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# Examiners' Report

## June 2017

IAL Accounting 2 WAC12 01

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## Introduction

This was the first sitting of the WAC12 paper, testing the new specification. The new paper included two compulsory questions in Section A, replacing the choice of two questions from three. The format for Section B remained the same, with a choice of three questions from four. The overall results were mixed. Some areas of the specification have been learnt well, and as result, marks here were good. Candidates did not mark very well in evaluation parts of questions, which have now changed to a levels based mark scheme. Many candidates continued to answer in a bullet point style, which meant achieving the higher levels on the mark scheme was difficult.

## **Question 1**

This question was answered very well, as candidates had clearly learnt how to produce a statement of comprehensive income (SOCl), with good marks on (a)(i). Most of the items were classified in the correct section, and many of the additional information items were treated properly. Answers for (a)(ii), the statement of financial position were quite good, with the majority of candidates achieving over half of the marks available. Candidates did not do very well in (b), with few managing to achieve Level 3 or Level 4 answers. Centres need to be aware that the specification in this area has broadened, not just concentrating on the Auditors Report. The specification now looks at the role of the auditor including the role of the auditor in corporate governance.

Common errors:

Use of "old" terminology such as sales, fixed assets, long-term liabilities, stock, debtors, and creditors, instead of IAS terms.

Calculating the depreciation of the factory buildings by taking 2% of the carrying value, rather than working back to find the cost price, and then finding 2% of this.

Incorrectly taking 2% of the trade receivables figure, and using this in the SOCl, instead of just the increase in allowance for doubtful debts.

Not taking account of the balance on retained earnings, or realising it was a debit balance.

Incorrectly including the bank loan under non-current liabilities, despite information stating it is repayable in December 2017.

In (b), concluding by stating that the Auditors Report was important, instead of addressing the question which was about the importance of the role of the auditor in a company.

This response achieved a top of Level 3 band, achieving 9 out of 12 marks.

### SECTION A

Answer BOTH questions in this section.

Source material for Question 1 is on pages 2 to 4 of the source booklet.

- 1 (a) Prepare, in accordance with International Accounting Standard (IAS) 1, a:  
 (i) Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 March 2017.

(27)

Statement of Profit or Loss & Other Comprehensive Income for the year ended 31/03/17

Sales		9864 000
(-) cost of sales		(4601900)
Gross Profit		5262100
Other income		1000
		<u>5263100</u>
(-) Distribution costs	(2251330) <del>(1994230)</del>	
(-) Administration costs	(1667400)	
(-) Financial costs	(102000)	(4020730)
Net profit on ordinary activities before tax		1242370
(-) tax		(218000)
Net profit on ordinary activities after tax		<u>1024370</u>

Workings →

Cost of sales

Opening inventory	772 000
Direct material purchase (2150000 - 43000)	<del>2150000</del> 2107000
(-) Closing inventory	(779 000)
Direct factory labour wages	1890 000
Depreciation on factory buildings	92 000
Depreciation on production machinery	43 900
Power (680 000 × 70%)	<u>476 000</u>
	4601900

Distribution costs

Delivery staff wages	476 000
Sales staff wages	632 000
Depreciation on motor van	76 800
Warehouse rent (280000 - 23000)	257 000
Power <sup>for warehouse</sup> (680 000 × 10%)	68 000

~~Shops~~

Power for shops (680000 × 15%)	102 000
commission on sales	94 530
Delivery cost	178 000
<del>Marketing</del>	324 000
Motor van running expenses	<u>43 000</u>
	<del>1000000</del>
	<u>2251330</u>

Administration costs

Head office staff wages 881 000

~~Power bill (650 000 - 24 000)~~

Head office power (680 000 x 5%) 34 000

Increase in provision for doubtful debts 900

Auditors fees 12 500

Bad debts 26 000

Discount allowed 87 000

Head office expenses 510 000

Trade fairs and exhibition expenses 110 000

Financial costs 1 667 400

Bank loan interest (12 000 + 1000) 12 000

Depository interest (45 000 + 45 000) 90 000

102 000

Other income → Bank current a/c interest 1 000

Depreciation for factory buildings

~~Cost = 368 000~~  $\frac{\text{cost}}{50} \times 10 = 368 000$

$\text{Cost} - \left( \frac{\text{cost}}{50} \times 10 \right) = 368 000$

~~cost = 1840 000~~

cost = 4600 000

Depr. for the year =  $\frac{4600000}{50} = 3680000$  92000

Motor van depreciation →  $\frac{384 000}{5} = 76 800$

Production machinery depreciation →  $439 000 \times \frac{10}{100} = 43 900$

## (ii) Statement of Financial Position at 31 March 2017.

(16)

Statement of Financial Position as at 31/03/17

NON-CURRENT ASSETS	COST	Acc. depr.	NBV
Factory buildings	4 600 000	(1 012 000)	3 588 000
Motor van	384 000	(252 800)	131 200
Production machinery			395 100
Goodwill			90 000
			<u>4 204 300</u>
<u>CURRENT ASSETS</u>			
Closing inventory		779 000	
Prepaid rent on warehouse		23 000	
Trade receivables (221 000 - <sup>26 000</sup> <del>15 000</del> )	79 500 <del>80 600</del>		
(-) Provision for doubtful debts	(15 900) <del>(16 000)</del>	77 910 <del>77 900</del>	
Bank cash		117 000 58 000	175 610
Total Assets			<u>5 960 400</u>
<u>EQUITY</u>			
<del>General</del> General reserve		56 000	
Ordinary shares of £0.50 each		3 700 000	
Retained earnings (-624 470 + 1 024 370)		399 900	4 155 900
<u>CURRENT LIABILITIES</u>			
Outstanding power bill		24 000	
Other payables		17 500	
<del>Corporation</del> Corporation tax		218 000	
Bank loan interest owing		1 000	
Debenture interest outstanding		45 000	
Trade payables		<u>175 000</u>	480 500
<u>NON CURRENT LIABILITIES</u>			
Bank loan		150 000	130 500
Debenture		<u>1 200 000</u>	<u>5 941 400</u>



(b) Evaluate the importance of the role of the auditor in limited companies.

(12)

### For role of auditor

Auditors are independent scrutineers of accounts who make sure that the accounts are prepared correctly, in accordance to International Accounting standards.

Auditors

~~The~~ report shows how directors have used the funds invested by shareholders. Auditors role is to the shareholders.

The report is required by Companies Act/legislation.

If auditor is not happy with the accounts, report will be qualified.

Report can help users make decisions. Eg: buy or sell shares in the company.

### Against role of auditor

Auditors may not be independent as they may go along with the wishes of clients. Eg: conflict of interest in order to earn a fee, which may include non-audit work.

Auditors may be misled by directors, therefore report may be inaccurate.

Auditors cannot guarantee that material fraud has not occurred.

### Conclusion

Auditors role is important in limited companies as they check the accuracy of the accounts.

(Total for Question 1 = 55 marks)



## ResultsPlus

### Examiner Comments

Good general introduction into the role of the auditor.

Line 5 "role" should be "duty".

Points made about the Auditors Report were valid, and it was good that they were kept together.

In points against, "conflict of interest" needs explaining.

The last two sentences in points against could be linked together to highlight developing a point made.

Good conclusion, which related to the question set.



## ResultsPlus

### Examiner Tip

In order to develop, for example, "chains of reasoning", keep all statements made about one point together. Ideally, there will be a logical progression from one statement to the next.

When concluding, look back at what the question was asking, and use this as the basis for the conclusion/evaluation, giving the most important point for the decision made.

## **Question 2**

This compulsory question was found difficult by many candidates and the marks attained were not very good. Part (a) was answered well and scores were high. The production budget for (b)(i) was answered quite well, but (b)(ii) candidates found difficult. Candidates often adopted a difficult approach to (c), taking 5% of each continents production, instead of the total production. Whilst this would have arrived at the same answer, the volume of calculations required meant an error was often made. Answers to (d) were weak, with candidates having to use production figures from (b)(i), which often proved too difficult. Part (e) was not answered well, although some candidates successfully calculated amounts for Option 1 and Option 2. The calculations for Option 3 were found more challenging by candidates. The evaluations of the payment options in (f) were reasonable, as advantages and disadvantages were discussed and a preferred option selected.

Common errors:

Confusion over delivery times resulted in figures being in the wrong column in (b)(i).

Assuming, in (b)(ii), that 500 cars per continent were going into inventory.

Not using own figures from (b)(i) to calculate the purchases budget in (d).

Unable to separate deposits from monthly payments in Option 3, and arriving at an incorrect figure.

### **Question 3**

This was a popular question in section B, and marks were reasonably good. Many candidates had clearly learnt the structure of the statement of cash flows, and were able to apply this knowledge to the question. Candidates did not achieve marks where they were caught out by the detail of the question, for example the interest paid on the debenture. Answers to (b) were often good, with candidates working out the current ratio and the acid test ratio for both years. Whilst there were arguments for and against the company handling liquidity well, candidates should have mentioned the cash and cash equivalent balances for the two years.

Common errors:

Confusion when calculating the depreciation figure, which was often incorrect.

Calculating the profit on the sale of the property incorrectly.

When a section of the statement showed an outflow, e.g. operating activities, the term "from" was given instead of "used in".

Not completing the final section of the statement, probably because the figure from the candidate's workings was not correct. However, the candidate should still have used the "beginning of the year" and the "end of the year" figures from the statement of financial position.

This was a Level 1 answer, achieving 2 marks.

3 (a) Prepare a Statement of Cash Flows for the year ended 31 March 2017 in accordance with International Accounting Standard (IAS) 7.

(24)

Cash flow from operating activities.		
Profit from operation	(40500)	
Depreciation on NCA	21000	
Sale <del>an</del> Profit on sale of non current asset.	(72000)	( <del>121500</del> )
Cash flow from operating activities before working capital changes	(91500)	
Increase in inventory.	(6000)	
Decrease in trade receivable.	3000	
Increase in trade payable.	7000	
Net cash flow from operation.	( <del>87500</del> )	(87500)
Cash flow from investing activities.		
Sale of NCA	228000	
Purchase of NCA	(48000)	
Tax paid.	(2000)	178
Cash flow from investing activities.		178000
Cash flow from financing activities.		
Repayment of debentures.	(50000)	
Dividend paid.	(6000)	( <del>56000</del> )
Net cash flow from financing activities.		(56000)
Use in cash and cash equivalents.		34500
Use or Use in cash and cash equivalents at the beginning.		11000
Use or Use in cash and cash equivalents at the end		(1000)
		<u>10000</u>

(b) Evaluate how well Kericho Builders plc has managed liquidity in the year ended 31 March 2017.

(6)

In March 2016 the cash and cash equivalents of the business was £11000 but at the end of the year it was nil in the current assets. However, as there was no short term borrowings such as bank overdraft at the beginning, in the end there was an overdraft of £1000 which means the Kericho Builder Plc has managed liquidity but not so well in the year end.



**ResultsPlus**  
Examiner Comments

Here, the candidate gave their conclusion as practically the whole answer. Whilst the argument was correct, there were no other points included for or against the argument.



**ResultsPlus**  
Examiner Tip

Candidates need to think of a number of points they can bring into their argument, both for and against.

## **Question 4**

This question on project appraisal was a popular question in section B, and marks were fairly good. Section (a) was handled very easily, with many candidates obtaining full marks. In (b), revenue was calculated well, but costs proved difficult. Many candidates omitted the depreciation and/or the interest charged. When calculating the average rate of return, profit is used, so the correct labels would have been revenue or income and expenses or costs, rather than cash inflow and cash outflow. However, candidates were awarded marks for the figures calculated, even if the headings were not strictly correct. The evaluation in (c) was often handled quite well, with candidates bringing in a range of points to be considered.

Common errors:

Did not notice that the operating costs were given per week, and not per year.

Omitting depreciation (or the cost of the project) from the calculations.

Did not include the interest charge in the costs section.

Incorrect formula applied when calculating the average rate of return (accounting rate of return).

This response achieved 6 out of 18 marks.

(b) Calculate the average rate of return (accounting rate of return) of the project.

(18)

Year	Cash Inflow	Cash outflow
1	93 600 000	400 000 - 80 000 = 320 000
2	98 280 000	420 000 - 84 000 = 336 000
3	103 194 000	420 000 - 84 000 = 336 000
4	108 108 000	440 000 - 88 000 = 352 000
5	115 830 000	440 000 - 88 000 = 352 000.

Year	Cash Inflow	Cash outflow	Net cash
1	93 600 000	320 000	93 280 000
2	98 280 000	336 000	97 944 000
3	103 194 000	336 000	102 858 000
4	108 108 000	352 000	107 756 000
5	115 830 000	352 000	115 478 000
			321 428 000

$$\text{ARR} = \frac{321\,428\,000}{260\,000\,000}$$

$$= 1.24 \text{ times.}$$



### ResultsPlus

#### Examiner Comments

The revenue (called cash inflow) was correct and scored 3 marks.  
 The costs (called cash outflow) failed to use figures for the year, using the weekly figures instead. Then 20% was deducted, a confused treatment of depreciation. No marks were awarded.  
 No marks were awarded for the incorrect total figure, labelled net cash flow.  
 The annual profit was not calculated, no division by 5 was shown.  
 The ARR was awarded a generous 3 marks, using the own figure rule, despite not being expressed as a percentage.



### ResultsPlus

#### Examiner Tip

Read the question carefully, to spot the costs were per week (this was stated twice).  
 Learn formulas carefully.



## Question 5

This question was the least popular question on section B, and also the question with the lowest marks achieved. The Journal entries for (a) were disappointing, with many candidates giving a confused answer, often omitting the share premium. Most candidates left out the required transfer to the capital redemption reserve. Part (b) was better, with most marked well. The least successful answer was for (iv) where candidates worked with the £12 million share capital, omitting the redemption that took it down to £11 million. Part (c) was disappointing with answers often being irrelevant, wrong, or from the viewpoint of the shareholder. Although what is good for the shareholder is often good for the company, how this logic applies would have to be worked into the answer somehow.

Common errors:

Omission of share premium entry in the Journal in (a).

Did not show transfer to capital redemption reserve in (a).

In (b) multiplying 1.1 pence by £12 million instead of £11 million which was now the value of share capital.

Thinking that the company could hold onto the shares they have redeemed, then sell them on at a profit. (They would be cancelled).

This was a Level 3 response and achieved 5 marks.

(c) Evaluate, from the point of view of Knightswell Hotels plc, the redemption of ordinary shares on 8 July 2016.

(6)

Redemption of the ordinary share will reduce outflow in the future as dividend. Now the dividend payment will be reduced. Because they have redeemed 1000000 shares. Also it will be easy in decision making, when the shareholders become to reduce they can take decisions quickly, ~~because~~

However, there is a huge cash outflow from the business there is an outflow of £4000000. They can use that amount for other profitable investment other than ~~the~~ redeeming shares. Also it may be affect the reputation of the business. ~~at~~ when company redeem 1000000 share at a time, the potential investors will be demotivated. ~~they~~ and they may invest in other company

To conclude, redemption of ordinary shares is good. Because reduce dividend payment and it lead to easy decision making.

(Total for Question 5 = 30 marks)



### ResultsPlus Examiner Comments

The first point about future dividends being reduced was good. The second advantage concerning decision making was rather tenuous. The two disadvantages stated were both valid points. A good conclusion, stating briefly the reasons for the decision.



### ResultsPlus Examiner Tip

Here, the candidate has read the question carefully, and answered from the viewpoint of the company. It is easy to stray and give answers from the view of the shareholder.

## Question 6

This was the most popular question in section B and marks were reasonable. Part (a) was often completed quite well, but candidates encountered problems with some of the detail. Calculating the quantity of the closing inventory and also the value of the inventory was found the most challenging. For part (b), some candidates had learnt some of the relevant points, but were not sure if they were an advantage or disadvantage, often putting them in the wrong place. The usual mix of answers were given for (c), with the better ones making a decision using marginal costing.

Common errors:

Calculating the quantity and value of the closing inventory incorrectly.

Mixing up the treatment of opening inventory (added to cost of sales) and closing inventory (deducted from cost of sales).

Did not use marginal costing to make a decision concerning the customer's offer.

This response was a Level 1 answer and achieved 1 mark.

6 (a) Prepare a Statement of Profit or Loss and Other Comprehensive Income for the year ended 30 April 2017, in **columnar format**, showing:

- marginal costing inventory valuation.
- absorption costing inventory valuation.

	marginal costing		Absorption cost.	
Revenue (32750 x 64)		2096000		2096000
(-) Cost of production				
Direct materials (19.75 x 33000)	651750		651750	
Direct labour (45 x 33000 x 8.40)	12474000		12474000	
Semi variable (1.40 x 33000)	46200	<del>1311950</del>	46200	<del>1311950</del>
	13171950		13171950	
<u>Fixed costs</u>				
Semi variables cost (8000 x 12)	<del>96000</del>		<del>96000</del>	
Fixed costs (12762.50 x 12)	153150	(13421100)	153150	(13421100)
		(11325100)		(11325100)
(-) closing inventory		(399)		(406.7)
+ opening inventory		21050		27200
		(1130429)		(11298302)

(b) Explain to management:

(i) **two** advantages of valuing inventory using absorption costing

(4)

- It takes both the costs (variable and fixed costs) to value inventory. So better valuation of inventory

->

(ii) **one** disadvantage of valuing inventory using absorption costing.

(2)

Time consuming and waste of energy. Because it should ~~be~~ take two costs: Fixed and variable.

In April 2017, a potential customer is interested in buying the product, but is only prepared to offer £30 per unit.

(c) Evaluate the offer of £30 per unit and advise Hercules Baggage Limited whether this offer should be accepted.

(6)

This offer should not be accepted. Because the customer considered a very lower price rather than Hercules Baggage Limited price.  $(64 - 30)$  there is a big difference of £34. ~~the~~ If company sell these products to £30, then it is likely to get a very lower revenue. Moreover, this may leads to a difficulty in covering the costs. Even in production there is more expenses.

So Hercules Baggage Limited needs a new buyer who can buy the products even in company's price or a price that is closer to company's price. that company has considered.



### ResultsPlus Examiner Comments

There were one or two points that were correct, but not strongly connected to the question. No mention was made of marginal costing theory.



### ResultsPlus Examiner Tip

Learn the theory.

## Paper Summary

Based on their performance on this paper, centres are offered the following advice:

- There is a clear benefit from showing all workings. If an error occurs early in the question, the candidate may not be awarded any marks for the figure calculated. However, if this figure is taken forward and treated correctly, the candidate will benefit from the "own figure" rule and achieve marks.
- The levels-based mark scheme will require candidates to adopt a different approach to the evaluation section of each question, especially in Section A. Previously, candidates could list a number of bullet points, often just one sentence. However, candidates are now advised to try to develop the point being made to a greater depth where possible. This will allow access to the higher levels on the mark scheme. For example, at Level 2, "chains of reasoning are present but may be incomplete or invalid". To move to Level 3 requires "developed chains of reasoning, showing causes and/or effects". Centres are advised to carefully study the requirements of the higher levels, and try to guide candidates to answer in a style that reflects these levels.

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