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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 = $\frac{\text{Prior charge capital}}{\text{Capital employed}}$ x 100 √

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

Other formulae for gearing are acceptable **6 marks**

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

= $\frac{£650\,000 \text{ √}}{£15\,578\,000 \text{ √}}$ x 100 = 4.17% √

4 marks

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

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

4 marks

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

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

4 marks

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

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

4 marks

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

= $\frac{£90\,000 – 70\,000 \text{ √}}{£280\,000 \text{ √}}$ = 0.07 times √

4 marks

(vii) Dividend yield = $\frac{\text{Ordinary dividend per share}}{\text{Market price of ordinary share}} \times 100$ √

= $\frac{5.6\text{p o/f √}}{74\text{p √}} \times 100 = 7.57\%$ o/f √

4 marks

(b) **Own figure rule applies**

Strengths

Net profit before interest and tax is a good figure. √
ROCE could be said to be quite good (in present financial situation) √ possibly more than any returns in bank deposit accounts. √
Price/earnings very high (which means market has confidence in company) √ which may mean shareholders will not sell shares held. √
Dividend per share is high (which keeps shareholders happy) √ a better return than many other investments. √
Dividend yield is high (which keeps shareholders happy) √ they get a better return than many other investments. √

Weaknesses

Net profit after interest and tax is **much** lower than before interest and tax √ because there are very high interest payments (of 530 000) √ and tax payments (of 30 000). √
ROCE could be said to be quite poor √ possibly less than any returns in bank deposit accounts. √
Gearing ratio is high √ which means risk is high √ Appear to have been borrowing fairly regularly √ taking out a debenture in 2009 and a bank loan in 2014. √
EPS is very low, so poor return for investors in ordinary shares. √
Price/earnings very high (so may discourage future investors in ordinary shares) √ as it would take a very long time to get money back/recover investment made. √
Dividend per share is high (which means funds are leaving the company) √ which may give future problems eg repaying loans √ future expansion etc. √
Dividend cover is very low √, meaning company cannot afford to pay this level of dividend. √
Dividend yield is high (which means company is paying out more than it needs to) √ probably more than many other companies. √

Maximum of 8 marks for arguing one side

Conclusion 2 marks
Company has some serious problems √√
OR profitability is a problem √ and gearing √

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	√C

12 x √

W5 Financial cost

2 x √

Interest on bank loan	48000	√
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		

W3Administrative 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 x √ = 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 x 40 x £5.90) √ = £1 180 √ **(2)**

(ii) Actual labour cost = (200 x £5.90) √ + (7 x £8.10) √ = £1 180 + £56.70 = £1 236.70 √ **(3)**

(iii) Labour efficiency variance = (Actual hours – Standard hours) x Standard rate

= (207 √ – 200 √) x 5.90 √ = £41.30 Adv √ **(4)**

(iv) Labour rate variance = (Actual rate – standard rate) x Actual hours

$$= \left(\frac{1236.70\ \surd}{207} - £5.90\ \surd\right) \times 207\ \surd$$

= (£5.974 - £5.90) x 207 = £15.32 (£15.40) Adv √ **(4)**

(v) Total labour variance = Actual labour cost - Standard labour cost

= (£1 236.70 - £1 180) √ o/f = £56.70 Adv √ o/f

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

(b)

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

(3)

(c)

(i) Actual material cost of production

= (220 x £0.28) √ + (1700 x £0.28) √ = £537.60 √ **(3)**

(ii) Standard material cost of production = (£0.26 x 3 x 600) √ = £468 √ **(2)**

(iii) Material usage variance = (Actual usage - Standard usage) x Standard price

= ((220 + 720 + 720 + 720 – 460) – 1800) x £0.26

= (1 920 √ – 1800 √) x £0.26 √ = £31.20 Adv √ **(4)**

(iv) Material price variance = (Actual Price - Standard price) x Actual usage

= (£0.28 √ o/f - £0.26 √) x 1920 √ = £38.40 Adv √ **(4)**

(v) Material cost variance = Actual material cost - Standard material cost

= (£537.60 - £468) √ o/f = £69.60 Adverse √ 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) √ o/f = £1 648 √

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) √ o/f = £1 774.30 √ 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. √
Zahir is inefficient – does overtime and still cannot meet quota, suggest reduce overtime. √
Mohon is inefficient – does not meet target, do not give overtime to him. √
Chadni is very efficient, surpasses quota in normal time, suggest give overtime to her. √
Rubia meets deadline so is efficient – can be given overtime √

Maximum of 2 marks if candidate argues in general terms, not mentioning individual workers.
Eg no or little overtime is permitted √ which may make all workers more efficient √

(3)

(f)

Performed poorly

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

Labour efficiency – could improve training, √ especially to Mohon, Susmita, and Zahir. Any 2. √
Labour rate – perhaps pay overtime at standard rate, √ especially if 120 target not met √
Material usage – better training of staff, √ or buy better quality material √ or new machinery. √
Material price – look for alternative suppliers √ or negotiate better prices √ or pay quickly to ensure discounts. √

Performed well

Section may be efficient, √ it is just that the standards set are unrealistic.√ maybe they are not reviewed regularly √ in which case review and change standards √
Some workers are efficient and meet or surpass targets √ ie Rubia and Chadni. √
Overall, the department has met its production target. √

Maximum of 8 marks if argued one side only.

Conclusion 2 marks
Blouse section has probably performed poorly. √√

(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)

Calculation of Purchase Price			
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)

Shares issued = $\frac{75\ 230\ 000\surd\ o/f}{£2.50\ \surd\surd}$ = 30 092 000 shares √ o/f

4 marks

(d)

Acquisition account							
Jan1	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	45 138 000	√o/f
		85 670 000				85 670 000	√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) √
Rent	£9 300	Total £0.83 per unit √
Depreciation	£2 800 √ both	
Electricity	£3 740	
Insurance	£1 420 √ both	Contribution per unit
Manager	£12 000	
Loan	£2 700 √ both	(£1.30 - £0.83 o/f) √ = £0.47 √ o/f
Total FC	£31 960 √ o/f	

Break Even Point = $\frac{\text{£31 960 o/f √}}{\text{£0.47 o/f √}}$ = 68 000 ice creams o/f √ **11 marks**

(b) Margin of safety = 184 800 √ - 68 000 √ o/f = 116 800 units √ o/f **3 marks**

(c) Profit for 2014

Sales = 1400 x 12 x 11 = 184 800 units √
Sales revenue = 184 800 x 1.30 = £240 240 √
Less VC = 184 800 x 0.83 o/f = £153 384√o/f
Less FC = £31 960 √o/f
Profit = £54 896 √o/f

5 marks

(d) New profit = £54 896 x 1.05 = £57 640.80 o/f √

Increase in profit = £2 744.80 o/f √

Increase in rent = £25 x 12 = £300 √

So managers pay must fall by £3 044.80 o/f √

So new pay must be £12 000 - £3 044.80 = £8 955.20 o/f √ **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 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			Connectns		Other	Total	
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			Net		Discount	Discounted	
	Inflow	Outflow	Cash Flow		Factor	Net Cash Flow	
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)	Shoes		Boots		Trainers		Sandals	
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	Shoes		Boots		Trainers		Sandals	
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	*Shoes		Boots		Trainers		*Sandals	
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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