3)

Mark out of 3

(b) Suggest **four** reasons why a forecast balance sheet for *Simply Bake plc* could help a potential investor decide whether to invest in the business.

(4)

Mark out of 4

*7 Sam is planning to expand her business and is considering taking out a bank loan.

Evaluate the importance of her annual Profit and Loss Account and Balance Sheet to the bank when she applies for a loan.

(10)

Mark
out of 10

Tess has been helping to prepare financial statements for *ETP*. She has been asked to explain why these are of interest to the stakeholders of *ETP* and has started the table in the memo below.

(c) Complete the table below, giving **four** stakeholders of *ETP* and outlining why financial statements are of interest to each of the stakeholders you have named.

(8)

Memo

To: All Finance Staff
From: Tess
RE: Interest of financial statements to our stakeholders

Stakeholder	Interest in financial statements

Mark
out of 8

That's It,

You're Done!

All you need to know for your exam is in this booklet. If you do have any questions or you are struggling with anything then please do email your teacher:

Asmith@beaumontleys.leicester.sch.uk

Or

APatel@beaumontleys.leicester.sch.uk

If you have managed to complete the entire booklet then well done you! I'm sure it will make a difference to your final grade.

I hope you have found it some use and we wish you all the best of luck on your final exam.

Mr Smith & Mr Patel