



# Examiners' Report June 2018

## IAL Accounting WAC12 01

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# Introduction

This was the second summer sitting of the WAC12 paper, testing the new specification. The overall results were good and the standard of answers provided was high.

It was pleasing to see how well many candidates tackled the stretch questions. Candidates are slowly improving their answers to the evaluation parts of questions, which are now using a levels-based mark scheme.

## Question 1

This question was answered very well, as most candidates have clearly learned how to produce a Statement of Cash Flows, required for (a)(i). It was good to see that candidates could handle the complex calculations required to find depreciation and payments to acquire tangible non-current assets. Most of the items were classified in the correct section and appropriately bracketed if they were an outflow. Candidates did fairly well in (b), with some managing to achieve Level 3 or Level 4. Those who carried out further calculations eg to find working capital, the current ratio, or the return on capital employed were appropriately rewarded.

Common errors:

- Use of "old" terminology such as fixed assets, stock, debtors, and creditors, instead of IAS terms.
- The calculation of the bank loan interest was often incorrect, taking 6% of the £500 000 figure. This overlooked the increase in the loan halfway through the year.
- Incorrect labelling of the final entry in each section, as "from" and "used in" were often confused.
- Not using the figures given in the question for cash and cash equivalents.
- Merely repeating in (b), the figures used in (a), without any analysis of what the cause or consequences of the figures were.

- 1 (a) Prepare a Statement of Cash Flows for the year ended 31 March 2018 for Kullna Stores plc in accordance with International Accounting Standard (IAS) 7 Statement of Cash Flows (revised).

<i>Kullna Stores plc Statement of Cash Flows (revised) for the year ended 31 March 2018</i>		(43)
	£	£
<i>Operating Profit</i> $68000 + 400k \times 6.2$		<i>92000</i>
<i>Net Cash from Operating activities</i>		<i>415</i>
<i>Adjustment for: Add Depreciation (2358 - 7)k</i>	<i>2351000</i>	
<i>Add Disposal Loss of property</i>	<i>110,000<sup>(LWI)</sup></i>	<i>2461,000</i>
<i>Cash flow before movements in working capital</i>		
<i>Add Decrease in inventories (2804k - 2769k)</i>	<i>35,000</i>	
<i>Less Increase in trade receivables (945k - 923k)</i>	<i>(22,000)</i>	
<i>Less Decrease in trade payables (742k - 684k)</i>	<i>(58,000)</i>	<i>(45,000)</i>
<i>Cash generated from operations</i>		
<i>Less Interest</i>	<i>24000</i>	
<i>Tax</i>	<i>323</i>	<i>(347)</i>
<i>Net cash from operating activities</i>		<i>1001800</i>

## Net Cash

<u>Net Cash from investing activities</u>		
<u>Add</u> Proceeds from sale of retail property	970,000	
<u>Less</u> Payment to acquire retail property	<sup>w2</sup> (2,358,000)	(1,388,000)
Net cash used in investing activities		<del>(1,388)</del>
<u>Net Cash from financing activities</u>		
<u>Add</u> Issue of shares (400k + 50k)	450,000	
<u>Add</u> - Proceeds from bank loan	100,000	
<u>Less</u> Ordinary share dividend paid (400k × 0.019)	(7,600)	
<u>Less</u> Interim dividend paid (440k × 0.005)	(2,200)	
<u>Less</u> Preferred dividends paid (600k × 5.5%)	(33,000)	507,200
Cash and cash equivalents for the year		(121,000)
Cash and cash equivalents at year start		121,000
Cash and cash equivalents at year end		<u>0</u>

The financial statements for the year ended 31 March 2018 were presented to the Directors at a Board meeting in April. The Human Resources Director stated "It looks like Kullna Stores plc must concentrate on profitability rather than liquidity in the next year".

(b) Evaluate the statement made by the Human Resources Director concerning Kullna Stores plc.

(12)

~~There is no cash and cash equivalents at year end for Kullna Stores plc. So, the liquidity is very low that will be dangerous for the business. Low liquidity means there is not enough current assets to repay the current liabilities and may even lead to closure of business which is unable to repay the debts and goes into bankruptcy.~~

~~Therefore,~~ The liquidity ratio is ~~(270k/445k)~~ (3765k/795k) > 4.74:1. That means there are too much current assets on hand and the ideal ratio is 2:1. Kullna Stores plc should also concentrate on lowering the liquidity by selling out more inventories to decrease the value of current assets. 4.74:1 is too high and the firm could also make more investments using the current assets.

For the ROCE, it is  $\frac{68,000 - 17,000}{10,358k + 500k} \times 100\%$  it is very low as the

net profit is only 51,000 so Kullna Stores plc must concentrate on improving the profitability first. The business could cut down the expenses to increase the net profit. Moreover, to repay the long term bank loan as soon as possible to cut down the liabilities they have. In conclusion, it is most ~~is~~ urgent to increase profitability first than liquidity but it should be taken care as well ~~of~~ right after improving profitability as there is no cash flow ~~of~~ on the business which could be dangerous.

### Question 1

This candidate has worked only with the bank loan at £400 000 for the whole year - there is a need to take note of "Additional information". Depreciation calculation scores nil, as it seems to be solely based on the property bought this year. Some labels/sub-totals have no figure next to them - all figures need a label when producing a financial statement for the year end. The faint tax figure appears to have lost the three 0's - be careful with 0's when working with large numbers. Net cash from operating activities is correctly labelled, but is an incorrect addition. The investing activities section is all correct and scores the full 7 marks. The final and interim dividend figures are wrong as they are only based on the £400 000 issued in August and have ignored the SOFP. There is no total for Financing activities - each section must have a total. The final section is very confused, but scores 1 mark for the start year figure - use the SOFP for the start and end year cash and cash equivalent figures. The total for section (a) is 19, a below average score. In (b) there is a correct calculation for the current ratio which is good. Also sensible comments about what the business could do in this situation. The comment about ROCE is correct, but it appears the candidate gave up on the calculation. The conclusion is good, including a comment about liquidity and profitability. This is a Level 2 answer that scores 5 marks, a slightly below average score.

## Question 2

This question was also answered well. Many candidates were able to correctly calculate the standard cost of producing one packet of Grainbox. It was impressive to see the number of candidates that could correctly treat the formulae and the figures to calculate the labour and material variances. Section (c) was not handled so well, as many answers omitted the opening and closing inventory, or did not correctly calculate the number of units in closing inventory at the end of the month. There were some good answers for (d), although many answers merely repeated the figures calculated in (b), without any depth to their analysis.

Common errors:

- Confusion over units of pounds (£) or pence, in (a) with £0.04 often being converted to 40 pence.
- Incorrect formulae being stated in (b) which meant marks for the calculations were obviously very limited.
- Omitting the 16 (for the number of workers) from the calculation in (b)(i).
- Failing to correctly calculate the number of units in closing inventory in (c), or leaving out opening and closing inventory entirely.
- Not mentioning indicators such as meeting production targets, or making profit, when discussing the performance of the company for the month.

2 (a) Calculate the budgeted (standard) cost of producing **one** packet of Grainbox for:

- labour
- materials
- total variable cost.

(8)

$$\begin{aligned} \text{Total labour cost} &= 16 \times 8 \times 4 \times 5 \times 8 \\ &= 20480 \end{aligned}$$

$$\text{Total packets} = 512000$$

$$\bullet \text{ labour cost per packet} = \frac{20480}{512000} = 0.04$$

$$\bullet \text{ Total material cost} = \frac{0.15}{5}$$

$$= 0.03$$

$$\begin{aligned} \text{Total variable cost} &= 0.04 + 0.03 \\ &= 0.07 \end{aligned}$$

(b) (i) Calculate for the month of May, stating the formula used in each case, for the **total** production of Grainboxes, the:

- labour efficiency variance
- labour rate variance
- total labour variance.

(13)

$$[SH - AH] \times SP = [160 - 158] \times 8$$
$$= 16 \text{ Favourable}$$

$$\bullet [SR - AR] \times AH = [8 - 8.25] \times 158$$
$$= 39.5 \text{ adverse}$$

$$\bullet [SH \times SR] - [AH \times AR] = (160 \times 8) - (158 \times 8.25)$$
$$= 1280 - 1303.5$$
$$= 23.5 \text{ Adverse}$$

(ii) Calculate for the month of May, stating the formula used in each case, for the **total** production of Grainboxes, the:

- material usage variance
- material price variance
- total material variance.

(14)

$$\begin{aligned} & [SQ - AQ] \times SP \\ & = [102,400 - 104,000] \times 0.03 \\ & = 48 \text{ Adverse} \end{aligned}$$

$$\begin{aligned} \bullet (SP - AP) \times AQ & = (0.03 - 0.0304) \times 104,000 \\ & = 41.6 \text{ Adverse} \end{aligned}$$

$$\begin{aligned} & (SQ \times SP) - (AQ \times AP) \\ & (102,400 \times 0.03) - (104,000 \times 0.0304) \\ & = 3072 - 3161.6 \\ & = 89.6 \text{ Adverse} \end{aligned}$$

(c) Calculate the actual profit for the month of May 2018.

(8)

Sales	295,900
(+) closing stock	15,240
(-) Variable Cost	(35840)
(-) fixed costs	<u>(24775)</u>
	<u>250525</u>

(d) Evaluate the performance of Primoatco plc for May 2018.

(12)

The company made good sales for the month as compared to their expenses. They managed high and high profits which is a good sign. However, they have a lot of inventory in hand. This could be viewed as a bad sign as well as they should try clearing out stock as soon as possible. The actual quantity of production was greater than the standard quantity which is once again a good sign.

The actual price (Rate) was just a bit over the budgeted which is OK but to certain extent. The standard working hours are higher than the actual which proves a good performance by the employees as they produced more than expected in lesser amount of time. The labour charge had exceeded the budgeted price which is OK only because targets were met.



In (a), the calculations are correct, although no units (ie £ or pence) are shown - always show units when answering.

The difference between standard and actual may be shown either way in (b) for example (SH - AH) or (AH - SH).

The 16 workers have been omitted from the calculations in (b)(i), which meant scores of 3, 4 and 2 respectively.

In (b)(ii) the candidate is confused, working with the material price per box (£0.03), instead of per kilogram (£0.15).

The answer to (c) only achieves 2 marks. Opening inventory is labelled "closing stock" and the variable cost is using the standard cost, not the actual figures. The profit figure would require a label and a closing inventory figure to achieve an "own figure" mark.

The answer makes reference to profits and "stock" in (d), which is good, although the terminology should be more up-to-date. Then follows some confused reference to actual quantity being greater than standard quantity, which is not correct. It is unclear whether the "actual price (rate)" refers to material or labour. The comments concerning labour efficiency and labour rate at the end are correct.

The answer is Level 2, scoring 4 marks, as it shows little analysis. Although there is "application to the scenario", there are no "developed chains of reasoning".

## Question 3

Question 3 concerning a take-over was reasonably well done by candidates. Most managed to find the agreed value of assets and liabilities to be taken over for (a)(i) and (ii). The calculation of the purchase price proved trickier. It was not possible to use the value of assets and liabilities taken over to calculate the purchase price in (a)(iii), it had to be done using the cash and shares received. Calculating goodwill in (a)(iv) was usually successful, with many benefitting from the own figure rule (even if goodwill was negative!). The Journal entries for (b) often saw answers that were all correct or totally wrong or even omitted. Answers to (c) were often confused, with some answering from the point of view of the larger Wan Chai plc.

Common errors:

- Omitting to adjust for assets (cash and trade receivables) and liabilities (tax payable) that were not included in the value of assets and liabilities taken over.
- In (a)(iii), overlooking the fact that the shares were £0.25 per share, not £1.00 shares. Also not accounting for the fact that the shares (£0.92) and cash (£0.48) were for 5 shares in North Point plc, not one.
- Not appreciating the fact that it would be shareholders in North Point plc receiving the shares and cash, and answering as if North Point plc itself would be the recipient.

Shareholders in North Point plc received shares in Wan Chai plc and cash in exchange for their shares.

(c) Evaluate whether it is preferable for shareholders to receive shares or cash during a takeover.

(6)

It is preferable for shareholders to receive shares during a takeover.

It is because the share price may rise in the future. The shareholders of North Point plc can gain from the increase in market price of the shares. In addition, the shareholders of North Point plc can receive dividends from Wan Chai plc when Wan Chai plc pay dividends.

However, when there is an increase in number of shares in the market, the share price may fall. The shareholders of North Point plc may make a loss. In addition, receiving cash can let the shareholders of North Point plc immediately get the realised value for the shares. The cash received can be used for another investment.

In conclusion, it is preferable for shareholders to receive shares during a takeover as they can receive dividends in the ~~for~~ future.



The answer gives both sides to the argument and the theory is almost totally correct. The share price may not fall (paragraph 2), given the extra assets Wan Chai take over and maybe the market may like the takeover. The conclusion is good, as there is a decision and the most important reason (for the candidate) is given. The answer does not quite make it into Level 3 and scores 4 marks.

## Question 4

This question provided stretch for the candidates. Most were able to complete (a) successfully, producing a Purchases Budget. Most candidates for (b) were able to calculate the possible production given the numbers of each part, but then did not state the final maximum production possible for the company. This meant that candidates were quite confused when attempting (c), although some own figure marks were attained. Answers to (d) were quite weak, but own figure marks were awarded where candidates multiplied their inventory figure at the end of month 4 by the value per part. Part (e) saw fairly weak answers, with few candidates arriving at 19 000 units of output.

Common errors:

- Adding the three possible production figures for (b) to give 52 000 as the answer, instead of taking the lowest figure.
- In (c), omitting either the Purchases row, or the Used in Production row from the Inventory Budget.
- Failing to correctly calculate the number of each part left in inventory at the end of month 4 in (d).

(f) Evaluate whether Brainboxxe plc should be worried about the value of parts in inventory at the end of month 4.

(6)

For

Inventory of parts can be used in the future

Inventory can be used if demand increases.

Against

Having too much left over inventory affects the cash flow



In (f), the answer includes 3 valid statements. However, there are no "developed chains of reasoning" and no "application to the scenario". The candidate does not give a conclusion. The answer is a Level 1 answer and scores 2 marks.

## Question 5

This question was answered quite well by candidates. Part (a) was found very straightforward, with most achieving full marks. The creation and utilisation of reserves was found to be the most difficult part of the question. Too often, general statements were made that were not specific enough to obtain any marks. The Journal entry in (c) was completed well. However, the Journal entry in (d) was less successful, as many were unsure of the accounts to debit or credit, or the amount of the entry. It was acceptable for candidates to use a Disposal account for the sale if they wished. Almost all candidates were able to have at least a reasonable attempt at (e). It was good to see that many answers included relevant calculations that candidates had decided to include. These were dividend cover, dividend per share, and the percentage of profit paid as dividends. Where the candidate successfully undertakes meaningful, appropriate calculations for a levels-based answer, this strengthens the answer and may move it to a higher level.

Common errors:

- Lack of knowledge of how reserves can be created or what exactly they can be used for.
- Entering an incorrect account or amount when making Journal entries in (d).
- Failure to apply the statement made by the shareholder in (f) to the scenario, giving a wholly theoretical answer.

The financial statements were presented to the shareholders at the Annual General Meeting. One shareholder stated at the meeting "I think the dividend policy of the company is not very generous to the shareholders".

(e) Evaluate the statement made by the shareholder.

(6)

The dividend policy of the company is not very generous to the share shareholders. It is because assuming that the par value of each share is £1, the dividend per share is only  $\frac{£23}{320} \approx £0.07$ . Therefore, it is quite low for a public limited company.

However, Pontus Transport plc may just want to keep the money for further developments. When the developments take place, the company may earn more profit and therefore the shareholders can receive more dividends in the future.

In addition, there is no other company's data to compare with. Also, there is no information about the amount of dividend in last year. Therefore, it is hard to judge whether it is generous or not.

In conclusion, the dividend policy is not very generous to the shareholders.



The candidate states an assumption that the shares are £1 each, before calculating the dividend per share, which is good. The statement that this is low for a plc may be erroneous. The second paragraph sees a "well developed chain of reasoning" which is pleasing. The answer then brings in relevant points which may make it difficult to assess if the dividend policy is generous. There is a conclusion, but this is very "thin". The answer just makes it into level 3 and scores 5 marks.

## Question 6

This was the best answered question on the paper. Most candidates managed to score very well on (a) often getting the correct answer. Similarly, (b) scored well with many achieving full marks. Answers to (c) showed the candidates had the general idea, although more needed to comment on "positive contribution" or "negative contribution" and their effects on the future of the gold mines.

Common errors:

- Failing to use a bracket (or a minus figure) to indicate a loss rather than a profit.
- For the Orange Deep mine, not distinguishing between the long-term future and the short-term future.
- Not reading the question carefully and assuming the mines were all open at present. In fact, they were all closed at present, and the decision was whether to re-open the mines.

(c) Evaluate the figures calculated in (b) to make a decision as to the future of **each** of the three gold mines.

(6)

According to the profit & loss of three mines, ~~the~~ Boksville mine must not be reopened, even ~~if~~ the ~~the~~ Witwater mining plc is making a loss. This mine is making loss even though with no fixed cost. ~~the~~ Igolide mine should be reopened. Although it gain slightly ~~but~~ low profit, it will be useful for the company. Orange Deep mine can be reopened only if the company adjust for the fixed cost. Without fixed cost, Orange deep mine is still having contributions, just because of the high ~~the~~ value of fixed cost. The method of depreciation can be changed to reducing balance which ~~costs~~ ~~can~~ cost less.



The answer here recognises that the decision is whether to reopen each mine. The correct decisions are arrived at, although there is no mention of "positive" or "negative" contribution, which will determine the short-term future of each mine. The candidate suggests the fixed costs of Orange Deep should be reduced, which is promising. However, the suggestion made is to change to a reducing balance method of depreciation. If the £135 million of plant is to be depreciated over 15 years, the reducing balance method will see a greater amount of depreciation in the early years. The answer is Level 2 and scores 4 marks.

# Paper Summary

Based on their performance in this paper, candidates are offered the following advice:

- When completing a financial statement, such as a Statement of Cash Flows, each figure should have a "label" or wording to indicate what the figure actually is.
- The levels-based mark scheme will require candidates to adopt a different approach to the evaluation section of each question, especially in Section A. Previously, candidates could list a number of bullet points, often just one sentence, and still score very well. Candidates are now advised to try to develop the point being made to a greater depth where possible. This will allow access to the higher levels on the mark scheme. For example, at Level 2, "chains of reasoning are present but may be incomplete or invalid". To move to Level 3 requires "developed chains of reasoning, showing causes and/or effects". Centres are advised to carefully study the requirements of the higher levels, and try to guide candidates to answer in a style that reflects these levels. It is also important that candidates give a final decision or recommendation in order to be awarded one of the higher levels. When giving the final decision, the candidate may reinforce that decision by stating the most important reason as to why the decision is being made.
- Candidates must ensure they are familiar with the double entry system. The A2 paper still tests candidate's knowledge of this essential part of accounting. Candidates need to practice the double entry questions found on previous papers, as these indicate the areas where double entry knowledge is required. The main area is limited companies.
- Candidates should be aware of the need to read the "Additional Information" etc and to ensure they have used it. Candidates could check back to the question paper, to ensure they have used each item.

## Grade Boundaries

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>



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