



ASSESSMENT and  
QUALIFICATIONS  
ALLIANCE

# Mark scheme

# June 2003

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## GCE

## Accounting

### Unit ACC6

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**June 2003****ACC6****MARK SCHEME****INSTRUCTIONS TO EXAMINERS**

You should remember that your marking standards should reflect the levels of performance of Advanced Level candidates, mainly 18 years old, writing under examination conditions.

**Positive Marking**

You should be positive in your marking, giving credit for what is there rather than being too conscious of what is not. Do not deduct marks for irrelevant or incorrect answers as candidates penalise themselves in terms of the time they have spent.

**Mark Range**

You should use the whole mark range available in the mark scheme. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **must** be given. A perfect answer is not required. Conversely, if the candidate's answer does not deserve credit, then no marks should be given.

**Alternative Answers / Layout**

The answers given in the mark scheme are not exhaustive and other answers may be valid. If this occurs, examiners should refer to their Team Leader for guidance. Similarly, candidates may set out their accounts in either a vertical or horizontal format. Both methods are acceptable.

**Own Figure Rule**

In cases where candidates are required to make calculations, arithmetic errors can be made so that the final or intermediate stages are incorrect. To avoid a candidate being penalised repeatedly for an initial error, candidates can be awarded marks where they have used the correct method with their own (incorrect) figures. Examiners are asked to annotate a script with **OF** where marks have been allocated on this basis. Similarly, **OF** marks can be awarded where candidates make correct conclusions or inferences from their incorrect calculations.

**Quality of Written Communication**

Once the whole script has been marked the work of the candidate should be assessed for the Quality of Written Communication, using the criteria at the end of the mark scheme. The mark should be shown separately on the candidate's script.

**Synoptic Assessment**

Synoptic assessment is located in the last question. Candidates will be required to integrate their knowledge, understanding and skills learned in different parts of the A Level course.

1

Total for this question: 8 marks

**REQUIRED**

Prepare the “reconciliation of operating profit to the net cash flow from operating activities” for the year ended 31 December 2002.

**Musketts Group plc**  
**Reconciliation of operating profit to net cash flows** (one mark for title including name)

	£ 000	
<b>Operating profit</b>	<b>13 367</b>	
<b>Depreciation</b>	<b>4 750</b>	(1)
<b>Amortisation of goodwill</b>	<b>216</b>	(1)
<b>Profit on sale of tangible fixed assets</b>	<b>(152)</b>	(1)
<b>Increase in stocks</b>	<b>(70)</b>	(1)
<b>Increase in debtors</b>	<b>(32)</b>	(1)
<b>Increase in creditors</b>	<b><u>5 907</u></b>	(1)
<b>Net cash flow from operating activities</b>	<b><u><u>23 986</u></u></b>	(1) or 0

**8 marks**

2

**Total for this question: 8 marks****REQUIRED**

Explain, with reference to FRS 10, how **each** of the items (1) to (4) above should be treated when preparing the final accounts of Go Getter plc.

- 1 Internally generated intangible assets (1) should only be included as fixed assets (1) if there is a readily available market value (1). They should then be amortised (1) over its useful economic life (1).**
- 2 Inherent goodwill (1) should never be included as a fixed asset (1).**
- 3 Purchased goodwill (1) can be included as a fixed asset (1) and should be amortised (1) over its useful economic life (1).**
- 4 Purchased intangible assets (1) can be included as a fixed asset (1) and amortised (1) over their useful economic life (1).**

**Treatment in published accounts (1)**

**Overall max 8 marks**  
**Subject to all four items being covered**

3

Total for this question: 22 marks

**REQUIRED**

- (b) Prepare the capital and reserves extract from the balance sheet
- after*
- the bonus issue.

<b>Capital and reserves</b>	<b>£ 000</b>	
Ordinary shares of 10p each	2 000	(1) of
Profit and loss account (240-10)	<u>230</u>	(1) of
	<u>2 230</u>	(1) or (0)

**Workings**

Shares issued	1 600 000 x 10 = 16 000 000
Bonus issue	16 000 000/4 = 4 000 000 shares x 10p = £400 000 (1)

	<b>Bonus issue</b>	<b>400 000</b>	
	Share premium account	(250 000)	(1)
	Revaluation reserve	<u>(140 000)</u>	(1)
	Profit and loss account	10 000	

**6 marks**

- (b) Explain why a company might choose to make a bonus issue of shares.

To reward shareholders (1) when no cash is available for dividends (1). To reward shareholders in the future (1) with increased dividends (1). To dilute the share price (1) to make shares easier to sell (1). To reduce the dividend % announcement (1) plus (1) for development.  
To distribute non-distributable reserves (1).  
To restructure the balance sheet (1).

**max 4 marks**

- (c) Assess the effect of the bonus issue on an ordinary shareholder.

The bonus issue increases the shares held (1) this should reduce the price (1) as the value of the company is unchanged (1), but more shares are in issue (1). The shareholders wealth will be unchanged (1) – numerical example or explanation (1). It may mean increased future dividends (1).

**max 4 marks**

Assessment/judgement 0-2 (1 mark for attempt at assessment/judgement + 1 for development: e.g. this is not good for the shareholder because no cash received therefore no income, but wealth unchanged, however the shares may be easier to sell as the price has fallen.

**overall max 6 marks**

- (d) Explain, with reference to accounting concepts, why this is so.

Prudence concept (1) states that profit should not be anticipated (1). The increase in value will not be realised (1) until the asset is actually sold (1). The revaluation of the asset is a capital transaction (1) and not revenue (1) therefore correctly treated by crediting reserves (1). If it was included in the P&L a/c it would make comparability between years difficult (2).

**max 6 marks**

4

Total for this question: 12 marks

**REQUIRED**

- (a) Explain the role of the auditor.

**The auditor is an independent (1) accountant (1), whose job is to investigate the accounts (1) and to report to the shareholders (1) as to whether the accounts show a true and fair view (1). Accounting standards (1).**

**max 4 marks**

- (b) Evaluate the potential effect on shareholders if auditors are not truly independent.

**In limited companies and plc's there is a separation of ownership and control (1), the owners are often not involved in the running the business (1) and rely on the annual accounts to see how the business is performing. (1)**

**If the auditor is not independent they may (1) be persuaded to accept accounts where accounting standards (1) are not applied (1) or which do not show a true and fair view (1). Example (1) (Maxwell, Polly Peck, Enron). This means that the shareholders cannot rely (1) on the information in the annual accounts (1) and this may lead to incorrect decision (1) with examples (up to 2 marks) and possibly to the loss of their investment (1).**

**max 8 marks**

5

Total for this question: 50 marks

**REQUIRED**

- (a) Using the list of industry average ratios calculate comparative ratios for Magpie Brewery Ltd. (State the formulae used.)

<b>Net profit margin</b>	<b>Net profit/sales</b>	<b>(1)</b>	<b>7.04%</b>	<b>(1)</b>
<b>Return on capital employed</b>	<b>PBIT/total capital</b>	<b>(1)</b>	<b>9.65%</b>	<b>(1)</b>
<b>Current ratio</b>	<b>Current assets/current liabilities</b>	<b>(1)</b>	<b>3.42:1</b>	<b>(1)</b>
<b>Acid test ratio</b>	<b>C A – Stock/CL</b>	<b>(1)</b>	<b>2.27:1</b>	<b>(1)</b>
<b>Debtors collection period</b>	<b>Debtors/Sales*365</b>	<b>(1)</b>	<b>24 days</b>	<b>(1)</b>
<b>Stock turnover</b>	<b>Cost of sales/stock</b>	<b>(1)</b>	<b>7.27 times</b>	<b>(1)</b>
<b>Gearing</b>	<b>Long term liability/shareholders funds</b>	<b>(1)</b>	<b>31.12%</b>	<b>(1)</b>
	<b>or Long term liability/total capital</b>	<b>(1)</b>	<b>23.7%</b>	<b>(1)</b>

**14 marks**

- (b) Comment on the ratios, assessing the strengths and weaknesses of Magpie Brewery Ltd using the industry average ratios as a means of comparison.

**As a general rule: Comparison of ratio to industry (1), judgement (1).**

**Profitability :** Net profit margin measures profit in relation to sales (1).  
ROCE measures profit in relation to the size of the business (1).

Both ratios are below the industry average (1). The ratios could be lower because of lower gross margins (1); control of expenses (1); or asset efficiency (1).

**Liquidity :** Current ratios measures the ability to pay current liabilities from current assets (1). Acid test ratio removes stock to measure the ability to pay current liabilities from liquid assets (1). Debtors collection period measures how long it takes to collect payment from debtors (1). Better than the industry average (1). Stock turnover measures the number of times the stock is sold in the year (1). This is less than the industry average (1). Comment on weakness (1)

Current ratio is considerably above the industry average (1). Acid test ratio is considerably above the industry average (1). This may mean that Magpie has too much stock (1) with considerable scope for improvement (1). Improvement in stock control could lead to reduced costs (1) and increased profit (1).

**Gearing ratio** Measures the amount of capital invested by the shareholders compared with external sources (1).

This is slightly lower than the industry average (1) they could raise external investment (1) without becoming highly geared or exceeding the industry average (1).

**Max 10 – for ratios in general i.e. no discussion of Magpie Ltd**

**Overall max 14 marks**

(c) Assess the usefulness of using industry averages when comparing ratios.

**The average may not actually exist (1), it can be distorted by one or two companies with exceptional results (1) e.g. one large very efficient company may distort the average (1). To be useful ratios must be compared (1), the industry average provides a useful benchmark (1).**

**max 4 marks**

(d) Explain the advantages **and** disadvantages of the **two** methods of finance being considered and advise the board which one it should choose.

<b>Source</b>	<b>Advantage</b>	<b>Disadvantage</b>
<b>Ordinary shares</b>	<b>Dividends are not compulsory No repayment</b>	<b>Change control Change voting rights Affect share price Dividends are usually higher than other forms of finance Issue costs</b>
<b>Debentures</b>	<b>Rate of interest is usually lower than dividends. Deducted as expense therefore tax efficient</b>	<b>Have to pay interest May have to repay May need to be secured on assets Possible to lose assets/business if not paid Issue costs</b>

**0-8 for advantages/disadvantages of sources, advice/decision (1) plus justification/explanation (0-2)**

**max 10 marks**

(e) Discuss to what extent published accounts are useful in making investment decisions.

**Accounts provide audited figures (1) it is possible to assess profitability (1), liquidity (1), etc. (only 2 marks for examples could also include security, efficiency gearing). They may be the only reliable (1) source of information (1).**

**But**

**They are historical (1) which may not be a good predictor for future performance (1). They may not reflect the actual position of the company (1) because of window dressing (1) e.g. (1). They are total (1) and do not provide profit figures on individual products or departments (1). They do not provide detailed information about products (1); management (1); quality of workforce (1) plus (1) for examples/development. Do not provide information about markets (1) or external factors (1).**

**Only provide 2 years of comparison (1).**

**max 8 marks**



## QUALITY OF WRITTEN COMMUNICATION

After the candidate's script has been marked, the work should be assessed for the Quality of Written Communication, using the following criteria.

### Marks

- 0** Accounts and financial statements are unclear and poorly presented.  
There is little or no attempt to show workings or calculations.  
Descriptions and explanations lack clarity and structure.  
There is very limited use of specialist vocabulary.  
Answers may be legible but only with difficulty.  
Errors in spelling, punctuation and grammar are such that meaning is unclear.
- 1-2** There is some attempt to present accounts and financial statements in an appropriate format.  
Workings are missing or are not clearly linked to the answers.  
Descriptions and explanations are understandable but they lack a logical structure.  
There is some use of specialist vocabulary but this is not always applied appropriately.  
In most cases answers are legible, but errors in spelling, punctuation and grammar are such that meaning may be unclear.
- 3-4** Accounts and financial statements are generally well presented but there are a few errors.  
Workings are shown and there is some attempt to link them to the relevant account(s).  
Descriptions and explanations are usually clearly expressed but there are some weaknesses in the logical structure. There is a good range of specialist vocabulary which is used with facility.  
Answers are legible. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed.
- 5** Accounts and financial statements are well organised and clearly presented.  
Workings are clearly shown and easy to follow. Descriptions and explanations are clearly expressed.  
Arguments are logically structured. There is wide use of specialist vocabulary which is used relevantly and precisely.  
Answers are clearly written and legible. Spelling is accurate and the standard conventions of punctuation and grammar are followed so that meaning is clear.