



General Certificate of Education

Accounting ACCN2

**Unit 2 Financial and Management
Accounting**

Mark Scheme

2009 examination - January 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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January 2009

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MARK SCHEME**INSTRUCTIONS TO EXAMINERS**

You should remember that your marking standards should reflect the levels of performance of candidates, mainly 17 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.

1

Total for this question 10 marks

Tony has the opportunity to buy some equipment in February. He estimates the equipment will cost £2500. He is not sure whether he will have enough cash available. He has provided the following budgeted information.

	January	February
	£	£
Sales	4800	3600
Purchases of materials	2800	2400
General expenses	1894	1688

Additional information

- (1) Sales are made on the basis of 80% cash and 20% credit. Credit customers will pay one month after the sale.
- (2) All purchases of materials are on credit. Tony will pay his suppliers one month after the purchase of materials.
- (3) General expenses are paid in the month in which they are incurred.
- (4) Tony depreciates all equipment at 10% per annum on cost. He depreciates his existing equipment by £750 per month.
- (5) Tony calculates that the cash balance at 31 January will be £2176.

REQUIRED

- 1 Prepare a cash budget for February **only** and state if Tony can afford the equipment.

(Option 1)**Cash budget for February**

	£		
Income			
Cash sales	2 880	(3OF)	(3600(1) x 80%(1))
Credit sales	960	(3OF)	(4800(1) x 20%(1))
	<u>3 840</u>		
Expenditure			
Purchases	2 800	(1)	
General expenses	1 688	(1)	
Purchase of equipment	2 500	(1)	
	<u>6 988</u>		
Net cash flow	(3 148)		
Opening balance	<u>2 176</u>	(CF)	
Closing balance	<u><u>(972)</u></u>	(1OF)	

10 marks

Plus 1 mark for stating 'cannot afford this'

(Option 2)

Cash budget for February

	£	
Receipts		
Cash sales	2 880	(3OF) (3600(1) x 80%(1))
Credit sales	960	(3OF) (4800(1) x 20%(1))
	<u>3 840</u>	
Payments		
Purchases	2 800	(1)
General expenses	1 688	(1)
	<u>4 488</u>	
Net cash flow	(648)	
Opening balance	<u>2 176</u>	(CF)
Closing balance	<u><u>1 528</u></u>	(1OF)

Can Tony afford the equipment?

Plus 1 mark for stating cannot afford equipment10 marks

2

Total for this question: 10 marks

The Directors of TJ Ltd needed to raise funds to finance the expansion of the business. They decided to make a rights issue of ordinary shares on the basis of 1 new share for every 4 shares held, at a price of £1.20 each. The issue was fully subscribed.

The capital and reserves section of the balance sheet, **before** the issue, is shown below.

Capital and reserves	£
Ordinary shares of £1 each fully paid	400 000
Share premium	40 000
Profit and loss account	185 642
	<u>625 642</u>

REQUIRED

2(a) Prepare the capital and reserves section of the balance sheet immediately **after** the rights issue.

Capital and reserves	£		
Ordinary shares of £1 each fully paid	500 000	(2)	(1 for 100 000 + 1 for adding)
Share premium account	60 000	(2)	(1 for 20 000 + 1 for adding)
Profit and loss account	185 642	(1)	
	<u>745 642</u>	(10F)*	

*OF if consistent with ordinary shares

6 marks

2(b) Define the term 'capital reserves'. Give **one** example of a capital reserve.

Capital reserves are:

- gains arising from non-trading activities (1) + (1) revaluation reserve
- statutory reserves – example: share premium.

2 marks

2(c) Define the term 'revenue reserves'. Give **one** example of a revenue reserve.

Revenue reserves are profits arising from normal trading activities. (1) + (1) retained earnings.

2 marks

3

Total for this question: 30 marks

The following trial balance has been extracted from the books of account of Mandeep, a sole trader, at 30 November 2008.

	£	£
Bank	1 713	
Capital at 1 December 2007		109 439
Discounts	1 286	2 375
Equipment at cost	38 800	
Equipment - provision for depreciation		12 865
Motor vehicles at cost	67 500	
Motor vehicles - provision for depreciation		28 500
Operating expenses	115 782	
Provision for doubtful debts		2 281
Purchases and sales	225 550	525 000
Rent and rates	46 750	
Returns	2 500	
Stock at 1 December 2007	38 500	
Trade debtors and trade creditors	87 500	65 421
Wages	120 000	
	745 881	745 881

Additional information

- (1) Stock at 30 November 2008 was valued at £39 750.
- (2) During the year ended 30 November 2008, Mandeep had taken £2550 of goods for his own use.
- (3) At 30 November 2008, wages due and unpaid amounted to £5780.
- (4) Rent paid for the year ending 30 November 2009 amounted to £4200.
- (5) The provision for doubtful debts is to be 5% of debtors at 30 November 2008.
- (6) Depreciation on motor vehicles is to be provided using the reducing balance method at 33 $\frac{1}{3}$ % per annum.
- (7) Depreciation on equipment is to be provided using the straight-line method at 15% per annum.

4

Total for this question: 30 marks

The Directors of Russel Ltd are concerned about the liquidity of the company.

Sales and purchases for the year ended 31 December 2008 were:

	£
cash sales	156 500
credit sales	145 000
cash purchases	36 000
credit purchases	120 000

Current assets and liabilities at 31 December 2008 were:

	£
stock	14 008
trade debtors	22 660
bank overdraft	11 560
trade creditors	12 860

REQUIRED

4(a) Calculate the net current asset (current) ratio. State the formula used.

Formula

$$\frac{\text{Current assets}}{\text{Current liabilities}} \quad (1)$$

Calculation

$$\frac{14008 + 22660}{11560 + 12860} \quad (1)$$

$$= 1.5:1 \quad (1)$$

3 marks

OF marks for ratios are available for situations where numerator/denominator are incorrect, eg transposition; omission of items.

4(b) Calculate the liquid capital (acid test) ratio. State the formula used.

Formula

$$\frac{\text{Current assets - stock}}{\text{Current liabilities}} \quad (1)$$

Calculation

$$\frac{22\,660}{11\,560 + 12\,860} \quad (1)$$

$$= 0.93:1 \quad (1)$$

3 marks

4(c) Calculate the debtor collection period. State the formula used.

Formula

$$\frac{\text{Trade debtors} \times 365}{\text{Credit sales}} \quad (1)$$

Calculation

$$\frac{22\,660 \times 365}{145\,000} \quad (1)$$

$$= 58 \text{ days} \quad (1)$$

3 marks

4(d) Calculate the creditor payment period. State the formula used.

Formula

$$\frac{\text{Trade creditors} \times 365}{\text{Credit purchases}} \quad (1)$$

Calculation

$$\frac{12\,860 \times 365}{120\,000} \quad (1)$$

$$= 40 \text{ days} \quad (1)$$

3 marks

The Directors of Russel Ltd want to see how their business compares with others in the same sector. To do this, they have obtained the following average ratios for the sector.

Net current asset ratio	0.9:1
Liquid capital ratio	0.5:1
Debtor collection period	45 days
Creditor payment period	60 days

REQUIRED

4 (e) Write a report to the Directors of Russel Ltd.

4 (e) (i) Explain the ratios you have calculated in your answers to 4a to 4d.

4 (e) (ii) Compare the ratios calculated with the sector average ratios.

4 (e) (iii) Assess the ratios calculated for Russel Ltd .

Report

To: Directors of Russel Ltd (must say 'Directors')
From: A Student (no silly names)
Date: 9 January 2009 (in full)
Subject: Explanation of ratios and assessment of liquidity position (should include indication of assessment; do not accept: ratios on liquidity)

(i) Explanation

Net current asset ratio: 0-2 marks

The net current asset (current) ratio measures the company's ability to pay its short-term liabilities with its current assets.

In this case TJ Ltd has £1.50 of current assets for every £1 they owe.

Liquid capital ratio: 0-2 marks

The liquid capital (acid test) ratio measures the company's ability to pay short-term liabilities using liquid assets eg current assets less stock.

In this case TJ Ltd has 93p of liquid assets for every £1 they owe.

Debtor collection period: 0-2 marks

The debtors' collection period measures how long on average it takes to collect the company's debts.

In this case it takes TJ Ltd 58 days to collect its debts.

Creditor payment period: 0-2 marks

The creditors' payment period measures how long it takes on average to pay the company's creditors.

In this case TJ Ltd pays its creditors in 40 days.

8 marks

(ii) Comparison of the net current asset and liquid capital ratios. (All based on OF):**!! For reference (not to be marked):**

Net current asset ratio	0.9:1	1.5:1
Liquid capital ratio	0.5:1	0.93:1
Debtor collection period	45 days	58
Creditor payment period	60 days	40

The sector average ratios are lower (1OF), indicating that other companies have fewer current assets (1) or more current liabilities (1). (If treated separately: 1 mark)

Comparison of debtor collection period – but average figure may not reflect (1) actual situation – year end figures could be distorted by delaying sales.

Or the average distorted by one large company.

The sector average is shorter (1), this means that other businesses collect their debts more quickly (1) or have shorter credit periods (1).

Comparison of creditor payment period:

The sector standard is longer (1), this means other businesses take longer to pay their creditors (1) or are allowed longer credit periods (1).

max 4 marks**(iii) Assessment (for at least 2 comparisons of ratios):**

Russel Ltd appears to have too many resources tied up in working capital (1). Other businesses in the sector are able to operate on lower ratios (1). The sector average indicates that businesses collect their debts 25 days before paying creditors, however Russel Ltd is paying creditors 18 days before collecting debts (1); this could lead to cash flow problems (1).

Limitations of using industry standard averages:

The average may be biased by a few very efficient businesses.

It may not be representative of the sector.

The sector standard may reflect businesses that are in trouble and should not be used as a benchmark.

max 4 marks

Quality of written communication (QWC)

Plus 2 marks

1 mark for report format

1 mark for spelling, punctuation and grammar

2 marks