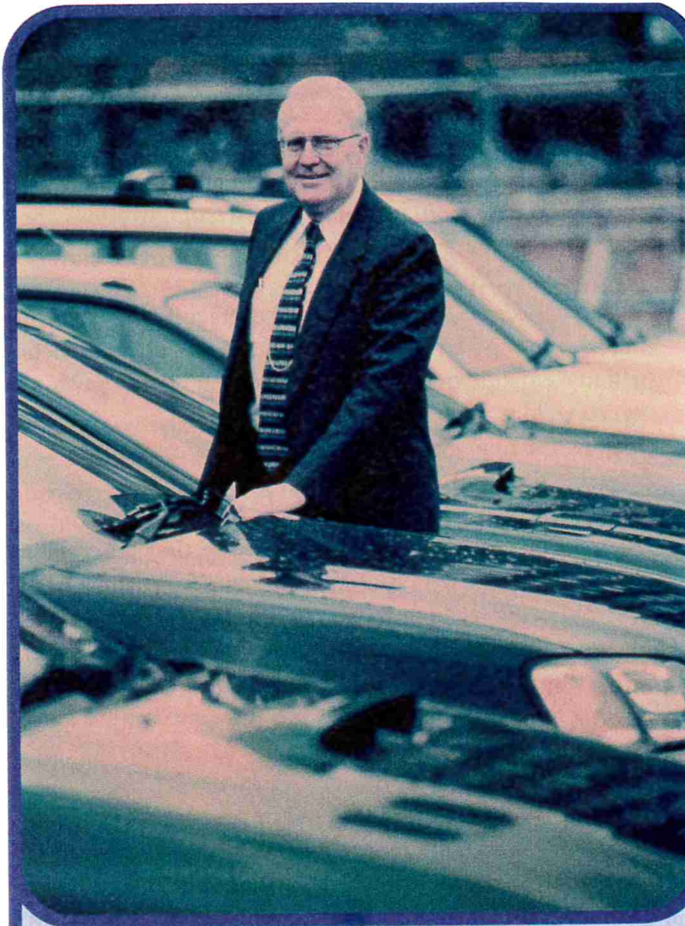

Question 1.

Pennell's plc is a medium sized car dealership in East Anglia. This year has been very disappointing for sales. Despite record sales nationally, Pennell's sales have actually declined. Senior management were worried about the impact this would have on the share price and on shareholder reaction. They therefore agreed on a strategy to boost sales in the all important last financial month of the year to 30 April.

All car sales staff were offered twice the bonus they normally received for selling cars during April so long as the customer took delivery of the car and paid for it in full by the last day of the financial year. As the end of the month approached, sales staff were having to be very persuasive to get some customers who had chosen a car and placed a deposit on it to take delivery of the car on the 30 April rather than in early May.

At the same time, employees were told to cut all unnecessary expenses. There had been a ban in place since mid-February on replacing existing staff who left. Stocks of parts were also run down as far as possible. All this led to some operating difficulties. Waiting times for a service lengthened from around 3 days to 4 days, while some customers found that their repairs took a day longer because parts, normally kept on site, had to be ordered specially from suppliers.

(a) Explain how the managers at Pennell's manipulated (a) sales and (b) costs to window dress the profits of the company at its year end.

(b) Discuss what impact this window dressing might have had on revenues, costs and profits for the next financial year.

Case Study: CNV Plastics

CNV Plastics is a large private limited company based in Leeds. It is an engineering business which designs and produces pvc piping, tanks, scrubbers and hoods. In 2008 the business egan to struggle financially. It was undercapitalised and needed to aise £10 million to boost working capital and provide funding for roduct development. A bank loan was being considered by the irectors. Unfortunately the 2007 accounts did not look good. Some f the ratios used to analyse the company's performance suggested hat most banks would be reluctant to lend money to the company. owever, at an emergency board meeting the financial director uggested that the performance of the company could be enhanced y 'window dressing' the accounts. The managing director was ubious about this. However, the finance director reassured all board nembers that 'window dressing' was legal and could be used to how the company in a better light. She suggested two actions.

- The method used to calculate depreciation could be changed. This would increase profit in 2008 by £2 million from £6 million to £8 million.
- Selling its factory and leasing it back. This would boost liquidity by injecting some cash into the company. The financial director also explained that this would also help to boost working capital.

The board of directors eventually agreed with the finance director nd the suggested actions were taken. Table 1 shows some financial atios for CNV Plastics after the accounts had been window dressed 2008.

able 1: Financial ratios for CNV Plastics

	2008	2007
Net profit margin	5.40%	2.40%
ROCE	4.60%	1.90%
Current ratio	1.6	1.1
Gearing	42%	41%

(a) What would be the value to CNV of using ratio analysis? (8 marks)

(b) What is meant by 'window dressing' the accounts? (4 marks)

(c) What might be the danger of 'window dressing' to CNV Plastics? (6 marks)

(d) (i) Explain the effect on the net profit margin and the ROCE of changing the method used to calculate depreciation. (8 marks)

(ii) Explain the effect on the current ratio and gearing ratio of selling the factory and leasing it back. (8 marks)

(e) What might be the long-term effects on CNV Plastics of selling the factory and leasing it back? (8 marks)