

# GCE 2004

## *June Series*



# Mark Scheme

## Accounting

### *Unit ACC6*

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

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**June 2004****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. **OF** always makes the assumption that there are no extraneous items. 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: 30 marks

**REQUIRED**

- (a) Prepare a “reconciliation of operating profit/loss to the cash inflow/outflow from operating activities”.

**Reconciliation of operating loss to the net cash inflow from operating activities (1)**

<b>Operating loss</b>	<b>(2127)</b>	<b>(1)</b>	
<b>Depreciation</b>	<b>3490</b>	<b>(1)</b>	
<b>Loss on disposal of assets</b>	<b>58</b>	<b>(1)</b>	
<b>Decrease in stocks</b>	<b>48</b>	<b>(1)</b>	
<b>Decrease in debtors</b>	<b>986</b>	<b>(1)</b>	
<b>Decrease in creditors</b>	<b>(1787)</b>	<b>(1)</b>	
<b>Net cash inflow from operating activities</b>	<b>668</b>	<b>(2)</b>	<b>correct figure (1) OF</b>

**max 9 marks**

- (b) Prepare a draft cash flow statement. Use the format given in FRS 1.

**Adagio plc**  
**Cash flow statement for the year ended 30 April 2004 (1)**

	<b>£000</b>	<b>£000</b>	
<b>Net cash inflow from operating activities</b>	<b>(1)*</b>	<b>668</b>	<b>(1) OF</b>
<b>Taxation</b>	<b>(1)*</b>	<b>(278)</b>	<b>(1)</b>
<b>Capital Expenditure</b>			
<b>Payments to acquire fixed assets</b>	<b>(1795)</b>	<b>(1)</b>	
<b>Receipts from the sale of fixed assets</b>	<b>818</b>	<b>(1)</b>	<b>(977)</b>
			<b>(587)</b>
<b>Equity dividends paid</b>	<b>(1)*</b>	<b>(299)</b>	<b>(1)</b>
<b>Decrease in cash in the period</b>		<b>(886)</b>	<b>(1) OF</b>

\* marks are for labels, and 1 mark for correct sequence

**11 marks**

- (c) Explain to what extent a cash flow statement is essential in judging the financial performance of a company.

**Focus on cash**

**The cash flow statement focuses on cash (1). Cash is the lifeblood of a business (1). It is possible for a business to survive for a significant period of time (1) whilst making losses (1): however, without cash a business can fail quickly (1).**

**Profit can be distorted, but cash is more difficult to manipulate.**

**Cash is also seen as being a more certain figure (1) and harder to manipulate (1), therefore it may be seen as a more accurate measurement of business success or failure (1). Profit can be distorted (1) because decisions need to be made (1) about:**

**examples such as**

**recognition of sales**

**distinguishing between capital and revenue expenditure**

**depreciation.**

**(reward examples from recent business events).**

**0-2 marks for each example**

**Profit is significant**

**Investors are interested in profit (1) as this is the source of dividends (1) and significant for the long term survival of the business (1).**

**max 7 marks**

**Judgement:**

**The cash flow statement is important in judging the financial performance (1) of the business - it shows:**

**liquidity (1)**

**solvency (1)**

**financial adaptability (1).**

**However, the remaining statements also show significant information (1) e.g. profits/losses and assets and liabilities. 0-2 marks for examples**

**max 5 marks**

**Overall max 10 marks**

2

Total for this question: 20 marks

**REQUIRED**

- (a) Explain how a potential investor would use earnings per share (EPS), given in financial statements, in making investment decisions.

**Formula (1)**

**Earnings per share measures the profit available to shareholders (1). The EPS indicates the business' ability to pay a dividend (1). The potential investor could use this to assess the profitability (1) of the company and to compare alternative investment opportunities (1).**

**4 marks**

- (b) Explain each of the two limitations of financial statements given above.

**Financial statements only measure the monetary aspects (1) of business e.g. those transactions which can be valued in money terms (1) + (1) for example - sales, assets, liabilities. There are many aspects of business which are important (1), which are not shown (1), for example (up to 3 marks for relevant examples) the quality of the management or the levels of motivation of the workforce, the quality of research and development, impact on environment, ethical considerations etc. All of these would affect the performance of the business (1) but are not fully reflected in the financial statements (1).**

**max 5 marks**

**The financial statements are for an accounting period and are prepared after the year-end (1); by the time they are published they are likely to be at least 3 months out of date (1). The financial statements focus on what has happened (1) and do not consider what is likely to happen in the future + 0-2 for development e.g. changing markets or economy which could have a significant impact on the performance of the business.**

**max 5 marks****Overall max 8 marks**

- (c) Discuss the impact that each of the two limitations might have on potential investors.

**Potential investors are usually (1) seeking a financial return (1) on their investment either in the form of dividends (1) or by buying and selling the shares at a higher price (1). However, the financial performance of the business will be significantly affected by the non-financial factors (1) which are not quantified in the financial statements (0-2 for development/examples).**

**The investor is looking for future performance (1), and historical performance as shown in the financial statements (1) is only a guide to future performance (1).**

**0-2 for development/examples**

**Therefore, the investor should be very aware of these limitations (1) when making investment decisions, and should investigate all aspects of a business (1) and not rely solely on the financial statements (1).**

**max 8 marks**

3

Total for this question: 50 marks

**REQUIRED**

- (a) Prepare an extract from the balance sheet to show the effect of the bonus issue on the Capital and Reserves section.

<b>Capital and Reserves</b>	<b>£000</b>	<i>Working</i>
<b>Called-up Share Capital</b>	<b>50 000(2)</b>	<b>160 000 000/4=40 000 000(1) x .25(1)=£10 000 000</b>
<b>Share Premium</b>	<b>63 466(1) OF</b>	
<b>Profit and Loss Account</b>	<u><b>33 733</b></u>	
<b>Equity shareholders' funds</b>	<u><b>147 199(1)</b></u>	

**4 marks**

- (b) Calculate the following ratios (to two decimal places). State the formulae used.

<b>Gross profit %</b>	<b>Gross profit/turnover (1)</b>	<b>63 891/69 144 x 100</b>	<b>92.40%(1)</b>
<b>Net profit %</b>	<b>Profit before tax/turnover (1)</b>	<b>10 919/69 144 x 100</b>	<b>15.79%(1)</b>
<b>ROCE</b>	<b>PBIT/Capital employed (1)</b>	<b>13 367/175 611 x 100</b>	<b>7.61%(1)</b>

<b>Current ratio</b>	<b>Current assets/Current liabilities (1)</b>	<b>13 414/77 981</b>	<b>0.17:1(1)</b>
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	<b>Current assets – stock (1)</b>		
<b>Acid test ratio</b>	<b>Current liabilities</b>	<b>13 011/77 981</b>	<b>0.17:1(1)</b>

**10 marks**

- (c) Calculate the following ratios, taking into account the bonus issue of shares (to two decimal places). State the formulae used.

<b>Dividend per share</b>	$\frac{\text{Dividend}}{\text{No. of shares issues}}$	<b>(1)</b>	$\frac{4\,553\,000}{200\,000\,000(1)\text{OF}}$	<b>2.28p (1) OF</b>
<b>Dividend yield</b>	$\frac{\text{Div per share}}{\text{Share price}}$	<b>(1)</b>	$\frac{2.28 \times 100}{60\text{p (1)}}$	<b>3.79% (1) OF</b>

**6 marks**

- (d) Assess the profitability and liquidity of the business, based on the ratios calculated in (b).

**The profitability is measured by:**

**Gross profit % – this measures the profit made by buying and selling (1). 92.4% seems a very high figure (1): however, this reflects the nature of the business which is a service industry (2).**

**Net profit % measures the profitability of the business after expenses (1) 15.79% shows a significant reduction (1) from the gross profit margin which again reflects the nature of the business (1). This appears to be a healthy return (1).**

**ROCE measures the profitability in relation to the size of the business. 7.61% seems a reasonable return (1), higher than could be earned (1) on risk-free investments currently (1).**

**Liquidity is measured by:**

**Current ratio – this measures the ability to cover current liabilities using current assets (1).**

**The figure of 0.17:1 means that the company has only 17p to pay every £1 of current**

**liabilities (1). This appears to be dangerously low. (2) + 1 for development**

**Acid test ratio – this measures the ability to cover current liabilities excluding stock, which is the least liquid of the current assets (1). Again the figure of 0.17:1 is very low (1), but how serious it is, depends on the nature of the business (1).**

**max 8 must include both liquidity and profitability – if only one, max 5 marks**

**Assessment:**

**The profitability appears satisfactory (1) but the liquidity appears dangerous (1). However, any judgement depends on the nature of the business (1) and comparison with other businesses (1).**

**max 2 marks**

**Overall max 10 marks**

- (e) Explain **three** limitations of using ratios when making investment decisions.

**Limitations:**

**Need comparison – with past figures; other businesses; industry averages**

**Only an indicator – it does not tell you the cause of the problem**

**Based on historical data – past performances are not necessarily an indicator of future performances**

**Different organisations use different accounting methods, therefore it may be difficult to compare**

**Based on numerical data only – which may not fully reflect the future performance of the business**

**1 mark per limitation + 1 mark for each aspect of development**

**max 3 marks per limitation**

**1 mark for relating comments to investment decisions**

**Overall max 10 marks**



- (f) Advise Ian whether or not he should sell the shares.

**Quantifying the investment (max 6 marks)**

62 500 (1) shares (50 000 +12 500 bonus) x 60p (1) = £37 500 (1) OF

Ian will receive dividends (1) of:

62 500 (1) x 2.28p (1) OF = £1425 per year (1) OF – assuming the current dividends maintained (1)

The dividend yield is only 3.8%, (1) OF comparison with returns currently earned on risk-free investments (1)

**Things to consider: (max 4 marks)**

how significant the investment or dividends are to Ian? (0-2)

Ian's motivation for holding the investment e.g. income or capital gain (0-2)

**Assessment of the company (max 5 marks)**

profitability satisfactory (1)

liquidity – worrying(1)

EPS appears to be satisfactory (1)

Calculation of P/E ratio

$\frac{60}{5.58}$  (1) = 10.75 (1)

5.58 (1)

**Overall max 9 marks**  
Advice based on arguments (1)

## 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.