



General Certificate of Education

Accounting ACC 6

**Unit 6 Published Accounts of Limited
Companies and Accounting
Standards**

Mark Scheme

2008 examination - June series

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.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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June 2008

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 (QWC)

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.

Total for this question: 20 marks

1

REQUIRED

1(a) Explain **three** reasons why a public limited company publishes its annual report and accounts.

<p>Explain each reason</p>	<p>1 mark for identification</p> <p>0-3 for development/explanation</p>	<p>Legal requirement of Companies Act 1985 because of the divorce of ownership and control to keep the owners informed of the performance of the business and the stewardship of the directors.</p> <p>To inform current shareholders - the current/potential shareholders will want to make decisions based on the reported performance of the business eg profit and dividends paid.</p> <p>To attract potential investors – potential investors will make decisions based on reported performance of the business eg profit and dividends paid.</p>
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max 7 marks for 2 reasons identified
max 9 marks

1(b) Explain **three** limitations to a potential investor of using published accounts.

<p>Identify three limitations</p>	<p>1 for identification</p> <p>0-3 for development/explanation</p> <p>+1 for application to potential investor</p>	<p>They do not focus on significance of non-financial transactions – such as profit but do not reflect non-financial transactions which may be significant to potential investors eg ethical policy; policy to workforce etc.</p> <p>They are historical and do not reflect future events or transactions - the focus is on past events and these may not be good indicators of what will happen in the future eg new products, changes in technology, actions of competitors.</p> <p>They do not anticipate the impact of changes in the economic environment - a changing economic environment could significantly affect the business performance eg recession, inflation etc but this is not reflected in the published accounts.</p> <p>Classification and aggregation of transactions - it is difficult to see in detail how the business is performing as many</p>
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		<p>figures are added together. This could disguise an underperforming product or department.</p> <p>They allocate continuing operations to discrete time periods.</p> <p>The directors of the business have to decide how to allocate profits from continuing operations to particular years – how they do this may have significant effects on the performance of the business</p>
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max 8 if only 2 limitations identified

max 11 marks

2

Total for this question: 30 marks

Jane has £40 000 to invest and is considering buying some ordinary shares in Staton plc. The current market price of the ordinary shares is 80p.

The following information has been extracted from the published accounts of Staton plc for the year ended 30 April 2008.

	£
Operating profit for the year	1 144 000
Interest payable	394 000
Net profit for the year	750 000
Total dividends for the year	200 000
Fixed assets: net book value	13 800 000
Stock	478 600
Other current assets	597 680
Creditors: amount falling due within one year	1 187 600
Creditors: amounts falling due after more than one year	7 880 000
Issued ordinary shares of £1 each fully paid	5 000 000
Reserves	808 680

Additional information

The following ratios relate to Staton plc for the year ended 30 April 2007.

Gearing	68.65%
Earnings per share	12p
Dividend per share	3.75p
Dividend yield	6.25%
Dividend cover	3.2 times
Price/earnings ratio	5

REQUIRED

2(a) Calculate the following ratios for the year ended 30 April 2008. State the formulae used.

- (i) Gearing
- (ii) Earnings per share (EPS)
- (iii) Dividend per share
- (iv) Dividend yield
- (v) Dividend cover
- (vi) Price/earnings ratio.

Gearing	$\frac{\text{Long term liabilities} \times 100}{\text{Capital employed}}$	(1)	$\frac{7\,880\,000 \times 100}{13\,688\,680}$	57.57% (1)
Earnings per share (EPS)	$\frac{\text{Net profit}}{\text{Issued ordinary shares}}$	(1)	$\frac{750\,000}{5\,000\,000}$	15p (1)
Dividend per share	$\frac{\text{Ordinary dividends}}{\text{Issued ordinary shares}}$	(1)	$\frac{200\,000}{5\,000\,000}$	4p (1)
Dividend yield	$\frac{\text{Dividend per share} \times 100}{\text{Market price of share}}$	(1)	$\frac{4 \times 100}{80}$	5% (1) OF
Dividend cover	$\frac{\text{Net profit}}{\text{Ordinary dividends}}$	(1)	$\frac{750\,000}{200\,000}$	3.75 times (1)
Price/earnings	$\frac{\text{Market price of share}}{\text{EPS}}$	(1)	$\frac{80}{15}$	5.33 (1) OF

12 marks

2(b) Write a report to Jane advising, with reasons, whether or not she should invest in Staton plc.

To: Jane
 From: A student
 Date: 6th June 2008
 Subject: Advice on investment in Staton plc

2 marks for all 4 headings
 1 mark for 2 or 3 headings

Calculation of investment	0-2	$40\,000 \div 0.8 = 50\,000$ shares
Analysis of ratios	<p>1 mark per ratio for description of change</p> <p>0-3 per ratio for development/analysis</p> <p>Max 14 for calculation and analysis</p>	<p>EPS has improved from 12p to 15p per share – this means that profit has increased.</p> <p>Gearing – the ratio has fallen to 57.57% - this is still high and therefore high risk.</p> <p>Dividend per share has improved from 3.75p to 4p per share; this means that Jane will receive an extra 25p per share – she would receive a dividend of $50\,000 \times 4p = \pounds 2000$.</p> <p>Dividend yield has worsened from 6.25% to 5 %, this can be compared with risk-free investment in a bank – the yield has fallen despite dividend per share rising – this indicates that the share price has increased.</p> <p>Dividend cover has improved to 3.75 – this means they could pay current dividend 3.75 times from profit and that they are retaining more profit in the business – this appears conservative but may indicate the company is retaining profit for future investment and growth.</p> <p>P/E ratio has improved slightly to 5.33 reflecting increased confidence in the shares – as EPS has increased; this means share price has increased at a faster rate.</p>
Advice	0-3	<p>Yield could be obtained risk free, however share price is rising and could lead to a capital gain.</p> <p>However need to compare ratios with other businesses.</p>

max 16 marks
 2 marks for report format
Overall max 18 marks

Total for this question: 50 marks

3

The balance sheets for Lawless Ltd at 31 May 2008 and at 31 May 2007 are shown below.

Balance sheet		
	at 31 May 2008 £000	at 31 May 2007 £000
Fixed assets	25 686	21 650
Current assets		
Stock	4 050	3 560
Debtors	6 858	4 878
Bank	<u>25</u>	<u>1 670</u>
	<u>10 933</u>	<u>10 108</u>
Creditors: amounts falling due within one year		
Creditors	5 888	8 808
Proposed dividends	1 020	700
Taxation	<u>850</u>	<u>500</u>
	<u>7 758</u>	<u>10 008</u>
Net current assets	3 175	100
Total assets less current liabilities	28 861	21 750
Creditors: amounts falling due after more than one year		
Debentures (2015-2018)	<u>3 500</u>	<u>6 500</u>
Net assets	<u>25 361</u>	<u>15 250</u>
Share capital and reserves		
Ordinary shares £1 each fully paid	15 000	10 000
Share premium account	5 000	3 500
Profit and loss account	<u>5 361</u>	<u>1 750</u>
	<u>25 361</u>	<u>15 250</u>

Additional information

(1)	Tangible fixed assets	
	Cost	£000
	At 1 June 2007	25 650
	Additions	6 686
	Disposal	<u>(2 000)</u>
	At 31 May 2008	<u>30 336</u>
	Depreciation	£000
	At 1 June 2007	4 000
	Charge for the year	1 850
	Eliminated on disposal	<u>(1 200)</u>
	At 31 May 2008	<u>4 650</u>

- (2) The proceeds from the disposal of fixed assets were £846 000.
- (3) Debenture interest paid for the year ended 31 May 2008 was £210 000.
- (4) No interim dividends had been paid.

REQUIRED

- 3(a) Calculate the operating profit for the year ended 31 May 2008.

	£000	
Retained profit for the year	3 611	(1)
Dividends	1 020	(1)
Taxation	850	(1)
Interest	210	(1)
	<u>5 691</u>	(10F)

5 marks

- 3(b) Prepare the reconciliation of operating profit to the net cash flow from operating activities for the year ended 31 May 2008.

Reconciliation of operating profit to the net cash flow from operating activities

	£000	
Operating profit	5 691	(1) OF
Depreciation for the year	1 850	(1)
Profit on sale of assets	(46)	(6) OF*W1
Increase in stock	(490)	(2)*
Increase in debtors	(1 980)	(2)*
Decrease in creditors	<u>(2 920)</u>	(2)*
Net cash inflow from operating activities	2 105	(1) OF

W1	£	
Disposals at cost	2 000 000	(1)
Depreciation eliminated on disposals	<u>1 200 000</u>	(1)
Net book value	800 000	(1)
Proceeds	<u>846 000</u>	(1)
Profit on disposal	<u>46 000</u>	(1)

*1 mark for calculation and 1 mark for correct treatment

15 marks

- 3(c) Prepare a cash flow statement for the year ended 31 May 2008, using the format given in FRS 1.

Cash flow statement for the year ended 31 May 2008
Lawless Ltd (1)

	£000	£000	
Net cash inflow from operating activities*		2 105	(1) OF
Returns on investment and servicing of finance*			
Interest paid		(210)	(1)
Taxation*		(500)	(1)
Capital expenditure and financial investment*			
Payment to acquire fixed assets	(6 686)		(1)
Receipts from sale of fixed assets	846		(1)
		(5 840)	
Equity dividends paid*		(700)	(1)
Cash flow before the use of liquid resources		(5 145)	
Financing*			
Issue of share capital	6 500		(2) W1
Repayment of loans	(3 000)		(1)
		3 500	
Decrease in cash*		(1 645)	(2) CF (1) OF

W1 5000 (1) + 1500 (1)
* 1 mark for all headings

13 marks

- 3(d) Evaluate, providing examples from the question, the usefulness of the cash flow statement when used to assess business performance.

<p>Explain purpose of cash flow statement</p>	<p>0-6 marks</p> <p>0-6 for examples from question</p> <p>12 marks for explanation</p>	<p>Cash flow statement shows: the sources of cash; the uses of cash.</p> <p>It focuses on liquidity, solvency and financial adaptability.</p> <p>Cash flow statement focuses on cash which is less subjective than profit and less easy to manipulate than profit.</p>
<p>Evaluation of cash flow statement</p>		<p>Cash flow statement is important because it focuses on cash which is essential for short term survival + eg.</p> <p>Other final accounts are also important as they show other things such as profit which is essential for long term survival.</p> <p>Consideration of other factors – these can be important in assessing business performance for example ethical or non-finance factors + eg.</p>

max 17 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.

To help them to make judgements, examiners should focus on the following issues.

Are there clear presentations of formats and prose answers?

Are there clear and logical workings, where appropriate?

Is the whole script legible and understandable (including spelling, punctuation and grammar)?

Is there a grasp of accounting terminology (eg avoiding slang, avoiding text language, avoiding abbreviations in prose answers)?

Are arguments logically argued?