

Mark Scheme (Results)

Summer 2008

GCE

GCE Accounting (6002) Paper 01

- 6002/01 Mark Scheme Summer 2008

Question Number	Answer	Mark
1(a)(i)		(24)

Q1 Mark Scheme (a) (i)

Profit and Loss Account for Rainbow plc for Year Ended 31st March 2008

Turnover	1678000	✓
Cost of sales	578000	✓ o/f
Gross profit	1100000	✓ o/f
Distribution costs	311000	✓ o/f
Administrative expenses	49000	✓ o/f
Interest payable	35000	✓ o/f ✓ C
Profit on ordinary activities before tax	705000	✓ o/f
Corporation tax	72000	✓
Profit on ordinary activities after tax	633000	✓ o/f ✓ C

11

W1 Cost of Sales

Direct Labour	225000	✓
Direct materials	312000	✓
Factory Depreciation	32000	✓✓
Stock Adjust	9000	✓✓
	<u>578000</u>	6

W2 Distribution Costs

Advertising	53000	✓
Warehouse Rent	60000	✓✓
Lorry Drivers Wages	86000	✓
Warehouse Staff	112000	✓
	<u>311000</u>	5

W3 Administrative Expenses

Bad Debts Written Off	1000	✓
Office Expenses	48000	✓
	<u>49000</u>	2

Question Number	Answer	Mark
1(a)(ii)		(16)

Balance sheet of Rainbow plc as at 31 March 2008				
B Fixed assets				
<i>I Intangible assets</i>				
Goodwill *		120000	✓✓	
<i>II Tangible Assets</i>				
Buildings (1600000 £ - 32000 £ o/f)	1568000	✓✓		
Motor Lorries	250000	✓		
		1818000		
				1938000
C Current Assets				
<i>I Stocks</i>				
Stocks of Finished Goods	65000	✓		
<i>II Debtors</i>				
Trade debtors	41000	✓		
Prepayments **	5000	✓		
<i>IV Cash at bank and in hand</i>				
Bank	96000	✓		
				207000
D Prepayments and Accrued Income				
E Creditors: Amounts falling due within one year				
Trade Creditors	75000	✓		
Bank interest	3000	✓		
				78000
F Net current assets (liabilities)				
				129000
G Total assets less current liabilities				
				2067000
H Creditors: amounts falling due after more than one year				
Bank loan				400000
I : Provisions for liabilities and charges				
Taxation Provision ***				72000
				1595000
K :Capital and reserves				
<i>I Ordinary share capital called up</i>	500000	✓		
<i>V Profit and loss account (462000 £ + 633000 o/f £)</i>	1095000	✓✓		
				1595000

*Goodwill gets 1 tick only if not separate from fixed assets/not shown under 'intangible' assets

** Prepayments can be shown in CII Debtors or D Prepayments

*** Taxation provision can be shown under I Provisions or E Creditors

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 1(b) 	<ul style="list-style-type: none"> • Max 8 ✓ for arguing one side • • <u>Case For Importance of Director's Report</u> • • Report gives information to e.g. shareholders ✓ which they could use to make a decision ✓ e.g. invest more funds in the company. ✓ • Directors may use the report to try to inform shareholders that the company is acting in an ethical manner ✓ e.g. renewable fuel sources ✓ • Other stakeholders e.g. pressure group ✓ may use information in the Report to bring about change in company policy ✓ e.g. treatment of disabled ✓ • Disclosures may be required under Stock exchange regulations ✓, which may be appropriate in the Directors Report e.g. legislation pending ✓ • Information is given to shareholders which allows them to see in some detail how the company is performing ✓ <ul style="list-style-type: none"> ▪ E.g. 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 ✓ • • <u>Case Against Importance of Directors Report</u> • • Report costs personnel time ✓ to prepare and money to print etc ✓ • Directors may use Report to give an unrealistic, positive view of the company, ✓ as it is in their interest to do so. ✓ • • • <u>Conclusion</u> • • Should relate to above points. E.g. Directors Report is important. ✓✓ 	<ul style="list-style-type: none"> • (12)

Question Number	Answer	Mark
2(a)		(20)

To obtain tick, entry must show correct figure and narrative.

Ordinary Share Capital Account

			Apr 1	Balance b/d	500 000 ✓
			May18	Application & Allotment	40 000 ✓
			June30	Application & Allotment	100 000 ✓
Mar31	Balance c/d	<u>700 000</u>	Sept30	First & Final Call	<u>60 000 ✓</u>
		<u>700 000</u>			<u>700 000</u>
			Apr 1	Balance b/d	700 000

+ ✓ if balanced off correctly o/f
5

Share Premium Account

			Apr 1	Balance b/d	100 000 ✓
Mar31	Balance c/d	<u>180 000</u>	May18	Application & Allotment	<u>80 000 ✓</u>
		<u>180 000</u>			<u>180 000</u>
			Apr 1	Balance b/d	180 000

+ ✓ if balanced off correctly o/f
3

Application and Allotment Account

May18	Ordinary Share Capital	40 000 ✓	May18	Bank	174 000 ✓
	Share Premium	80 000 ✓	June30	Bank	70 000 ✓✓
May25	Bank	24 000 ✓			
June30	Ordinary Share Capital	<u>100 000 ✓</u>			
		<u>244 000</u>			<u>244 000</u>

7

First and Final Call Account

Sept30	Ordinary Share Capital	<u>60 000 ✓</u>	Sept30	Bank	<u>60 000 ✓</u>
		<u>60 000</u>			<u>60 000</u>

2

+ ✓ if these two accounts closed off correctly, showing no balance

+ 2 ✓ if ALL dates correct OR

+ 1 ✓ if SOME dates correct

Question Number	Answer	Mark
2(b)		(4)

Oct 1	Buildings Revaluation reserve	£ 50 000 /	£ 50 000 /
Nov 1	Profit and Loss General reserve	40 000 /	40 000 /

Question Number	Answer	Mark
2(c)		(12)

Profit available for distribution:

$$\begin{aligned} \text{Profit and Loss Reserve} &= 312 / - 40 / + 246 / = 518 \\ \text{General Reserve} &= 80 / + 40 / = 120 \\ \text{Total available} &= 638 / \text{ o/f } / 2 = 319 / \text{ o/f } / \text{ C} \end{aligned}$$

$$\text{Number of Ordinary shares} = 500 / + 200 / = 700$$

$$\text{Dividend per share} = \frac{319}{700} = 45.57 / \text{ o/f pence (per share) } /$$

Question Number	Answer	Mark
2(d)		(4)

$$\begin{aligned} \text{Dividend Yield} &= \frac{\text{Dividend Per share}}{\text{Market Price of share}} \times 100 / \\ &= \frac{45.6 / \text{ o/f}}{185 / \text{ o/f}} = 24.6 \% / \text{ o/f} \end{aligned}$$

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 2(e) 	<ul style="list-style-type: none"> • Maximum of 8 x ✓ for arguing one side • • Answers may include: • • <u>Case for Ordinary shares</u> <ul style="list-style-type: none"> • Shareholders do not have to be paid dividends, ✓ useful when short of funds. ✓ • No “outside” parties having any influence on running of company ✓ eg place on Board ✓ • No interest has to be paid, ✓ so profits of company higher. ✓ • No assets offered as security, ✓ so no claims on assets by banks, if loan not repaid, or company fails. ✓ • Do not have to be paid back ✓ so are a permanent/long term source of finance. ✓ • Bank loans result in higher gearing, ✓ which increases risk to company. ✓ • • • <u>Case for Bank Loans</u> <ul style="list-style-type: none"> • Interest is allowable for tax, ✓ so company may be able to retain more funds than if paying dividends. ✓ • Bank may bring expertise and experience to company, ✓ and maybe Board. ✓ • Bank may be flexible ✓ regarding repayments, length of loan etc. ✓ • Issue of shares may dilute ✓ control of existing shareholders ✓ • Issue of shares results in share price fall ✓ so existing shareholders are unhappy. ✓ • Shares take a longer time to issue ✓ e.g. completing forms etc. ✓ • Shares are costlier to issue ✓ e.g. handling applications ✓ • • <u>Conclusion</u> 2 x ✓ • Should relate to above points made. • Eg Ordinary shares are a preferable source of finance. ✓✓ 	<ul style="list-style-type: none"> • (12)

Question Number	Answer	Mark
3(a)		(12)

Reconciliation of operating profit to net cash flow from operating activities

Net Operating Profit	56 600	£
Add Interest : Bank overdraft	3 800	£
Debenture	8 000	££
Loss on Sale of fixed asset	6 000	£
Depreciation	20 000	££
Decrease in Stock	9 600	£
Increase in Debtors	(600)	£
Decrease in Creditors	(2 000)	£
Net Cash Inflow from Operating Activities	101 400	£ o/f £C

Question Number	Answer	Mark
3(b)		(22)

Cash Flow Statement for the Year ended 31st March 2008

Wording is required to obtain the mark(s). Item also needs to be in correct place.

<u>Net Cash Inflow from Operating Activities</u>		101 400 £ o/f
<u>Returns on Investment and Servicing of Finance £</u>		
Interest Paid		(11 800) £ o/f
Preference Dividend Paid		(7 200) £
<u>Taxation £</u>		
Tax Paid		(17 000) £
<u>Capital Expenditure + Financial Investment £</u>		
Payments to acquire tangible fixed assets	(90 000) £	
Receipts from sales of tangible fixed assets	19 000 £	
Net Cash Flow from Investing Activities		(71 000) £ o/f
<u>Equity Dividends Paid £</u>		
Final Dividend 2007	5 000 £	
Interim Dividend 2008	8 400 ££	(13 400)
Net Cash Outflow before Financing		(19 000) £ o/f
<u>Financing £</u>		
Issue of Ordinary Shares	100 000 £	
Redemption of Preference shares	(80 000) £	
Net Cash Inflow from Financing		20 000 £ o/f
Increase in Cash £		1 000 £ o/f £ C

Question Number	Answer	Mark
3(c)		(6)

Analysis of Changes in Cash and Bank Balances during year ended 31 March 2008

	31 March 2007	31 March 2008	Change in Year
Cash	4 000	1 000 ✓	(3 000) ✓
Bank	(22 000)	(18 000) ✓	4 000 ✓
Total	(18 000)	(17 000) ✓	1 000 ✓

Need first two columns for first ✓
Other layouts for reconciliation are acceptable.

• Question • Number	• Answer	• Mark
• 3(d)	<ul style="list-style-type: none"> • <u>Answers may include the following:</u> • • 8 ✓ available for arguing only one side. • • Profit most important • Without profit, business would close down ✓ in the long run. ✓ • If short term liquidity problem, ✓ many sources are available as source of finance ✓ • e.g. banks, shareholders, debt factoring etc (need two sources). ✓ • No/low profits may result in firm unable to attract finance ✓ or investors/shareholders. ✓ • No/low profits may see share price fall, ✓ as investors lose confidence. ✓ • • Liquidity most important (or both equally important) • Liquidity problems result in unable to pay daily bills ✓ eg wages, electricity (need two) ✓ • Unable to pay some bills may result in closure of business ✓ e.g. tax bill ✓ • Unable to pay some bills may mean business unable to operate ✓ e.g. electricity cut off ✓ • Can survive short term losses ✓ if previous profits have been built up ✓ • • 2 ✓ for Conclusion e.g. Profit more important 	• (12)

Question Number	Answer	Mark
4(a)		(12)

High Quality Jacket

$$\begin{aligned} \text{Variable cost for one jacket} &= (11 \times 3) + (15 \times \text{£}4) \\ &= \text{£}33 \text{ /} + \text{£}60 \text{ /} = \text{£}93 \text{ / o/f} \end{aligned}$$

$$\text{Break Even Point} = \frac{\text{£}2\,300 \text{ /}}{149 - 93 \text{ / o/f}} = 42 \text{ jackets / o/f}$$

Low Quality Jacket

$$\begin{aligned} \text{Variable cost for one jacket} &= (8 \times 3) + (13 \times \text{£}3) \\ &= \text{£}24 \text{ /} + \text{£}39 \text{ /} = \text{£}63 \text{ / o/f} \end{aligned}$$

$$\text{Break Even Point} = \frac{\text{£}2\,000 \text{ /}}{99 - 63 \text{ / o/f}} = 56 \text{ jackets / o/f}$$

Question Number	Answer	Mark
4(b)		(4)

Margin of Safety

$$\text{High Quality Jacket} \quad (160 - 42) \text{ / o/f} = 118 \text{ jackets / o/f}$$

$$\text{Low Quality Jacket} \quad (210 - 56) \text{ / o/f} = 154 \text{ jackets / o/f}$$

Question Number	Answer	Mark
4(c)		(8)

		High Quality		Low Quality
Sales Revenue	149 X 160	23840/	210 x 99	20790/
Material Costs	11 x 3 x 160	5280	8 x 3 x 210	5040
Labour Costs	15 x 4 x 160	9600	13 x 3 x 210	8190
Fixed Costs		2300		2000
Total Costs		17180/		15230/
Profit		6660/o/f / C		5560/o/f / C
OR				
Contribution per Unit		56 o/f	(o/f from (a))	36 o/f
Sales Units		160		210
		8960/ o/f		7560/ o/f
Less Fixed Costs		2300/		2000/
Profit		6660/o/f / C		5560/o/f / C

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 4(d) 	<ul style="list-style-type: none"> • Case for one side of argument only 4 x ✓ maximum • • <u>Case for High Quality Jacket</u> • Profit is higher✓ by £1100 o/f✓ • Break Even point in units is lower✓ by 14 units. ✓ o/f • Contribution is higher✓ by £20 ✓o/f • Profit margin is higher✓ so less risky✓ • • <u>Case for Low quality jacket</u> • Margin of Safety is higher✓ by 36 units ✓ o/f • Figures are only estimates✓, e.g. may actually sell fewer high quality jackets ✓ • Costs are lower✓ so less risky ✓ (or stated as high quality costs higher) • • <u>Conclusion</u> • Should relate to above points. e.g. high quality jacket is best choice. ✓✓ 	<ul style="list-style-type: none"> • (8)

Question Number	Answer	Mark
5(a)		(16)

Budgeted Profit and Loss Account for June 2008				Any 2 figures for first ✓
OUTPUT	2000	2500	3000	
Materials	9600	11400	12996	✓✓
Labour	52000	65000	78000	✓✓
Transport	2400	2800	3200	✓✓
Water + Electric	1825	2125	2425	✓✓
Fixed Costs	11500	11500	11500	✓✓
Total Costs	77325	92825	108121	
Sales Revenue	110000 ✓	123750 ✓	133650 ✓	
Profit	32675 ✓ o/f	30925 ✓ o/f	25529 ✓ o/f	

Question Number	Answer	Mark
5(b)(i)	(As output increases), profits are falling. ✓✓ o/f	(2)

Question Number	Answer	Mark
5(b)(ii)	<p>Reduce material costs ✓ for larger output by negotiating better discounts ✓</p> <p>Reduce labour costs ✓ eg by introducing piecework, bonus, etc ✓</p> <p>Improve transport efficiency ✓ eg ensure lorries only travel when full ✓</p> <p>Reduce electric bill ✓ eg turn off lights when not needed etc ✓</p> <p>Negotiate better price with customers ✓ eg reduce discount given. ✓</p> <p>Produce 2000 units (o/f) ✓ as this gives the highest profit level ✓.</p> <p>Investigate figures for a lower output level ✓ eg 1500 ✓.</p>	(6)

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 5(c) 	<ul style="list-style-type: none"> • For argument one side only max = 4 x J • • Answers may include • • <u>Case For flexible budgets</u> • Allow good decision making J as “like compared to like” eg similar output levels J. • May save time and money J by allowing “Management by Exception” ie action only if a variance J. • Allows choice of optimum output J eg 2000 units J. • Meeting the targets J leads to motivation of workforce J. • • <u>Case Against flexible budgets</u> • Labour time J which means money in preparation J. • Figures are only estimates J so some variances may be misleading/action inappropriate J. • • <u>Conclusion</u> • Should relate to points made above. Eg Flexible budgets are a very useful tool JJ. 	<ul style="list-style-type: none"> • (8)

Question Number	Answer	Mark
6(a)(i)		(10)

Package A	£ million	Interest Rate/ Expected return	Interest £	
Debenture	5	16%	800 000	✓ Both figures needed
Bank Loan	5	14%	700 000	
Preference Shares	5	12%	600 000	✓ Both figures needed
Ordinary Shares	15	10%	1 500 000	
Total	30		3 600 000 ✓	o/f

$$\text{Weighted Average Cost of Capital} = \frac{3\,600\,000 \text{ o/f}}{30\,000\,000} \times 100 \checkmark = 12\% \text{ o/f } \checkmark$$

Package B	£ million	Interest Rate/ Expected return	Interest £	
Debenture	12	15%	1 800 000	✓ Both figures needed
Bank Loan	3	13.5%	405 000	
Preference Shares	3	12.5%	375 000	✓ Both figures needed
Ordinary Shares	12	11%	1 320 000	
Total	30		3 900 000 ✓	o/f

$$\text{Weighted Average Cost of Capital} = \frac{3\,900\,000 \text{ o/f}}{30\,000\,000} \times 100 \checkmark = 13\% \text{ o/f } \checkmark$$

Question Number	Answer	Mark
6(a)(ii)	Directors should choose Package A o/f (if correct reason) ✓ as it has the lowest WACC. ✓	(2)

Question Number	Answer	Mark
6(b)		(12)

Year	Sales	Running Costs Less Depreciation	Net Cash Flow	Discount Factor	Discounted Net Cash Flow
0			(30 000 000)	1.0	(30 000 000)
1	300 000	(500 000) ✓	(200 000) *	0.893	(178 600) ✓ o/f
2	500 000	(600 000) ✓	(100 000) ✓ o/f	0.797	(79 700) ✓ o/f
3	1 200 000	(1 200 000) ✓	0 **	0.712	0 ✓ o/f
4	60 000 000	(5 000 000) ✓	55 000 000 ✓ o/f	0.636	34 980 000 ✓ o/f
				NPV	4 721 700 ✓ o/f ✓ C

* Both (200 000) and (100 000) needed for ✓

** Both 0 and 55 000 000 needed for ✓

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 6(c) 	<ul style="list-style-type: none"> • Maximum for argument one side = 4 x ✓ • • Apply o/f rule from (b) to all points made • • <u>Case For Project</u> • NPV is positive / large / substantial / profitable ✓ at £4.7m o/f ✓ • Figures are estimates ✓ - could be greater profits. ✓ • Company could establish reputation, other lines/events ✓ etc and continue after 4 years ✓ • • <u>Case Against Project</u> • Figures are only estimates ✓ - could be less profits. ✓ • Need to apply other Investment Appraisal techniques ✓ e.g. Payback method ✓ • Positive cash flow only arrives in year 4, ✓ with 2 years of a negative cash flow. ✓ • Non-financial considerations ✓ e.g. building work, traffic problems ✓ • Need to consider alternative use of funds ✓ i.e. opportunity cost or example ✓ • • <u>Conclusion</u> 2 x ✓ • Should go ahead with project o/f conclusion. 	<ul style="list-style-type: none"> • (8)

• Question • Number	• Answer	• Mark
• 7(a)	•	• (8)

<u>Calculation of Goodwill</u>					
Buildings	1600000	√ All 3 requ'd	Purchase Price	2000000	√
Fixtures and Fittings	75000		Value of Net Assets	-1649000	√ o/f
Furniture	30000		Goodwill	351000	√ o/f √ C
Stock	3000	√ Both requ'd			
Debtors	1000				
Short Term Loan	-50000	√ Both requ'd			
Creditors	-10000				
Value of Net assets acquired	1649000	√ o/f			

Question Number	Answer	Mark
7(b)		(4)

$$\text{Cash received per share} = \frac{\text{£}100\,000 \text{ } \cancel{\text{£}}}{1\,000\,000 \text{ } \cancel{\text{£}}} = 10\text{p per share } \cancel{\text{£}} \times 3600 = \text{£}360 \text{ } \cancel{\text{£}}$$

• Question • Number	• Answer	• Mark
• 7(c)	•	• (12)

Balance Sheet of Hotel Maximus	as at 1April 2008	£	£	
Goodwill			351000	// o/f
Buildings	6600000	// for any two // all four		
Fixtures and Fittings	475000			
Furniture	230000			
Vehicles	30000			
			7335000	
Stock	28000	// need both		
Debtors	6000			
Bank	17000	// C		
Cash	32000	//		
			83000	
Short Term Loan	50000	// need both		
Creditors	74000			
			124000	
Working capital			-41000	
Net Assets			7645000	
Ordinary Shares of £1 each	3000000	//		
Share Premium	1900000	//		
Profit & Loss Reserve	2745000	//		
Capital + Reserves			7645000	

<ul style="list-style-type: none"> • Question • Number 	<ul style="list-style-type: none"> • Answer 	<ul style="list-style-type: none"> • Mark
<ul style="list-style-type: none"> • 7(d) 	<ul style="list-style-type: none"> • An intangible fixed asset on the balance sheet ✓ • Correct treatment of goodwill would be to amortize/depreciate/write off ✓ over its useful economic life/over a lengthy time period e.g. over 20 years. ✓ • • <u>Case For this treatment</u> • Likely to derive benefits from the expenditure over a number of years, ✓ so spread the cost of this expenditure over a number of years ✓ i.e. matching concept ✓ gives a True and Fair view of the accounts. ✓ • To write off immediately may make profit unrealistically low, ✓ and tax charge would be unfairly low. ✓ • In line with recommended practice ✓ i.e. FRS 10 ✓ • • <u>Case Against this Treatment</u> • If written off over a short(er) time period against reserves, ✓ the prudence concept is followed. ✓ • • <u>Conclusion</u> • Writing off over a number of years is required and beneficial as it gives a true and fair view of the accounts. ✓✓ 	<ul style="list-style-type: none"> • (8)

