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October 2002

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Mark Scheme and Chief Examiner's Report
June 2002

Accounting 9011

Mark Scheme

Chief Examiner's Report

Grade Boundaries

ACCOUNTING 9011, MARK SCHEME

Paper 1

Question 1

(a) (i)

	Brook Ltd	Side Ltd
Gearing	Nil	$\frac{£390000}{£547500} \propto 100 > 71\%$ **or** $\frac{£390000}{£937500} \propto 100 > 41.6\%$

(2)

(ii) Current Ratio

$$\frac{£343500}{£354000} > 0.97:1$$

$$\frac{£718000}{£252000} > 2.85:1$$

(2)

(iii) Acid Test

$$\frac{£144000}{£354500} > 0.41:1$$

$$\frac{£513000}{£252000} > 2.04:1$$

(2)

(iv) ROCE

$$\frac{£45000}{£547500} > 8.2\%$$

$$\frac{£45000}{£937500} \propto 100 > 4.8\%$$

or

$$\frac{£21600}{£547500} \propto 100 > 3.95\%$$

(2)

(b) **<u>Key Points:</u>**

Brook Ltd

÷ Nil
÷ Low working capital. 'Text book' level = 2.1
÷ Liquidity problems if creditors press for payment
÷ High ROCE compared to Side Ltd (comparable business sector?)
÷ Nil debentures, reduces risk factor Re ordinary shareholders

Maximum (4)

Side Ltd

- ÷ High geared at 71% (medium at 41.6%)
- ÷ Adequate working capital
- ÷ High liquidity (under utilisation of funds?)
- ÷ Low ROCE (comparable business sector?)
- ÷ Debentures increases risk for ordinary shareholders

Maximum (4)

Side Ltd would, on the basis of its liquidity position, seem to be the better investment. However, its high-geared situation (@71%) would mean the possibility of problems if profits deteriorated due to an economic downturn.

(Geared at 41.6% not as vulnerable to economic factors)

Brook Ltd, although being ungeared is in a weak liquidity position.

(Accept other valid points)

Conclusion: Both companies have problems, so invest elsewhere, based on the evidence. (Or a conclusion based on candidate's own figures).

Maximum (4)

(c) Where profits are susceptible to an economic downturn dividends for shareholders may be minimal or nil after payment of interest.

Lower returns to the shareholders will be reflected in the pricing of ordinary shares on the stock exchange.

The non-payment of interest may, under the terms of the debenture deed, results in the liquidation of the company.

When interest rates are low the return on debentures, fixed at a higher level previously, will represent an expensive capital component. Reflected in the WACC and thus influencing possible capital investment decisions in certain market circumstances.

(5)

Total 25 marks

Question 2
Journal

		£ Dr		Cr	
2002 Jan-01	Premises	150000	½		
	Fixtures & fittings	15000			
	Equipment	7500	½		
	Furniture	18000			
	Vehicles	94500	½		
	Stock	37650			
	Debtors	45900	½		
	Provision for doubtful debts			1050	½
	Goodwill	37500	½		
	Creditors			32400	½
	Bank	16050	½		
	Capital – Barn			266550 (W1)	
				122100 (W2)	
		422100		422100	

(Being the assets and liabilities as at the above date)

Working:

	(1) L Barn £		(2) G Yard £	
Original capital	247500	½	121650	½
Add: Goodwill	22500	½	15000	½
Asset appreciation: premises	15000	½		
Premises	285000		136650	
Less: Assets written down:				
Fixtures & fittings	3000	½		
Equipment			3000	½
Furniture			3000	½
Vehicles	12000	½	6000	½
Stock	2700	½	2250	½
Debtors	750	½	300	½
Capital	266550	(W1)	122100	(W2)

(22 x ½ marks = 11)

(a) **L Barn & G Yard**

Fixed assets	£	
Goodwill	37500	½
Premises	150000	½
Furniture	18000	½
Fixtures & fittings	15000	½
Equipment	7500	½
Vehicles	94500	½
	322500	

current assets			£			
Stock			37650	½		
Debtors	45900	½				
Less: Provisions for doubtful debts	1050	½	44850			
Bank			16050	½		
			98550			
Less: *Current liabilities*			32400	½	66150	½
					388650	

Financed by: Capital L Barn	£	
Capital L Barn	266550	½ of
Capital G Yard	122100	½ of
	388650	

(14 x ½ marks = 7)

(b) **Capital**

		Barn	Yard
2002		(1 ½)	(1 ½)
Jan-01	Goodwill	25000	12500
		(1)	(1)
Jan-01	Balance	241500	109600
		266500	122100

		Barn	Yard
2002		(½)	(½)
Jan-01	Balance b/d	266550	122100
		266550	122100

2002			
Jan-01	Balance b/d	241550	109600
		(½ of)	(½ of)

(7)

Total 25 marks

Question 3

(a) Russell plc

Cash flow statement for the year ended 31 December 2001

Cash inflow from operating activities (W1)		95,820	(8)
Returns on investments/servicing of finance interest paid		(13,500)	(1)
Taxation		(18,000)	(1)
Capital expenditure and financial investments			
Fixed assets acquired	(501,000)		
Fixed assets sold	25,000		
Acquisition and Disposals		(475,500)	(2)
Equity dividends paid (31,000 + 3,500)		(34,500)	(2)
Management of liquid resources			
Net cash outflow before financing		445,680)	(1)
Financing			
Issue of share capital	184,500		
Loan	225,000		
		409,500	(2)
Net cash outflow		(36,180)	

Working 1

Operating profit	118,800	(1)
Depreciation (W2)	57,000	(3)

Less gain on sale	(16,500)	(1)
Increase in stock	(53,100)	(1)
Increase in debtors	(22,380)	(1)
Increase in creditors	12,000	(1)
	95,820	

Working 2

Disposals 21 – (25.5-16.5) (1)	12	Bal b/f (39 – 210)	180 (1)
Bal c/f (870 –645) (1)	225	Profit & Loss	57
	237		237

(17)

(b)

Reasons include:

1. shows strength or weaknesses of liquidity in the year
2. shows how cash generated through operating activities compares with profits in the same period
3. show much of cash resources have been expended on fixed assets (sign of expansion)
4. 'financing' shows how the company managed to finance its activities if it was dependent on outside cash inflows

(8)

Total 25 mark

Question 4

(a) <u>Valuation of stock destroyed as at 6 November 2001</u>

			£	
Stock @ 31/10/01			10,080	
Add: Purchases at cost			6,710	(1)
Returns inwards at cost				
(£220 - £44)			176	(2)
			16,966	
	£			
Less: Stock @ NRV (£1380 - £69)	1,311	(2)		
Sales at cost				
(£7,740 - £1,548)	6,192	(2)		
Returns outwards at cost	100	(1)		
Purchases in transit	320	(1)	6,681	
			9,043	

(9)

(b) Cost – that expenditure which has been incurred in the normal course of business in bringing the product or service to its present location and condition.

(0-3)

NRV – the estimated proceeds from the sale of items of stock less all further costs to completion and less all costs to be incurred in marketing, selling and distributing directly to the item in question.

(0-3)

(6)

Total 15 marks

Question 5

(a) Ordinary share capital

2002	£
Jan – 31 Balance b/d	12000 (1)
Mar – 31 Application	1200 (1 of)
Apr –30 Allotment	1800 (1 of)

Share premium account

2002	£
Jan – 31 Balance b/d	2400 (1)
Mar – 31 Application	3600 (1 of)

Application and allotment account

2002	£	2002	£
Mar–31 Bank refund	1600 (1)	Bank	6400 (1)
Mar–31 Share capital	1200 (1)	Apr – 30 Bank	1800 (1 of)
Mar–31 Share premium	3600 (1)		
Apr-3 share capital	1800 (1)		
	8200		8200

(11)

(b)

To ensure that the asset worth per share prior to a new issue is maintained at the same value after a new issue has taken place.

To treat equitably the old and new shareholders where reserves imply that the asset worth per share is greater than the par value of shares issued. The premium charged maintaining the equilibrium of worth prior to and after the new issue.

(4)

Total 15 marks

Question 6

(a)

Bad debts

2001	£		2001	£	
May-31 sundry debtors	1450	(1)	May-31 profit & loss	1450	(1)
2002			2002		
May-31 sundry debtors	1620	(1)	May –31 profit & loss	1620	(1)

Provision for doubtful debts

2001	£	2001	W1	
May-31 balance c/d (1)	1630	Jun- 01 balance b/d	1440	(1)
		2001		
		May –31 profit & loss	190	(1)
	1630		1630	
2001				
May –31 profit & loss (1)		2001		
May-31 balance c/d (1)	120	Jun –01 balance b/d	1630 (1 of)	
	1510			
	1630		1630	
		2002		
		June – 01 balance b/d	1510 (1 of)	

(W1) provision $\frac{£1,440}{£28,800}$ x 100 5%

(11)

(b)

The prudence concept – Provision is made for all known liabilities (expenses and losses) whether the amount of these is known with certainty of is a best estimate in the light of the information available.

(4)

Total 15 marks

Question 7

(a) General reserve

Profit & loss

(1)

(b) Share premium

Capital redemption

Asset revaluation

(2)

(c) Revenue reserves

An amount voluntarily transferred from profits

Prudence – to restrict dividends and retain funds in the business

To provide internal investment for expansion

To assist dividend policy. Transfer back to profit & loss in years of lower profits

To maintain the value of the firm due to the effect of inflation

(3)

Capital reserves

Cannot be utilised for dividend purposes

Created by case law/Companies Acts

May be utilised for a bonus issue

Companies Acts allow specific utilisation of given reserves, e.g.

Share premium may be used for writing off expenses and

Commission paid on the issue of shares or debentures

(3)

(d) Where shares are redeemed or purchased and no new issue of shares is undertaken, but it is deemed that distributable profits are being utilised for the purpose, the Companies Acts require a transfer is made from profit & loss account to a capital redemption reserve.

Reason – to protect creditors, by restricting profits available for dividend pruposes.

The creditors 'buffer'

(4)

(e) If the assets are sold and the gain becomes 'realised', the gain becomes part of distributable profits.

(3)

(f) To provide a non-cash dividend from the revenue reserves.

To adjust the capital structure by converting reserves into non-returnable shares.

(4)

Total 20 marks

Question 8

(a) Profit and Loss Account vs Cash

Profit is calculated for a specific period for the year ended…

Profit is computed by matching revenue with related expenditure and its measurement is governed by the accruals convention.

Profit as a time measure of performance is more meaningful for identifying trends for decision-making purposes.

Profitability in ratio analysis means that inter-firm comparison is more meaningful.

Cash is simply a verifiable item in the form of notes etc., or bank balances and deposit.

(first statement 0 –4)

(second statement 0-4)

(third statement 0-4)

(b)

(i) The name given to the collective value of the parts of subsidiaries owned by outsiders.

(ii) Where another company owns the shares of one company sufficient to give control of that company, i.e. more that 50% of the voting shares in that company.

(iii) The final accounts of a parent undertaking and its subsidiaries brought together to provide an overall view for shareholders of their investments.

(iv) The excess paid for the shares of a subsidiary over and above the value of its shares and reserves at the time of purchase.

(4 x 2 marks)

Total 20 marks