

Mark Scheme with Examiners' Report GCE A Level Accounting (6002)

January 2006

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Mark Scheme with Examiners' Report

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January 2006

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ACCOUNTING 6002, MARK SCHEME

Question 1

(a) / is for figure and narration

(i) Preference share dividend	16 000/C	
Bank		16 000/C
P/L Appropriation	16 000/C	
Preference Share Dividend		16 000/C
(ii) Premises	400 000/C	
Revaluation reserve		400 000/C
(iii) Revaluation reserve	400 000/C	
Share premium	350 000/C	
Bonus shares		750 000/C
Bonus shares	750 000/C	
Ordinary share capital		750 000/C
(iv) Bank	3 300 000/C	
Ordinary share capital		1 650 000/C
Share premium		1 650 000/C
(v) P/L Appropriation	990 000/C	
Ordinary share dividend		990 000/C
P/L Approp	16 000/C	
Preference share dividend		16 000/C

18 x / = 9 marks

(b) Summarised Balance Sheet of Torre Vella plc at 31 October 2005

	£000
Fixed assets (+400/C)	7 400/OF
Net current assets (-16/C + 3 300/C -990/C -16/C)	4 778/OF
	12 178
Capital and Reserves	
9 900 000 ordinary shares of £1 (fp) (+750/C +1 650/C)	9 900/OF
800 000 8% pref shares of 50p (fp)	400/C
Share premium (-350/C +1 650/C)	1 650/OF
Profit and loss (-16/C -16/C -990/C)	228/OF
Revaluation reserve (+400/C -400/C) Item must be shown	00F
	12 178

20 x / = 10 marks

(c)

Award 1 for identification of each of two appropriate methods ...max 2 1s

Award up to 6 1s for evaluation of each method. 2 methods gives 12 1s or 6 marks.

Some possible methods:

Issue of debentures

Sale and lease back of fixed assets

Bank loan

For evaluation of each method award up to 11 for point in favour up to 11 for against and up to 11 for conclusion.

Example

An issue of debentures 1 would raise finance without affecting ownership 11 but would raise the gearing 11 giving a definite commitment to the payment of annual interest. However Torre Vella is low geared and would remain low geared should the finance have been raised by debentures rather than shares 11

Example

Lease back of fixed assets would give a commitment to an annual payment 11 and would give the bank a claim on the firm's assets 11. There would be no change to ownership of the company 11.

12 x 1 = 6 marks for evaluation and 2 x 1 = 1 mark for identification gives max 7 marks

	Method 1	Method 2
Identification	1	1
For	11	11
Against	11	11
Conclusion	11	11

Total 26 marks

Question 2

(a)

Up to 4 $\sqrt{\text{ }}$ s available for explanation (breakdown may involve explanation of variance/significant variance/corrective action)

Up to a further 2 $\sqrt{\text{ }}$ s available for an acceptable example

Max 6 $\sqrt{\text{ }}$ s or 3 marks

Example

When actual performance is compared with budgeted performance the resultant figure is known as a variance. $\sqrt{\text{ }}$ For example if budgeted wages was £100 000 and actual wages was £135 000, there would be a variance of £35 000 $\sqrt{\text{ }}$ adverse. $\sqrt{\text{ }}$ Every cost may produce a variance. Management by exception would focus on significant variances. $\sqrt{\text{ }}$ Management would investigate the variance and take corrective action. $\sqrt{\text{ }}$

(b)

(i) Materials		
Materials Price = (SP-AP) x AQ/C	(£5 - £5.50C) x 5 200/C	£2 600/C Adv/OV
Materials Usage = (SQ-AQ) x SP/C	(4 800 $\sqrt{\text{ }}$ /C ($\sqrt{\text{ }}$ /OF) - 5 200C) x £5/C	£2 000/OV Adv/OV
Overall Materials		£4 600/OV Adv/OV
12 x $\sqrt{\text{ }}$ = 6 marks		

(ii) Labour		
Labour rate = (SR-AR) x Ahrs/C	(£6 - £6.60C) x £6 000/C	£3 600/C Adv/OV
Lab efficiency = (SHrs-Ahrs) x SR/C	(4 000 $\sqrt{\text{ }}$ /C ($\sqrt{\text{ }}$ /OF) - 6 000C) x £6/C	£12 000/OV Adv/OV
Overall Labour		£15 600/OV Adv/OV
12 x $\sqrt{\text{ }}$ = 6 marks		

(c)(i)

Actual Sales		£136 000 $\sqrt{\text{ }}$
Less actual materials cost	£28 600 $\sqrt{\text{ }}$	
Less actual wages cost	£39 600 $\sqrt{\text{ }}$	£68 200
Actual profit		£67 800/C
So actual profit margin is £67 800/£136 000 $\sqrt{\text{ }}$ x 100 = 49.85% $\sqrt{\text{ }}$ /OF		

2 x $\sqrt{\text{ }}$ = 1 mark

(ii)

Up to 2 $\sqrt{\text{ }}$ s available for reason and further 2 $\sqrt{\text{ }}$ s for development

Example

The targeted profit of 75% was for the year, whereas the actual of 49.85% is for one month only. $\sqrt{\text{ }}$ Perhaps December is a seasonally poor month for sunshades. $\sqrt{\text{ }}$

4 x $\sqrt{\text{ }}$ = 2 marks

(d)

Up to 12 /s available here in total.

Candidate may comment on each of sales, materials and labour, give / for a suitable comment on each aspect of these (maximum 6 /s)

No more than 4 /s for any of sales, materials or labour.

6 x / = 3 marks

This leaves 6 /s for recommendations i.e. one / for straightforward recommendation e.g find cheaper supplier or two /' for a well developed recommendation.

So possible to get full marks with six recommendations or 3 well developed recommendations.

6 x / = 3 marks

Example

Comment	Recommendation
1. The number of items sold has fallen by 2000 sunshades/ but it has been possible to obtain a higher price (up £2) /. Overall the Sales revenue has fallen	Reduce the price / Perhaps the competition in sunshades is more fierce than anticipated and the price should be returned to £15 to recapture sales volume // Use an advertising campaign to increase market share. /. Although this will increase costs it may have a more than proportionate effect on sales volume //
2. The cost of materials has increased/ and more material has been used/	Find cheaper supplier/ Look for discounts through bulk buying Find better quality materials/
3. Workers are being paid more/ and the quality of work is poorer/	Depends whether this is due to Trade Union activity/more skilled labour // Depends whether due to machine breakdowns/unskilled labour etc //

Total 26 marks

Question 3

(a)

(i) SAFC Manufacturing Statement of Gross Profit for year ended 31 December 2004 (Yr 1)

	Marginal Costing		Absorption Costing	
	£	£	£	£
Sales (30 000 x £35)		997,500 /C		997,500 /C
less variable costs				
Direct materials (30 000 x £8)	240,000 /C		240,000 /C	
Direct labour (30 000 x £7)	210,000 /C		210,000 /C	
Overheads (30 000 x £2)	60,000 /C		60,000 /C	
Total variable cost	<u>510,000</u>			
Less valuation of closing stock (marginal)				
1500/30000 x 510 000	25,500 /C (JOF)			
Marginal cost of sales	<u>484,500</u>			
Fixed factory overhead	42,000 /C	526,500	42,000 /C	
Total production costs			<u>552,000</u>	
Less valuation of closing stock (absorption)				
1500/30000 x 552 000			27,600 /C (JOF)	
				524,400
GROSS PROFIT		<u>471,000</u>		<u>473,100 /JOF</u>

16 x / = 8 marks

(ii)

Statement of Gross Profit for year ended 31 December 2005 (Yr 2)

	Marginal Costing		Absorption Costing	
	£	£	£	£
Sales (31 000 x £34)		1,054,000 /C		1,054,000 /C
less variable costs				
Direct materials (30 000 x £9)	270,000 /C		270,000 /C	
Direct labour (30 000 x £8)	240,000 /C		240,000 /C	
Overheads (30 000 x £3)	90,000 /C		90,000 /C	
Total variable cost	<u>600,000</u>		<u>600,000</u>	
Add opening stock b/d	25,500 /J OF			
Less valuation of closing stock (marginal)				
500/30 000 x 600 000	10,000 /C (JOF)			
Marginal cost of sales	<u>615,500</u>			
Fixed factory overhead	44,000 /C	659,500	44,000 /C	
Total production costs			<u>644,000</u>	
Add opening stock b/d			27,600 /J OF	
Less valuation of closing stock (absorption)				
500/30 000 x 644 000			10,733 /J (JOF)	
				660,867
GROSS PROFIT		<u>394,500</u>		<u>393,133 /JOF</u>

20 x / = 10 marks

(b)

Award up to 6 \checkmark s or 3 marks for an appropriate evaluation. 2 \checkmark s for, 2 \checkmark s against and 2 \checkmark s for conclusion

Example

Absorption costing is superior for valuation of stock because fixed costs are a product cost and should be included within the value of stock. $\checkmark\checkmark$ Marginal costing does not include fixed costs as part of stock valuation and therefore undervalues stock. $\checkmark\checkmark$ This is why SSAP 9 recommends absorption costing. $\checkmark\checkmark$

6 x \checkmark = 3 marks

(c)

The extra 5 000 units will make a contribution of
Contribution = Selling price - Variable Costs
Contribution = £22 - (£9+£8+£3) \checkmark
Contribution = £2 per unit. \checkmark

Total contribution will be 5 000 x £2 = £10 000 \checkmark
SAFC would accept the offer because it is making a positive contribution \checkmark to profits $\checkmark\checkmark$ (financial factor)
(Non-financial) Impact on existing customers may disrupt brand loyalty etc
 $\checkmark\checkmark$ for acceptable non-financial factor

$\checkmark\checkmark$ for overall conclusion

10 x \checkmark = 5 marks

Total 26 marks

Question 4

(a)

Barca plc
Cash flow statement for year ended 30 November 2005

Operating profit	120	/C		
Depreciation	64	/C		
Profit on sale of assets	(5)	/C		
Decrease in stocks	2	/C		
Increase in debtors	(150.2)	/C		
Decrease in creditors	<u>(20)</u>	/C		
Net cash flow from operating activities	10.8	/C	(/OF[NC])	
Returns on investment & servicing of finance				
Interest paid	(60)	/C		
Preference dividends paid	<u>(4)</u>	/C	(64)	/ OF (NC)
Taxation			(25)	/C
Capital expenditure & financial investment				
Purchase of assets	(180)	/C		
Sale of fixed assets	<u>10</u>	/C	(170)	/OF(NC)
Equity dividends paid			(40)	/C
Management of liquid resources				
Sale of corporate bonds			7	/C with heading
Financing				
Issue of ordinary shares			<u>50</u>	/C with heading
Cash outflow			<u>(231.2)</u>	

20 x / = 10 marks

(b)

Cash budgets are: forecasts or plans//; prepared for internal users//; used to plan and control cash flows and obtain finance when needed//

Cash flow statements are: a statutory requirement for plcs//; historic//; for external users//; used to show sources and uses of cash//

Award // for identification and up to 4 / for development.

6 x / = 3 marks

(c)

FRS1 standardises the way in which cash flow statements must be prepared//

Before there was any standard on cash flow, firms could prepare them as they wished and this meant they were more difficult to understand// and potentially misleading//

So, thanks to FRS1 cash flow statements have become easier to prepare// and certainly more meaningful when comparing one firm with another//

Award up to // for saying what FRS1 is for and keep // for judgement of contribution of FRS1 to ease of preparation and comparison. 2 of the 4 / for judgement may be awarded to candidates identifying an acceptable downside to this process .

6 x / = 3 marks

Total 26 marks

Question 5

- (a) Award up to 2 Js for an acceptable definition and a further J for a development/further explanation point
- (i) **Margin of safety** is the difference between the output being produced and the break even output JJ. It shows the firm the extra amount being produced over and above that required to break even J
- (ii) **Contribution** is the difference between the selling price and the variable cost JJ. Contribution, then, goes towards the fixed cost and when the fixed cost is covered, towards profit J

6 x J = 3 marks

(b) point

$$\text{Break even point} = \frac{\text{Fixed Cost}}{\text{Selling price} - \text{variable costs}}$$

$$\text{Break even point} = \frac{\text{£150 000 J/C}}{\text{£20 J/C} - \text{£15 J/C}}$$

$$\text{Break even point} = 30\,000 \text{ units J/C}$$

4 x J = 2 marks

- (c) If sales are 35 000 J/C units this gives 5 000 units above BEP J/C ...giving a profit of 5 000 x £5 (contribution) = £25 000 JJ/C

4 x J = 2 marks

- (d) If management expects a return on investment of £30 000 then £30 000 divided by £5 contribution gives 6 000 JJ/C units above BEP must be produced raincoats JJ/OF

4 x J = 2 marks

- (e) If selling price is reduced to £18

$$\text{Break even point} = \frac{150\,000 \text{ J/C}}{\text{£18 J/C} - \text{£15 J/C}}$$

$$\text{Break even point} = 50\,000 \text{ units J/C}$$

If management expects a return on investment of £30 000 ..then £30 000 divided by £3 (new contribution) gives 10 000 JJ/OF

So a total of 60 000 JJ/OF units must be produced and sold at a price of £18 to give a profit of £30 000.

8 x J = 4 marks

- (f) Award up to JJ for benefit and up to JJ for limitation and up to JJ for conclusion

Example

Break even is a useful tool for management decision making, because it indicates exactly how many units must be made before profit is earned JJ. However, the concept has its limitations. It takes no account of stocks JJ. (It assumes that only one of the variables changes at one time). (It works best where there is only one product .. finds it difficult to cope with product mix). Overall, providing management understands the limitations of break even it can be an excellent tool for decision making JJ.

6 x J = 3 marks
Total 16 marks

Question 6

(a) Award up to 3 /s for explanation of what the item shows and up to a further 2 /s for further clarification.

- (i) **Shareholders funds** seeks to measure the amounts belonging/ to the members of the firm./ This would be represented by, for example, issued capital and reserves./
- (ii) **Liquidity ratio** measures the firm's ability to pay its debts/ as they fall due./ A ratio of 2:1 is usually considered ideal, however this does depend on the circumstances./

10 x / = 5 marks

(b) (i) Market price = P/E ratio x earnings per share
Market price = 5 /C x 30p /C = £1.50 /C

4 x / = 2 marks

(ii) If market price is £1.50 /OF and Santos has £10 000 to invest, he could buy 6 666 shares /OF
If the dividend per share is 15p /C, he can expect an annual dividend of 6 666 x 15p = £999 or £1 000 rounded /OF

4 x / = 2 marks

(c) Dividend Yield = Dividend per share/Market Price

At 30 November 2003

15p/C	x 100
8/C x 30p/C	Accept OF for Market Price from (b)

Yield = 6.25%/OF

At 30 November 2005

15p/C	x 100
5/C x 30p/C	Accept OF for Market Price from (b)

Yield = 10%/OF

8 x / = 4 marks

- (d) Award up to 6 /s for a reasoned decision, making use/reference to data. Give // for a decision and up to // for each reason (with data) contributing to that decision (max /////)

Example

Falling P/E ratio is worrying and is caused by falling market price./ However earnings per share is not falling./ Dividend per share is constant. May not be possible to maintain the dividend on ordinary shares in 2006 due to high gearing./ Yield has been rising and the latest 10% is well above comparable interest rates (less than 5%)./ As always with ordinary shares there is risk. I would advise Santos not to buy the shares/ because the falling market price may not have bottomed out (possibly resulting in a capital loss in the future) and with the high gearing, ordinary shareholders may receive little dividend in the future./

There is certainly plenty in the above answer for full marks! Of course full marks may also be obtained for the opposite answer.

6 x / = 3 marks

Total 16 marks

Question 7

(a)

Award up to 3 √s for explanation and up to a further 3 √s for example

A flexible budget is a budget that can be changed during the accounting period if output changes√√√. For example if the budget was set up on the basis that 100 000 units would be made and production turns out to be 200 000, all variable costs would be changed in proportion. √√√

6 x √ = 3 marks

(b)

Purchases Budget (in units)	
Sales	480,000 √C
Closing Stock	<u>30,000 √C</u>
	510,000
less Opening Stock	<u>25,000 √C</u>
Purchases	<u><u>485,000 √OF</u></u>

4 x √ = 2 marks

(c)

Exeter Limited
Budgeted Trading and Profit and loss account for year ended 31
October 2006

Sales (480 000 √C x £18 √C)		8,640,000 √OF
Opening stock (25 000)	250,000 √C	
Purchases (485 000 √OF x 11.4 √C)	<u>5,529,000 √OF</u>	5,779,000
Less closing stock (30 000 √ x 11.4 √)		<u>342,000 √OF</u>
Cost of sales		<u>5,437,000</u>
Gross profit		3,203,000 √√C (√OF)
Selling & Distribution expenses (+ £64 000)	864,000 √C	
Admin expenses (+20 000)	<u>520,000 √C</u>	<u>1,384,000</u>
Net Profit		<u><u>1,819,000 √√C (√OF)</u></u>

16 x √ = 8 marks

(d)

Candidate will be expected to give the benefits of budgeting and the limitations and reach a conclusion on the value of budgeting to a firm like Exeter plc.

Benefits

1. Forces busy managers to think about the future and to formulate goals and strategies
2. Exposes strategies and policies that will fail to deliver. It is better to fail on paper than in reality
3. Enforces consistency. Every department works towards the same goals with the same set of assumptions regarding sales volumes, selling prices, cost levels etc
4. Allows effective performance measurement. It is possible to compare actual performance (what happens in reality) with budgeted performance (what was planned to happen)
5. A communication and motivational tool. the budget process sets out clear business objectives and who is responsible for achieving them

Award up to $\mathcal{J}\mathcal{J}$ for well made point ..or \mathcal{J} per point (2 points max)

$2 \times \mathcal{J} = 1$ mark

Limitations

1. Can reduce emphasis on important long term planning. A detailed annual budget seems real and immediate and hence emphasises the short term
2. Time consuming
3. Budgets are often inflexible. In the real world, circumstances change. However, businesses may seek to stick to their original budget plans because managers are reluctant to give up the control that the budget appears to give them

Award up to $\mathcal{J}\mathcal{J}$ for well made point ..or \mathcal{J} per point (2 points max)

$2 \times \mathcal{J} = 1$ mark

Conclusion

Up to $\mathcal{J}\mathcal{J}$ for a definite conclusion

$2 \times \mathcal{J} = 1$ mark

Total 16 marks

ACCOUNTING 6002, PRINCIPAL EXAMINER'S REPORT

General Comments

Candidates found the paper challenging. The really excellent paper was rarely found. All seven questions were attempted by candidates. In Section A, question 1 was the least popular and in Section B, question least was the least popular.

The points listed below are areas where candidates could improve performance.

- Double entry is the foundation of accounting. Continual practice whilst learning accounting is essential.
- Evaluation usually involves giving point(s) in favour, point(s) against (limitations) and drawing a definite conclusion. Practice developing the skill of evaluation is essential.

Question 1

- (a) Very few candidates were able to display an acceptable understanding of basic double entry as applied to bonus and rights issues. Calculations were also weak as was the understanding of the appropriate order of utilizing reserves on bonus issue. Year end transfer of dividends were invariably not made.
- (b) The balance sheet was generally well done showing that candidates were aware of the impact of the transactions in part (a). Most followed the instruction to show working in brackets and this considerably helped examiners to award appropriate credit to candidates work.
- (c) Most could select appropriate methods of finance stating the advantages but few recognized limitations. Evaluation requires points for, points against, and a decision/conclusion.

Common errors were

- Failure to calculate the correct value of bonus and rights shares
- Lack of double entry knowledge
- Incomplete evaluation

Question 2

- (a) The term "management by exception" was not widely understood.
- (b) The majority was able to state the required formulae but only the most able could select the correct figures for each formula. There was little application of the concept of flexible budgets.
- (c) Many candidates were able to calculate the correct actual profit margin for December and explained a reason for the difference between actual and targeted profit margins.
- (d) Candidates who scored highly on this evaluation commented on each variance and gave an appropriate recommendation in each case.

Common errors were

- Failure to understand that 0.6 metres of material was required for each sunshade and that this must be multiplied by the 8 000 sunshades to give the budgeted materials
- The misunderstanding described above also related to labour

Question 3

- (a) and (b) Candidates displayed a good understanding of absorption and marginal costing. Calculations were sound but there was widespread weakness in the recognition and calculation of closing stock.
- (c) Most candidates recommended acceptance of the offer since a positive contribution was being made. Most could offer a relevant non financial factor. Full credit was given to an appropriate response using the candidates own figures.

Common errors were

- Non recognition of closing stock
- Incorrect valuation of closing stock

Question 4

- (a) Although only a small number of candidates gave the perfect solution, the overall standard of answer was high. Marks were lost for lack of headings and incorrect classification of items.
- (b) Most candidates could explain one difference between a cash budget and a cash flow statement.
- (c) There was little appreciation of the contribution made by FRS 1 (Revised), either positively or negatively. It is important that candidates are able to evaluate the usefulness of accounting techniques.

Common errors were

- Inability to recognize that profit on the sale of assets is a deduction from operating profit
- Duplication of items in the calculation of net cash flow from operating activities and in the remainder of the cash flow statement e.g. interest paid was frequently included twice.
- Lack of headings and incorrect classification of items under the wrong heading

Question 5

This question was well done showing a very good understanding of contribution and the break even concept. As in question 4 the evaluation required by (f) was relatively weak especially in relation to the limitations of break even analysis.

Common errors were

- Incomplete evaluation

Question 6

Those who knew the formulae usually performed well on the calculations required by (a), (b) and (c). Again the evaluation required by part (d) was weak showing a lack of appreciation of the meaning of the figures calculated.

Common errors were

- Lack of knowledge of shareholders formulae
- Inability to manipulate formulae
- Non existent or weak evaluation showing a lack of appreciation of shareholders formulae

Question 7

- (a) Only the best candidates could explain the meaning of “flexible budget”.
- (b) Many candidates were able to calculate the correct purchases figure.
- (c) It was pleasing (but rare) to find a correct net profit. Most could calculate sales but few could compute purchases or closing stock.
- (d) The main evaluation weakness was the inability to recognise limitations or state a conclusion.

Common errors were

- Lack of understanding of units and value of stock and purchases (similar to the weakness in question 3)
- Inability to convert the wording of the question into appropriate action in changing figures
- Lack of acceptable evaluation

ACCOUNTING 6002, GRADE BOUNDARIES

Grade	A	B	C	D	E
Lowest mark for award of grade	65	57	49	42	35

Note: Grade boundaries may vary from year to year and from subject to subject, depending on the demands of the question paper.

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