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Mark Scheme (Results)

January 2011

GCE

GCE Accounting (6002/01)
Paper 01

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A PEARSON COMPANY

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Section A

Question Number	Answer								Mark
1(a)					**W1 Cost of Sales**				
	Profit and Loss Account for Bangla Radios plc for Y/e 31st Dec 2010√								
					Direct Labour	521000	√		
					Direct materials	374000	√		
	Turnover	3645000	√		Factory Deprctn	84000	√√	**9 x** √	
					Machinery Depreciation	87000	√√		
	Cost of sales	1134000	√	o/f	Production Director	59000	√		
					Stock Adjust	9000	√√		
	Gross profit	2511000	√	o/f		1134000			
	Distribution costs	996700	√	o/f	**W2 Distribution Costs**				
					Commission on sales	36450	√		
	Administrative expenses	516750	√	o/f	Promotions and Advertising	47000	√		
					Fuel	73500	√		
	Other operating income	18650	√		Motor Lorries Depctn	133750	√√		
					Shop Rent	290000	√√		
	Other Investment Income √	46720	√		Transport Staff Wages	127000	√		
					Shop staff wages	231000	√		
	Interest Receivable	4780	√		Marketing Director	58000	√	**10 x** √	
						996700			
	Interest payable	91000	√	o/f					
					W3Administrative Expenses				
	Profit on ordinary activities before tax	976700	√	o/f	Bad Debts Written Off	1750	√		
					Administration staff wages	197000	√		
	Corporation tax	165000	√		Finance Director	64000	√	**4 x** √	
					Professional fees	254000	√		
	Profit on ordinary activities after tax	811700	√√C o/f			516750			
					W4 Interest Payable				
		15 x √			Debenture	91000	√√ C	**2 x** √	**(40)**

Question Number	Answer	Mark

1(b)	**Maximum 8 Marks for arguing one side only**
	
	<u>Case For Importance of Directors' Report</u>
	
	• Report gives information to eg shareholders √ which they could use to make a decision √ eg invest more funds in the company. √
	• Shareholders may be assured the company is acting in an ethical manner √
	• Other stakeholders eg pressure group √ may use information in the Report to bring about change in company policy √ eg treatment of disabled √
	• Disclosures may be required under Stock Exchange regulations, √ which may be appropriate in the Directors' Report √ eg legislation pending √
	• Information is given to shareholders which allows them to see in some detail how the company is performing √
	  ▪ Eg principal activities, √ review of position of business √
	  ▪ Post balance sheet events, √ future developments √
	  ▪ Names of directors, √ interests of directors √
	  ▪ Employee involvement, √ disabled employees policy √
	  ▪ Political √ and charitable donations √
	  ▪ Creditor payment policy, √ creditor payment days √
	  (Maximum of 4 marks for listing of items contained in Report)
	
	<u>Case Against Importance of Directors' Report</u>
	
	• Report costs personnel time √ to prepare and money to print etc √
	• Directors may use Report to "window dress" accounts, √ give an unrealistic positive view of the company, √ as it is in their interest to do so. √
	• Readers with no knowledge of accounts may not understand the report. √
	
	<u>Conclusion</u> **2 Marks**
	
	Should relate to above points. Eg Directors' Report is important. √√
		(12)

Question Number	Answer	Mark
2(a)		

Depreciation per year	675,000	5		135,000	√
Running Expenses	840,000	135,000		705,000	√√
Years 3,4,5	960,000	135,000		825,000	√√
Contracts	8	16	35,000	4,480,000	√√
Sales revenue	56	12,000	9	5,712,000	√√

Payback period

				Cumulative	
Year	Cash Inflow	Cash outflow	Net cash Flow	Cash Flow	
0		-2,000,000	-2,000,000	-2,000,000	√
1	5,712,000	5185000 √	527,000 √	-1,473,000	√
2	5,712,000	5,185,000	527,000 √	-946,000	√
3	5,712,000	5305000 √	407,000 √	-539,000	√
4	5,712,000	5,305,000	407,000 √	-132,000	√
5	5,712,000	5,305,000	407,000 √	275,000	√o/f √C
			Column o/f	Column o/f	

Payback is after 4 √ and $\frac{132}{407}$ ie 3.89 √√ months

26 marks

Net Present Value

			Discounted	
Year	Net cash Flow	Multiplier	Cash Flow	
0	-2000000 √	1.000	-2,000,000	√
1	527,000	0.893	470,611	√√
2	527,000	0.797	420,019	√√
3	407,000	0.712	289,784	√√
4	407,000	0.636	258,852	√√
5	407,000	0.567	230,769	√√
		NPV	-329,965	√o/f √C

14 marks

(40)

Question Number	Answer	Mark
2(b)	Answers may include : Payback method says invest √ as project does pay back √. However, is the payback period of 4 years 3.89 months (o/f) acceptable for the company? √ Is it too long? √ Project is profitable (each year) √ NPV method states do not invest √ as NPV is negative (o/f) √ NPV may be a better method to use √ as it includes falling value of money over time √ Other Relevant Points £2m has to be raised √ which may worsen the gearing ratio √ How accurate are the predictions √ for costs, cost of capital, and revenues? (need 2 of these 3) √ Chance of renewal of contract after 5 years ?√ Would this be profitable √ Other possible investment projects available at present? √ More or less profitable? √ Objectives/strategy of company? √ Is this investment in line with objectives? √ If only one side of argument maximum of 8 marks. **Overall Conclusion - 2 marks** Company should/ should not invest. √√	**(12)**

Question Number	Answer	Mark
3(a)	Reconciliation of operating profit to net cash flow from operating activities	

Net Operating Profit	67 210	√
Add Interest: Bank overdraft	1 220	√
Debenture 14 000 √ + 3 500 √	17 500	
Profit on Sale of fixed asset	(2 500)	√
Depreciation 38 000 √ + 15 000 √	53 000	
Decrease in Stock	1 500	√
Increase in Debtors	(1 590)	√
Decrease in Creditors	(1 970)	√
Net Cash Inflow from Operating Activities	134 370	√ o/f √C

(12)

Question Number	Answer	Mark
3(b)	Cash Flow Statement for the Year ended 31st December 2010 Wording is required to obtain the mark(s). Item also needs to be in correct place.	

Net Cash Inflow from Operating Activities		134 370 √ o/f
Returns on Investment and Servicing of Finance√		
Interest Paid		(18 720) √ o/f
Preference Dividend Paid		(8 000) √
Taxation √		
Tax Paid		(9 000) √
Capital Expenditure + Financial Investment√		
Payments to acquire tangible fixed assets	(80 000) √	
Receipts from sales of tangible fixed assets	4 500 √	
Net Cash Flow from Investing Activities		(75 500) √ o/f
Equity Dividends Paid√		
Interim Dividend 2010	(94 440) √√	(94 440)
Net Cash Outflow before Financing		(71 290) √ o/f
Financing √		
Issue of Ordinary Shares	50 000 √	
Redemption of Preference shares	(50 000) √	
Issue of Debenture	50 000 √	
Net Cash Inflow from Financing		50 000 √ o/f
Decrease in Cash √		(21 290) √ o/f √ C

(22)

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>3(c)</td><td>Analysis of Changes in Cash and Bank Balances during year ended 31 December 2010
<table>
<tr><th></th><th>31 December 2009</th><th>31 December 2010</th><th>Change in Year</th></tr>
<tr><td>Cash</td><td>3 700</td><td>1 110 √</td><td>(2 590) √</td></tr>
<tr><td>Bank</td><td>7 050</td><td>(11 650) √</td><td>(18 700) √</td></tr>
<tr><td>Total</td><td>10 750</td><td>(10 540) √</td><td>(21 290) √</td></tr>
</table>
Need first two columns for first √
Other layouts for reconciliation are acceptable.</td><td>(6)</td></tr>
</table>

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>3(d)</td><td>Max 8 marks available for arguing only one side.

<u>Handled poorly</u>
Working capital has decreased √ from £22 610 √ to (£940) √ ie by £23 550 √
Working capital ratio has worsened √ from 1.84:1 √ to 0.98 : 1 √
Liquid (acid test) ratio has decreased √ from 0.85 : 1 √ to 0.36 : 1 √
Bank/Cash has decreased √ by £21 290 √
Directors paid themselves an enormous √ interim dividend √

<u>Handled well</u>
Tax due at the start year has been paid. √
Funding via issue of debenture and/or ordinary shares √ that covers redemption of preference shares √

Conclusion 2 marks
Liquidity has been handled poorly by the directors through the year. √√</td><td>(12)</td></tr>
</table>

Section B

Question Number	Answer	Mark
4(a)(i)	Fixed Costs — Variable costs per unit Rent £6 000 √ — £30 + £10 = £40 √ Depreciation £2 800 √√ Telephone £3 000) — Contribution per unit Other £18 200) √ (need both) — £ 80 √ - £ 40 = £ 40 √ Total FC £30 000 √ Break Even Point = £30 000 o/f √ / £40 o/f √ = 750 units √ o/f √ C	**(12)**

Question Number	Answer	Mark
4(a)(ii)	Profit Contribution £40 x 2 400 = £ 96 000 √ o/f Less FC = £ 30 000 √ o/f Profit = £ 66 000 √o/f √ OR Sales = £192 000 √ Fixed Costs = (£30 000) √ o/f Variable Costs = (£96 000) √ o/f Profit = £66 000 √ o/f	**(4)**

Question Number	Answer	Mark
4(b)(i)	Fixed Costs now £27 000 o/f √ Variable costs per unit now £42.50 √o/f Contribution per unit £80.00 - £ 42.50 = £ 37.50 √ o/f Break even Point = £27 000 o/f / £37.50 o/f = 720 units o/f √	**(4)**

Question Number	Answer	Mark
4(b)(ii)	Profit Contribution £37.50 o/f x 2 400 = £90 000 √ o/f Less FC = £27 000 √ o/f Profit = £63 000 √ o/f √ C OR Sales = £192 000 √ Fixed Costs = (£27 000) √ o/f Variable Costs = (£102 000) √ o/f Profit = £63 000 √ o/f	**(4)**

Question Number	Answer	Mark
4(c)	Valid answers may include : Case for keeping Fixed charge (Option 1) Profit is higher √ by £3 000 o/f √ (if 2400 units are sold, option 2 telephone charge is £6000) Profit is the most important aim of a business √ more important than reducing break-even point √ especially when break-even point is easily met. √ Case for changing to Measured charge (Option 2) Measured charge sees break even point reduced √ by 30 units o/f √ which is beneficial to firm √ especially if trading is tough. √ Margin and safety is greater √ from 1650 (option 1) to 1680 (option 2) √ by 30 o/f √ Maximum of four marks if candidate argues for one side only. **Conclusion 2 marks** Keep with fixed charge method / measured charging method must be rejected. √√	**(8)**

Question Number	Answer	Mark
5(a)(i)	Total material cost variance = £6 720 - £6 510 √ = £210 √ Adverse √	**(3)**

Question Number	Answer	Mark
5(a)(ii)	Material Price Variance for one brick = $\frac{£210 \ √ \ o/f}{120\,000 \ √}$ = 0.175 pence √ o/f Adverse √ OR 5.6p √ – 5.425p √ = 0.175p √ o/f Adverse √	**(4)**

Question Number	Answer	Mark
5(a)(iii)	Actual cost per kilo of clay = $\frac{£6\,720 \ √}{120\,000 \ √ \times 2.5 \ √}$ = 2.24 pence per kilo √	**(4)**

Question Number	Answer	Mark
5(b)(i)	Budgeted Total cost = 120 000 x 2.5 x 2.2 p √ = £6 600 √ Total material cost variance = £7 392 - £6 600 o/f √ = £792 o/f √ Adverse √	**(5)**

Question Number	Answer	Mark
5(b)(ii)	Material usage variance for one brick = $\frac{£792 \ o/f \ √}{120\,000 \ √}$ = 0.66 pence o/f √ Adverse √ OR 6.16p √ - 5.5p √ = 0.66p o/f √ Adverse √	**(4)**

Question Number	Answer	Mark
5(b)(iii)	Kilos of clay to produce one brick = $\frac{£7\,392 \ √}{120\,000 \ √ \times 2.20 \ √}$ = 2.8 kilos √	**(4)**

Question Number	Answer	Mark
5(c)	Maximum of 4 marks for giving one side of the argument <u>Case for Chinclay</u> Probably better quality clay √ as no material usage variance. √ Earthworks has adverse usage variance √ so probably poorer quality clay. √ 0.3 kilos o/f √ of clay less used per brick √ Overall cost of using Chinclay is cheaper √ by £672 √ Cost of 1 brick for Chinclay is 5.6p, which is 0.56p √ cheaper than Earthworks √ which is 6.16p. <u>Case for Earthworks Limited</u> Cost per kilo of clay is cheaper √ by 0.04 pence per kilo. √ <u>Conclusion</u> 2 marks Best to stay with Chinclay √√	**(8)**

Question Number	Answer	Mark
6(a)(i)	$\frac{310\,000 \checkmark}{5\,000\,000 \checkmark}$ = 6.2 pence per share ✓	**(3)**

Question Number	Answer	Mark
6(a)(ii)	1900 ✓ x 6.2 p o/f ✓ = £117.80 o/f ✓	**(3)**

Question Number	Answer	Mark
6(a)(iii)	$\frac{420\,000 \checkmark}{310\,000 \checkmark}$ = 1.35 times ✓	**(3)**

Question Number	Answer	Mark
6(a)(iv)	$\frac{6.2 \text{ o/f} \checkmark}{197 \checkmark}$ x 100 = 3.14% ✓	**(3)**

Question Number	Answer	Mark
6(a)(v)	$\frac{420\,000 \checkmark}{5\,000\,000 \checkmark}$ = 8.4 pence per share ✓	**(3)**

Question Number	Answer	Mark
6(a)(vi)	$\frac{197 \checkmark}{8.4 \text{ o/f} \checkmark}$ = 23.45 times ✓	**(3)**

Question Number	Answer	Mark
6(b)	$\frac{44 \checkmark}{153 \checkmark}$ x 100 = 28.76% ✓ over 3 years $\frac{28.76 \checkmark}{3 \checkmark}$ = 9.59 % per year ✓ OR £3743 ✓ - £2907 ✓ = £836 ✓ = $\frac{£836 \checkmark}{3 \checkmark}$ = £278.67 ✓	**(6)**

Question Number	Answer	Mark
6(c)	Maximum of 4 marks for stating one side of argument only <u>Case for selling shares</u> Dividend yield is low. ✓ She could possibly earn a better return in another company, ✓ or maybe even in a bank deposit account. ✓ Price/Earnings ratio is high, ✓ so a seller would get a good price. ✓ Profit of £836 has been made ✓ <u>Case for holding shares</u> Dividend policy looks reasonably generous ✓ with about 75% ✓ large amount of this years profit paid as a dividend. ✓ Price/Earnings ratio is high, ✓ which means the market has confidence in the share, ✓ so price may continue to rise. ✓ Capital return of 9.59% per year is reasonably good ✓ and may continue. ✓ <u>Conclusion - 2 marks</u> Appears to be a share worth holding ✓✓	**(8)**

Question Number	Answer			Mark
7(a)		Debit	Credit	
	(i) Property / Buildings √	500 000 √		
	Revaluation reserve √		500 000	
	(ii) Profit and Loss √	26 000		
	Stock √		26 000	
	(iii) Foreign Exchange Reserve √	350 000		
	Profit and Loss √		350 000	
	(iv) Profit and Loss √	650 000		
	Corporation Tax provision √		650 000	
	(v) Profit and Loss √	27 500 √		
	Preference Share Dividend √		27 500	**(12)**

Question Number	Answer	Mark
7(b)	Answers could include A rights issue sees existing ordinary shareholders √ being offered the first right to purchase newly issued shares. √ The shares would be issued at a discount to the market value, √ to benefit the shareholders subscribing. √ The shareholder may be able to sell this right, √ if they do not wish to take up the issue themselves. √ Shareholders who do not take up the rights issue lose out √ by owning a smaller share of the company. √ A rights issue will involve the company receiving cash √ for the shares. The double entry would be Dr Cash √ Cr Ordinary shares. √ A bonus issue would involve the company issuing new shares √ to existing ordinary shareholders. √ The shareholders do not have to pay any money √ to the company for the shares. √ They may be issued to make the market price of the share lower, √ and therefore easier to trade. √ Or, the issue could be to make the balance sheet appear more like that of a "large company" √√. The shareholders do not really benefit, √ as they still hold the same percentage ownership of the company. √ If company has no cash for dividends √ they may give a bonus issue instead √ The double entry would be Dr Any Reserve √ Cr Ordinary shares. √	**(12)**

Question Number	Answer	Mark
7(c)	Maximum of 4 marks for stating one side of argument only <u>Case for debentures</u> Company raises cash required for new investment. √ Fees are likely to be low √ compared to an issue of shares √ e.g. prospectus, advertising, √ etc No capital repayments √ over the life of the debenture √ Interest is fixed √ which allows budgeting to take place √ Debenture interest is allowed against tax √ so less corporation tax is paid on profits √ Issuing debentures instead of shares reduces the chance of a takeover √√ <u>Case Against debentures</u> There will be some expenses involved in debenture issue √ e.g. administration, underwriting etc √ When debenture matures, √ a large capital sum has to be repaid √ Interest must be paid on debenture√ even when the company makes a loss √ and interest will reduce the profits √ Issue of debenture means gearing ratio √ will increase √ Debenture holders are likely to insist on a charge √ over company assets √ Debenture holders may insist on some form of control √ e.g. a seat on the board √ <u>Conclusion</u> 2 marks As a source of finance for the new marina, a debenture is probably (not) a good idea. √√	**(8)**

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