

Mark Scheme (Results)

January 2015

International A Level Accounting

WACO2

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WAC02/01 – January 2015

Mark scheme

Q1.

(a)

(i) Gearing ratio = $\frac{\text{Prior charge capital}}{\text{Capital employed}} \times 100 \quad \checkmark$

$$= \frac{1\,000\,000 + 4\,000\,000 + 5\,500\,000 \quad \checkmark \text{ any 2 } \checkmark \text{ 3rd}}{1\,000\,000 + 4\,000\,000 + 5\,500\,000 + 5\,000\,000 + 78\,000 \quad \checkmark \text{ any 3 } \checkmark \text{ next 2}} \times 100 = 67.4\% \quad \checkmark$$

Other formulae for gearing are acceptable

6 marks

(ii) Return on Capital employed = $\frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100 \quad \checkmark$

$$= \frac{£650\,000 \quad \checkmark}{£15\,578\,000 \quad \checkmark} \times 100 = 4.17\% \quad \checkmark$$

4 marks

(iii) Earnings per ordinary share = $\frac{\text{Net profit after interest and tax less preference dividend}}{\text{Issued ordinary shares}} \quad \checkmark$

$$= \frac{£90\,000 - £70\,000 \quad \checkmark}{5\,000\,000 \quad \checkmark} = 0.4 \text{ pence per share} \quad \checkmark$$

4 marks

(iv) Price/earnings ratio = $\frac{\text{Market price of ordinary share}}{\text{Earnings per ordinary share}} \quad \checkmark$

$$= \frac{74 \text{ p} \quad \checkmark}{0.4 \text{ p o/f} \quad \checkmark} = 185 \text{ times o/f} \quad \checkmark$$

4 marks

(v) Dividend paid per share = $\frac{\text{Total ordinary dividend paid}}{\text{Number of Issued ordinary shares}} \quad \checkmark$

$$= \frac{£280\,000 \quad \checkmark}{5\,000\,000 \quad \checkmark} = 5.6 \text{ pence per share} \quad \checkmark$$

4 marks

(vi) Dividend cover = $\frac{\text{Net profit after interest and tax less preference dividend}}{\text{Total ordinary dividend paid}} \quad \checkmark$

$$= \frac{£90\,000 - 70\,000 \quad \checkmark}{£280\,000 \quad \checkmark} = 0.07 \text{ times} \quad \checkmark$$

4 marks

$$\begin{aligned}
 \text{(vii) Dividend yield} &= \frac{\text{Ordinary dividend per share}}{\text{Market price of ordinary share}} \times 100 \quad \checkmark \\
 &= \frac{5.6 \text{ p o/f} \quad \checkmark}{74\text{p} \quad \checkmark} \times 100 = 7.57 \% \text{ o/f} \quad \checkmark
 \end{aligned}$$

4 marks

(b) Own figure rule applies

Strengths

Net profit before interest and tax is a good figure. \checkmark

ROCE could be said to be quite good (in present financial situation) \checkmark possibly more than any returns in bank deposit accounts. \checkmark

Price/earnings very high (which means market has confidence in company) \checkmark which may mean shareholders will not sell shares held. \checkmark

Dividend per share is high (which keeps shareholders happy) \checkmark a better return than many other investments. \checkmark

Dividend yield is high (which keeps shareholders happy) \checkmark they get a better return than many other investments. \checkmark

Weaknesses

Net profit after interest and tax is **much** lower than before interest and tax \checkmark because there are very high interest payments (of 530 000) \checkmark and tax payments (of 30 000). \checkmark

ROCE could be said to be quite poor \checkmark possibly less than any returns in bank deposit accounts. \checkmark

Gearing ratio is high \checkmark which means risk is high \checkmark Appear to have been borrowing fairly regularly \checkmark taking out a debenture in 2009 and a bank loan in 2014. \checkmark

EPS is very low, so poor return for investors in ordinary shares. \checkmark

Price/earnings very high (so may discourage future investors in ordinary shares) \checkmark as it would take a very long time to get money back/recover investment made. \checkmark

Dividend per share is high (which means funds are leaving the company) \checkmark which may give future problems eg repaying loans \checkmark future expansion etc. \checkmark

Dividend cover is very low \checkmark , meaning company cannot afford to pay this level of dividend. \checkmark

Dividend yield is high (which means company is paying out more than it needs to) \checkmark probably more than many other companies. \checkmark

Maximum of 8 marks for arguing one side

Conclusion 2 marks

Company has some serious problems $\checkmark\checkmark$

OR profitability is a problem \checkmark and gearing \checkmark

12 marks

(c) Possible answer

(i) Reduce gearing ratio by issuing more ordinary shares ✓ it is possible to issue £5 m more shares ✓
(on existing authorised share capital)
Payback loans ✓ and debentures ✓ and preference shares ✓ (any 2)

2 marks

(ii) Possible answers

Family could keep control if they bought the new shares ✓ Or it may result in outside expertise coming to the company if outside parties buy shares ✓ Could use share issue to pay off bank loan ✓
This would reduce interest payments ✓
Paying back loans means a large cash outflow ✓ which worsens liquidity ✓

2 marks

(d) Possible answers

Improve ROCE by making higher profits ✓ by reducing costs or increasing revenue. ✓

Improve EPS by making higher profits. ✓ but difficult if a new share issue has been made. ✓

Increase dividend per share by increasing profits ✓ and/or redeeming ordinary shares ✓
OR Reduce dividend per share ✓ to retain funds in company to pay interest etc. ✓

Improve dividend cover by paying smaller dividends ✓ or making higher profits. ✓

Keep dividend yield high by making healthy profits ✓ to maintain confidence of market in company shares. ✓

6 marks

Total 52 marks

Q2a**Statement of Comprehensive Income for
Gulf Furnishings plc for y/e 31st December 2014** ✓

Revenue	4482800	✓	
Cost of sales	(2276824)	✓	o/f
Gross profit	2205976	✓	o/f
Other Income	150025	✓	o/f
Distribution costs	(1349333)	✓	o/f
Administrative expenses	(604114)	✓	o/f
Financial cost	(55192)	✓	o/f
Profit on ordinary activities before tax	347362	✓	o/f
Corporation tax	(55000)	✓	
Profit on ordinary activities after tax	292362	✓	o/f/✓
	12 x	✓	

W5 Financial cost

Interest on bank loan	48000	✓	2 x
Interest on bank balance	7192	✓	
	55192		

TOTAL 40 marks**W1 Cost of Sales**

Direct Materials	843216		
Less closing Inventory	(4897)		both ✓
Less Discount Received	(41753)		✓
Factory Depreciation	47000		✓
Machinery Depreciation	277500		✓ 9 x
Factory Fuel	36441		✓
Factory Power	211948		✓
Machinery maintenance	27542		✓
Factory staff	828750		✓
Production Manager	55000		both
Stock Adjustment Finished Goods	(3923)		✓
	2276824		

W2 Distribution Costs

Commission on sales	67242		✓
Sales Manager	50000		✓
Transport Manager	45000		both
Fuel	182205		✓ 8 x
Motor lorries depreciation	112800		✓
Advertising and Marketing	155043		✓
Shop premises depreciation	123750		✓
Running cost of vehicles	88543		✓
Shop staff wages	435790		✓
Delivery staff wages	88960		both
	1349333		

W3 Administrative Expenses

Bad Debts Written Off	12255		✓
Finance manager	59000		✓ 7 x
Discount allowed	16548		✓
Hire of photocopiers	3120		✓
Accountancy staff wages	212870		✓
Office staff wages	202130		both
Office premises rent	45204		✓
Office power	52987		✓
	604114		

W4 Other Income

Canteen sales	122767		✓
Dividends received	27258		✓ 2 x
	150025		

(b)

Answers could include

IAS1 states additional line items in the Statement of comprehensive income, may be required when necessary ✓ to explain elements of financial performance. ✓

Treatment is required by law ✓ (Companies Act validates IAS)

When items are material ✓ they should be disclosed separately either on the face of the accounts, or in the notes. ✓

The items need to be disclosed by virtue of their size, ✓ or incidence ✓

Benefits

This will benefit users of accounts because they can see that the expense or revenue ✓ of the Exceptional Item will not be expected to be repeated regularly in the future. ✓✓

Although in the normal line of business ✓ the Exceptional Item should be disclosed because of its size. ✓

This allows the reader to predict more accurately ✓ future expected performance. ✓

This may help future potential investors / shareholders ✓ trade payables ✓ banks ✓ (maximum of 2) with decision making. ✓

Should be beneficial if required to be shown by IAS / FRS ✓

Disadvantages

Adds more figures and details to the accounts ✓ so makes them more difficult to understand. ✓

More time and money spent producing accounts ✓

Competitors may gain an advantage if they see this detail in the accounts. ✓

Maximum for arguing only one side $8 \times \checkmark = 4$ marks

Evaluation

Should conclude that it is beneficial to disclose Exceptional Items. ✓✓

12 marks

TOTAL 52 Marks

Q3

(a)

(i) Standard labour cost = $(5 \times 40 \times \text{£}5.90) \checkmark = \text{£}1\,180 \checkmark$ (2)

(ii) Actual labour cost = $(200 \times \text{£}5.90) \checkmark + (7 \times \text{£}8.10) \checkmark = \text{£}1\,180 + \text{£}56.70 = \text{£}1\,236.70 \checkmark$ (3)

(iii) Labour efficiency variance = (Actual hours – Standard hours) x Standard rate
 $= (207 \checkmark - 200 \checkmark) \times \text{£}5.90 \checkmark = \text{£}41.30 \text{ Adv } \checkmark$ (4)

(iv) Labour rate variance = (Actual rate – standard rate) x Actual hours
 $= \left(\frac{1236.70 \checkmark}{207} - \text{£}5.90 \checkmark \right) \times 207 \checkmark$
 $= (\text{£}5.974 - \text{£}5.90) \times 207 = \text{£}15.32 (\text{£}15.40) \text{ Adv } \checkmark$ (4)

(v) Total labour variance = Actual labour cost - Standard labour cost
 $= (\text{£}1\,236.70 - \text{£}1\,180) \checkmark \text{ o/f} = \text{£}56.70 \text{ Adv } \checkmark \text{ o/f}$

O/f applies if a(iii) and a(iv) are added together (2)

(b)

Actual purchase price of material per square metre = $\frac{\text{£}604.80 \checkmark}{2\,160 \checkmark}$ (OR $\frac{\text{£}201.60 \checkmark}{720 \checkmark}$) = $\text{£}0.28 \checkmark$ (3)

(c)

(i) Actual material cost of production
 $= (220 \times \text{£}0.28) \checkmark + (1700 \times \text{£}0.28) \checkmark = \text{£}537.60 \checkmark$ (3)

(ii) Standard material cost of production = $(\text{£}0.26 \times 3 \times 600) \checkmark = \text{£}468 \checkmark$ (2)

(iii) Material usage variance = (Actual usage - Standard usage) x Standard price
 $= ((220 + 720 + 720 + 720 - 460) - 1800) \times \text{£}0.26$
 $= (1\,920 \checkmark - 1800 \checkmark) \times \text{£}0.26 \checkmark = \text{£}31.20 \text{ Adv } \checkmark$ (4)

(iv) Material price variance = (Actual Price - Standard price) x Actual usage
 $= (\text{£}0.28 \checkmark \text{ o/f} - \text{£}0.26 \checkmark) \times 1920 \checkmark = \text{£}38.40 \text{ Adv } \checkmark$ (4)

(v) Material cost variance = Actual material cost - Standard material cost
 $= (\text{£}537.60 - \text{£}468) \checkmark \text{ o/f} = \text{£}69.60 \text{ Adverse } \checkmark \text{ o/f}$

O/f applies if c(iii) and c(iv) are added (2)

(d)

(i) Total standard cost = standard labour + standard material

$$= (£1\ 180 + £468) \checkmark \text{ o/f} = £1\ 648 \checkmark$$

O/f applies if a(i) and c(ii) are added

(2)

(ii) Total actual cost = actual labour + actual material

$$= (£1\ 236.70 + £537.60) \checkmark \text{ o/f} = £1\ 774.30 \checkmark \text{ o/f}$$

O/f applies if a(ii) and c(i) are added together

(2)

(e) Maximum of three marks for answers concerning individuals

Susmita is not efficient, and needs overtime to fulfil quota so suggest reduce overtime. \checkmark

Zahir is inefficient – does overtime and still cannot meet quota, suggest reduce overtime. \checkmark

Mohon is inefficient – does not meet target, do not give overtime to him. \checkmark

Chadni is very efficient, surpasses quota in normal time, suggest give overtime to her. \checkmark

Rubia meets deadline so is efficient – can be given overtime \checkmark

Maximum of 2 marks if candidate argues in general terms, not mentioning individual workers.

Eg no or little overtime is permitted \checkmark which may make all workers more efficient \checkmark

(3)

(f)

Performed poorly

Variances are adverse \checkmark maximum of 2 ticks for reasons eg inefficient labour \checkmark or expensive material \checkmark

Labour efficiency – could improve training, \checkmark especially to Mohon, Susmita, and Zahir. Any 2. \checkmark

Labour rate – perhaps pay overtime at standard rate, \checkmark especially if 120 target not met \checkmark

Material usage – better training of staff, \checkmark or buy better quality material \checkmark or new machinery. \checkmark

Material price – look for alternative suppliers \checkmark or negotiate better prices \checkmark or pay quickly to ensure discounts. \checkmark

Performed well

Section may be efficient, \checkmark it is just that the standards set are unrealistic. \checkmark maybe they are not reviewed regularly \checkmark in which case review and change standards \checkmark

Some workers are efficient and meet or surpass targets \checkmark ie Rubia and Chadni. \checkmark

Overall, the department has met its production target. \checkmark

Maximum of 8 marks if argued one side only.

Conclusion 2 marks

Blouse section has probably performed poorly. $\checkmark\checkmark$

(12)

Total 52 marks

Q4.

(a) (i) Goodwill is a sum paid in excess of the fair / agreed value ✓ of net assets acquired when purchasing a business ✓.

2 marks

(ii) Any two from

Existing customer base ✓ Supply channels set up ✓ Suitable location ✓ Skilled workers ✓
 Reputation of business ✓ Brand awareness ✓ Loyal staff ✓ Profitable business ✓

2 marks

(b)

<u>Calculation of Purchase Price</u>			
Property, plant and equipment	+ 1 200 000✓ - 165 000✓ - 352 000✓	79 778 000	✓
Intangibles		525 000	
Inventories		863 000	✓ both
Trade and Other Receivables	- 56 000	504 000	✓
Bank Loan		(10 000 000)	
Trade and Other Payables		(230 000)	✓ both
Current tax payable		(210 000)	✓
Goodwill		4 000 000	✓
Purchase price		75 230 000	✓o/f

10 marks

(c)

$$\text{Shares issued} = \frac{75\,230\,000 \checkmark \text{ o/f}}{\pounds 2.50 \checkmark \checkmark} = 30\,092\,000 \text{ shares } \checkmark \text{ o/f}$$

4 marks

(d)

Acquisition account							
Jan 1	Property, Plant, + Equipment	79 778 000	both	Jan 1	Bank loan	10 000 000	both
	Intangibles	525 000	✓o/f		Trade Payables	230 000	✓o/f
	Inventories	863 000	both		Current Tax payable	210 000	all 3
	Trade Receivables	504 000	✓o/f		Purchase price		
	Goodwill	4 000 000	✓o/f		£1 Ordinary shares	30 092 000	o/f
					Share premium	<u>45 138 000</u>	✓o/f
		<u>85 670 000</u>				<u>85 670 000</u>	✓o/f

6 marks

(e)

For financing using shares

Does not require any use of cash ✓ which would be a drain on liquid resources. ✓

If the market thinks the deal is a good one ✓ the value of all shares in buying company will rise, ✓ keeping shareholders happy. ✓

Improves gearing ratio ✓

No need to payback shareholders ✓

No capital repayment required unlike loans ✓

Dividends only need to be paid when profits are healthy ✓ unlike interest payments on loans that must take place ✓

No need to offer collateral ✓

Against financing using shares

If the market thinks the deal is a bad one ✓ the value of all shares in buying company will fall, ✓ making shareholders unhappy. ✓

Memorandum of Association ✓ may mean it is not possible to issue more shares, ✓ or may need to get approval from Stock Exchange Council ✓ to alter Memorandum and issue more shares. ✓

Number of shareholders in buyer rises ✓ so dilution of powers of existing shareholders. ✓

More dividends will be paid to a greater number of shareholders ✓ which may result in lower dividends per share ✓

Issuing of shares results in extra costs etc ✓

Maximum of 4 marks for arguing one side only

Conclusion – 2 marks

Financing purchase of another company is good/ not good idea.

8 marks

Total 32 marks

Q5.

(a)

Fixed Costs - per year	Variable costs per unit
	$(0.25 + 0.02 + 0.16 + 0.40) \checkmark$
Rent £9 300	Total £0.83 per unit \checkmark
Depreciation £2 800 \checkmark both	
Electricity £3 740	Contribution per unit
Insurance £1 420 \checkmark both	
Manager £12 000	
Loan £2 700 \checkmark both	$(£1.30 - £0.83 \text{ o/f}) \checkmark = £0.47 \checkmark \text{ o/f}$
Total FC £31 960 \checkmark o/f	

$$\text{Break Even Point} = \frac{£31\,960 \text{ o/f} \checkmark}{£0.47 \text{ o/f} \checkmark} = 68\,000 \text{ ice creams o/f} \checkmark$$

11 marks

(b) Margin of safety = $184\,800 \checkmark - 68\,000 \checkmark \text{ o/f} = 116\,800 \text{ units} \checkmark \text{ o/f}$

3 marks

(c) Profit for 2014

$$\begin{aligned} \text{Sales} &= 1400 \times 12 \times 11 = 184\,800 \text{ units} \checkmark \\ \text{Sales revenue} &= 184\,800 \times 1.30 = £240\,240 \checkmark \\ \text{Less VC} &= 184\,800 \times 0.83 \text{ o/f} = £153\,384 \checkmark \text{ o/f} \\ \text{Less FC} &= £31\,960 \checkmark \text{ o/f} \\ \text{Profit} &= £54\,896 \checkmark \text{ o/f} \end{aligned}$$

5 marks

(d) New profit = $£54\,896 \times 1.05 = £57\,640.80 \text{ o/f} \checkmark$

$$\text{Increase in profit} = £2\,744.80 \text{ o/f} \checkmark$$

$$\text{Increase in rent} = £25 \times 12 = £300 \checkmark$$

$$\text{So managers pay must fall by } £3\,044.80 \text{ o/f} \checkmark$$

$$\text{So new pay must be } £12\,000 - £3\,044.80 = £8\,955.20 \text{ o/f} \checkmark$$

5 marks

(e)

If moved to the variable rate

For

Business has profit target ✓ and has to take action to achieve these targets. ✓

May not be possible to decrease other costs, ✓ especially if fixed eg loan repayment, rent etc ✓

May not be possible to increase selling price to increase profit, ✓ as will result in reduced sales ✓

Manager may be motivated and improve performance / increase output ✓ eg train staff better to increase sales ✓ which may result in increased market share ✓ also in higher profits for business ✓ and higher pay for the manager ✓

Against

Manager is concerned only with output so quality may suffer ✓ and there may be more accidents ✓ and manager may put workers under more pressure which demotivates ✓

Budgeting for the managers salary maybe more difficult ✓ due to fluctuations in sales and output ✓

A rise in variable costs may raise the break even point ✓ (but remember fixed costs will rise ✓)

If stays on the fixed rate.

For

Managers are professionals and are usually paid a salary ✓ and changing to payment by linking to production may demotivate ✓

Against

Manager will be de-motivated ✓ if forced to take pay cut ✓

This is likely to effect running of the business ✓ in a negative way ✓

Could try to reduce other costs instead ✓ eg shop around for lower insurance. ✓

A reduction in fixed costs may lower the break even point ✓ (but remember variable costs will rise ✓)

Maximum of 4 ticks for arguing one side – for or against variable rate/fixed rate.

Conclusion - Two ✓✓

It is a good/bad idea to move to variable rate.

8 marks

Total 32 marks

Q6**6a**

Sales	Users	Charge					
Year 1	125000	13500000	√				
Year 2	225000	24300000	√				
Year 3	275000	29700000	√				
Year 4	325000	35100000	√				
Year 5	375000	40500000	√				
Running costs			<u>Connectns</u>		<u>Other</u>	<u>Total</u>	
Year 1	125000	50	6250000		5000000	11250000	√
Year 2	100000	50	5000000	√(2)	11000000	16000000	√
Year 3	50000	50	2500000		14000000	16500000	√
Year 4	50000	50	2500000		16000000	18500000	√
Year 5	50000	50	2500000	√(3)	17000000	19500000	√
NPV			<u>Net</u>		<u>Discount</u>	<u>Discounted</u>	
	<u>Inflow</u>	<u>Outflow</u>	<u>Cash Flow</u>		<u>Factor</u>	<u>Net Cash Flow</u>	
Year 0		(50000000)			1	(50000000)	√
Year 1	13500000	(11250000)	2250000	√ o/f	0.926	2083500	√ o/f
Year 2	24300000	(16000000)	8300000	√ o/f	0.857	7113100	√ o/f
Year 3	29700000	(16500000)	13200000	√ o/f	0.794	10480800	√ o/f
Year 4	35100000	(18500000)	16600000	√ o/f	0.735	12201000	√ o/f
Year 5	40500000	(19500000)	21000000	√ o/f	0.681	14301000	√ o/f
						(3820600)	√ o/f

24 marks

6(b) Evaluation

Answers may include:

Own figure rule applies

Case for Project

Net cash flow is positive from year 1/every year. ✓

NPV will be positive very soon /Year 6 ✓

Users will probably continue to rise in future ✓

Case Against Project

NPV method states do not invest ✓ as NPV is negative ✓ o/f

NPV is a good method to use ✓ as it includes falling value of money over time ✓

Other Relevant Points

Other investment appraisal methods should be used ✓ eg payback or average rate of return ✓

How accurate are the predictions ✓ for costs, cost of capital, and revenues? ✓

Is the 5 year payback time period appropriate? ✓ for a project such as this where users build up over the years ✓

Other possible investment projects available at present? ✓ More or less profitable? ✓

Objectives/strategy of company? ✓ Is this investment in line with objectives? ✓

Asia telecoms may face competition ✓ which may limit expansion ✓

Maximum of 4 marks for arguing one side

Conclusion - 2 marks

Company should not invest ✓ because of negative NPV after 5 years ✓

OR company should invest ✓ because NPV is likely to be positive after more than 5 years ✓

8 marks
Total 32 marks

Q7.

a)	<u>Shoes</u>		<u>Boots</u>		<u>Trainers</u>		<u>Sandals</u>	
Sales Revenue	150000		70000	√	312000		54000	√
				(2)				(2)
Direct Labour	65000		32000		96000		24000	
Direct Materials	50000		36000		72000		27000	
Semi-VC Variable	25000		4000	√	32000		3000	√
Fixed Costs	35000		6000	(all 8)	40000		6000	(all 8)
Profit (Loss)	-25000	√ o/f	-8000	√ o/f	72000	√ o/f	-6000	√ o/f
							8 marks	
Production	5000		2000		8000		3000	
b) Per Unit	<u>Shoes</u>		<u>Boots</u>		<u>Trainers</u>		<u>Sandals</u>	
Sales Revenue	30		35		39		18	
Direct Labour	13	√	16	√	12	√	8	√
Direct Materials	10		18		9		9	
Semi-VC Variable	5	√	2	√	4	√	1	√
Fixed Costs	7		3		5		2	
Profit (Loss)	-5	√ o/f	-4	√ o/f	9	√ o/f	-2	√ o/f
Contribution	2	√ o/f	-1	√ o/f	14	√ o/f	0	√ o/f
							16 marks	
c) o/f rule applies	<u>*Shoes</u>		<u>Boots</u>		<u>Trainers</u>		<u>*Sandals</u>	
Short Term	Continue	√	Stop		Continue		Stop/Continue	√
			ST or LT	√	ST or LT	√		
Long Term	Stop	√	Stop		Continue		Stop	√

*Shoes and Sandals must make mention to time period (ST or LT) for √

Plus two possible extra marks:

Maximum of 1 √ if correct mention made of positive contribution / or negative contribution anywhere

OR correct mention of marginal costing anywhere √

√ if reason given for supporting decision in ST for Sandals eg expect costs to increase or decrease in future.

If one department closes √ fixed costs may have to be reallocated to other departments √ which may mean that department/ whole business makes a loss. √

Footprint Ltd should use resources to increase production of trainers √

8 marks

Total 32 marks

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