GCE 2005
January Series

ASSESSMENT and QUALIFICATIONS ALLIANCE

Mark Scheme

Accounting

ACC6 Published Accounts of Limited Companies and Accounting Standards

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.

Further copies of this Mark Scheme are available to download from the AQA website: www.aqa.org.uk

Set and published by the Assessment and Qualifications Alliance.

The Assessment and Qualifications Alliance (AQA) is a company limited by guarantee registered in England and Wales 3644723 and a registered charity number 1073334. Registered address AQA, Devas Street, Manchester, M15 6EX. *Dr. Michael Cresswell Director General*

January 2005 **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:** ***20 marks***

REQUIRED

(a) Prepare the following extracts from the balance sheet **after** the rights issue:
(i) current assets;
(ii) creditors: amounts falling due within one year;
(iii) creditors: amounts falling due after more than one year;
(iv) capital and reserves.

Extracts from the Balance Sheet of Solano plc as at 31 December 2004

	Workings	£m	
CURRENT ASSETS			
Stock		**49**	
Debtors		**506**	
Cash at bank	*15+70* **(1) OF**	**85**	
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Trade creditors		**380**	
Short term loan	*120-120* **(1)**	**0**	
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
10% Debenture 2003-06	*450 -450* **(1)**	**0**	
CAPITAL AND RESERVES			
Called-up share capital	*1200+400* **(1)**	**1600**	
Share premium account	*50+(400 x 60p)(1)*	**290**	**(1) OF**
Revaluation reserve		**168**	
Profit and loss account		**2220**	

Working
Calculation of cash received:
400 shares x £1.60(1) = £640m (1) OF
(1) mark for remaining figures e.g. not adjusting Revaluation reserve or Profit and loss account.

9 marks

(1)

(b) Explain the term "gearing".

Gearing is the relationship between the use of debt (1) and shareholders' funds to finance the business (1). The gearing ratio measures the amount of long term debt (1) compared to the total capital of the company (1). If the ratio is greater than 50% (1) OF, the company is considered to be high geared (1) and therefore high risk (1). It is considered to be risky because the debt will carry interest payments (1) which have to be paid (1) and this may affect the company's ability to pay dividends (1). However, in periods of growing profits, high gearing can benefit the ordinary shareholder (1) + (1) for development. max 6 marks

(c) Calculate the gearing ratio before **and** after the rights issue. Show the formula used.

Formula		**Before**		**After**	
Debt x100 / Equity	**(1)**	**450 / 3638**	**12.4% (1)**	**0 / 4278**	**0 (1) OF**
OR					
Debt x100 / Capital employed	**(1)**	**450 / 4088**	**11% (1)**	**0 / 4088**	**0 (1) OF**

3 marks

(d) Comment on the ratios calculated in (c).

The ratios for Solano plc are both low geared (1), and following the rights issue, the shareholders provide all of the company's capital (1). The company could raise finance externally without incurring significant risk (1). max 2 marks

2 **Total for this question:** ***30 marks***

REQUIRED

(a) Calculate the following ratios for Barton plc, showing the formulae used:
- (i) dividend per share;
- (ii) dividend cover;
- (iii) dividend yield;
- (iv) price/earnings ratio.

Dividend per share	**Ordinary share dividend / No. of ordinary shares**	**125000 / 2000000**	**(1)**	**6.25p**	**(1)**
Dividend cover	**Profit available for dividends / Ordinary share dividend**	**250000 / 125000**	**(1)**	**2 times**	**(1)**
Dividend yield	**Dividend per share x100 / Market price of share**	**6.25 / 195**	**(1)**	**3.2%**	**(1) OF**
Price/Earnings ratio	**Market price of share / Earnings per share**	**195 / 12.5**	**(1)**	**15.6**	**(1)**

8 marks

(b) Discuss whether a potential investor should purchase ordinary shares of Barton plc.

Advice 1 mark + 1 for justification/explanation **2 marks**

Use of ratios to support advice. **max 6 marks**
If a potential investor purchased shares in Barton plc, assuming that the dividend policy was maintained (1), they would expect to receive 6.25p per share (1). The company has enough profit to pay its dividends twice (1) so the dividends appear safe (1). The PE ratio shows the stock market's view of the business (1) and this looks good at 15.6 (1). However (1), the dividend yield, which shows the return received on the investment, is only 3.2% - this could probably be achieved with a risk-free investment (1).

Discussion of other factors to consider. **max 6 marks**
In order to make a decision, it would be necessary to take into consideration a number of other factors (1) e.g:
- **ratios must be compared to be useful (1) + 1 for development**
- **other ratios should be calculated to provide a complete picture (1) + 1 for development**
- **the nature of the business (1) + 1 for development**
- **the ethical attitude of the company (1) + 1 for development**
- **the company's financial history (1) + 1 for development**
- **the state of the economy and its impact on the business (1) + 1 for development**

Discussion of characteristics of ordinary shares 0-4
Reward any other relevant comments. **Overall max 10 marks**

(2)

(c) Outline the objectives of FRS 18 (Accounting policies) with regard to the selection, review and disclosure of accounting policies.

FRS 18 states that a company should:

select accounting policies appropriate to its circumstances (1) to give a true and fair view of its accounts (1)

review its accounting policies regularly (1) to ensure they are appropriate (1) and change them if new policies become more appropriate (1)

disclose sufficient information (1) in the accounts so that users can understand (1) the accounting policies adopted (1) and how they have been implemented (1).

max 6 marks

(d) Explain why it is essential for a user of published accounts that companies disclose their accounting policies.

Accounting policies decide which facts (1) about a business will be shown (1) in the published accounts and how they will be shown (1). This enables users of the published accounts to understand (1) the accounts and to be able to compare (1) different businesses.
It is a legal requirement (1) + (1) for development
Accounting policies will enable users to:

understand the accounts (1)
rely on the accounts as they are free from bias (1)
and therefore make reliable decisions (1). **max 6 marks**

3 **Total for this question:** ***50 marks***

REQUIRED

(a) Calculate the operating profit for the year ended 31 December 2004.

Calculation of operating profit

Retained loss for the year (285-485)	**(200)(2)**
Add	
taxation	**20(1)**
dividends	**100(1)**
Operating profit	**(80)(1) OF**

5 marks

(b) Prepare the reconciliation of operating profit to the net cash flow from operating activities for the year ended 31 December 2004.

Reconciliation of operating profit to net cash flow from operating activities (1)

Operating profit	**(80)(1) OF**	
Depreciation	**165(1)**	
Profit on disposal of assets	**(66)(3)**	**Working**
Decrease in stock	**130(1)**	
Increase in debtors	**(47)(1)**	
Increase in creditors	**223(1)**	
	325(1) OF	

Working: Calculation of profit on disposal

	£000	
Cost	**665**	
Depreciation to date	**65**	**(1)**
NBV	**600**	
Proceeds	**666**	**(1)**
Profit on disposal	**66**	**(1)**

10 marks

(3)

(c) Prepare the cash flow statement, following the format given in FRS 1, for the year ended 31 December 2004.
(Note: you are **not** required to prepare the reconciliation of the movement of net debt.)

Cash flow statement for JMC plc for the year ended 31 December 2004 (1)

	£000	£000	
NET CASH FLOW FROM OPERATING ACTIVITIES (1)		**325(1)**	**OF**
TAXATION			
Corporation tax paid		**(60)(1)**	
CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT (1)			
Payment to acquire fixed assets	**(2396)**	**(1)**	
Receipts from sale of fixed assets	**666**	**(1)**	
		(1730)	
EQUITY DIVIDENDS PAID (1)		**(175)(1)**	
CASH FLOW BEFORE USE OF LIQUID RESOURCES		**(1640)**	
FINANCING (1)			
Issue of share capital		**1920(2)**	
Workings (6000-4410)* (1)= *1590 + (771-441)* (1) = *330			
Repayment of loans		**(200)(1)**	
INCREASE IN CASH (1)		**80(1)**	**OF**

15 marks

(d) Explain how a company can make a loss but still have an increase in cash.

General discussion of the differences between cash and profit: **max 5 marks**

Timing differences (1) – profits are recorded in the profit and loss account when the transaction is made (1) but the cash may not be received for some time (1).
Other payments (1) – payments for fixed assets (1) result in cash leaving the business but do not reduce profit (1).
Other receipts (1) – share issues (1) or loans received will increase cash (1) but are not shown in the profit and loss account (1).
Non-cash items (1) – provisions are made in the profit and loss account (1) that do not involve the movement of cash (1) e.g. depreciation (1).

Explanation of how a company can make a loss and still increase cash balance: **max 5 marks**

Non-cash items (1) - provisions for depreciation (1) or bad debts (1) will reduce the profit figure (1) but have no effect on cash (1) +(1) for example. Timing differences (1) - the company may have recorded purchases (1) but not paid for them yet (1) +(1) for example.
Other receipts (1). The company may have issued shares (1) or taken out loans (1) during the year and these will increase the cash balance (1) but not affect the profit figure (1) + (1) for example.

Overall max 10 marks

(3)

(e) Discuss the extent to which cash is more significant for business survival than profit.

Cash is essential for short term survival (1). Without cash, a business may not be able to meet its liabilities (1) and therefore may lose profit (1) or even be forced into liquidation (1) by its creditors (1). Also the business may not be able to pay dividends (1) and hence lose the confidence of shareholders (1).

Profit is needed for long term survival (1) to ensure that funds (1) are generated (1) to enable the business to invest (1) and to pay dividends to shareholders (1).

max 8 marks

Assessment 0-2
For example: both are essential for a business to survive and be successful.

10 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

Marks	Criteria
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.