GCE

Business Studies

Advanced GCE

Unit **F294:** Accounting

Mark Scheme for June 2011

Oxford Cambridge and RSA Examinations

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Question			Expected Answer	Mark	Additional Guidance
1			**Using Table 1, calculate the following liquidity ratios for TEL.** **(a) Current ratio** **(b) Acid test ratio**		
	(a)		Current ratio=Current Assets/Current Liabilities (1) $\frac{2,400+705+11,256}{23,768}$ (1) = 0.60 (1) (2)	**[2]**	Accept 0.61 1 mark only for 60.4% 1 mark for formula
	(b)		Acid test ratio=Current Assets less Stock/Current Liabilities (1) $\frac{705+11,256}{23,768}$ (1) = 0.50 (1) (2)	**[2]**	Accept 0.51 1 mark only for 50.3% 1 mark for formula
2			**Analyse <u>one</u> reason why Simon would be interested in TEL's balance sheet (see Table 1).** Simon may well be concerned by the liquidity ratios – both are well below theoretical benchmarks. Answers could include: • valuation of fixed assets – how, when? • valuation of stock – how, write-offs? • valuation of debtors – how, write offs? • long-term loan-interest charges, length of loan? • auditors comments, eg liquidity, going concern. Also other accounting information including: • profit and loss account • cash flow statement • depreciation methods • also directors' report		<u>Case study evidence</u> Table 1 Line 20-21 L2 for correct references to accounting conventions Reward L3 for appropriate use of liquidity ratios and/or reference to questions 1a and 1b Gearing = $\frac{48500}{243073} \times 100$ =20% Don't reward references to 'profit'

Question			Expected Answer	Mark	Additional Guidance
			Level 3 Candidate demonstrates analytical skills when discussing TEL's balance sheet and what other accounting information Simon would like to view from TEL's annual report. **(5-6)** **Level 2** Candidate demonstrates knowledge and understanding of an annual report and disclosure requirements. No context required. **(3-4)** **Level 1** Candidate offers only theoretical knowledge of an annual report and disclosure requirements. **(1-2)**	**[6]**	
3			**Analyse <u>two</u> ways in which the application of information technology would improve The Empire's accounting system.** Ways in which IT applications to accounting would include: • tracking income and expenses • cash flow statements • monitoring debtors and creditors • generating invoices and receipts • calculating VAT • calculating pay and production of pay slips • budgeting variance analysis. Gwen has carried out a variety of job roles but there is no reference to her qualifications/competence to carry out the accounting functions. Installing CCL's IT accounting applications would ensure that The Empire was in line with the accounting practices of all the other cinemas. Simon would be able to monitor The Empire's accounts more effectively.		<u>Case study evidence</u> Lines 27-29 Accept: • Accuracy • Saving time • Saving costs only if applied to accounting systems • References to accounting conventions eg 'consistency' • Reduces levels of mistakes Do not award any credit for 'disadvantages' **Only one way analysed can achieve L3 maximum of 5 marks**

Question			Expected Answer	Mark	Additional Guidance
			Gwen would need IT training and there will be resistance to this but she needs convincing that, in the long term, her workload will be reduced and she will be able to monitor The Empire's financial performance, eg cash flow. Ultimately Gwen will have to accept that the application of IT is imposed on The Empire as part of the CCL group of companies. **Level 3** Candidate demonstrates analytical skills when explaining the application of information technology to accounting in context. **(5-6)** **Level 2** Candidate demonstrates knowledge and understanding of the application of information technology to accounting. No context required. **(3-4)** **Level 1** Candidate offers only theoretical knowledge of the application of information technology to accounting. **(1-2)**	**[6]**	

Question			Expected Answer	Mark	Additional Guidance
4			**Using Table 4 and any other information, evaluate The Empire's forecast cash-flow position.** Analysis of the cash position Quarter 1: closing balance cash position improves by £14,800 or 119%. This is The Empire's busiest quarter due to tourism. However, is this figure too optimistic? What are the sales receipts based upon, eg previous years? Quarter 2: closing balance cash position improves by only £200, despite the fact that this is off peak season for tourism. Again, concern about the forecasts for sales receipts? Quarter 3: closing balance cash position falls by only £1,300 despite the fact that this must be the quietest quarter of the year. Quarter 4: closing balance cash position improves by £7,900. This appears to be a large increase, even though tourism will be increasing in this quarter. Overall Gwen is forecasting a £21,600 or 174% increase in cash flow! Is this a realistic forecast? Why is she so confident about sales receipts? How accurate are all her forecasts and how has she calculated them, eg used last year's figures? Has she taken the task seriously and/or considered it to be a priority? Having said this, there is some evidence to support Gwen's figures, at least for one quarter, when Table 2 (actual figures) is considered.		Case study evidence T2 and T4 Line 28-29 Line 31 No credit for references to: • Profit • Loss • Break-even • Depreciation • Allocation of overheads Award L2 general statement with regard to the cash-flow trend. Award L3 for appropriate use of correct percentage differences between quarters. No credit for solutions to the forecast cash-flow position eg overdraft

Question			Expected Answer	Mark	Additional Guidance
			What are Gwen's underlying objectives? Does she fear that CCL is concerned about The Empire's performance and so she has done some 'window dressing'? **Level 4** Candidate demonstrates evaluative skills when discussing The Empire's cash flow statement. **(9-13)** **Level 3** Candidate demonstrates analytical skills when discussing The Empire's cash flow statement. **(6-8)** **Level 2** Candidate demonstrates knowledge and understanding of a cash flow statement. No context required. **(3-5)** **Level 1** Candidate offers only theoretical knowledge of a cash flow statement. **(1-2)**	**[13]**	
5			**Using Tables 2 and 3 and any other information, discuss the extent to which introducing profit centres might affect CCL's financial performance.** A profit centre is a unit of a business for which a separate profit and loss account can be prepared. In CCL's context this could be defined as each cinema. Benefits include: • delegation of some control to each cinema (Manager) • financial performance is easier to track and can, therefore, be remedied quicker • managers and staff can achieve a higher level of motivation through the responsibility invested in them • sense of achievement can be enhanced due to each		Case study evidence T2 and T3 Lines 32-34 Lines 35-37 If no use of T2 or T3, award top L3 for good analysis of the advantages/disadvantages of introducing profit centres at CCL. To achieve top L4 there must be extensive use of T2 and T3.

Question			Expected Answer	Mark	Additional Guidance
			cinema knowing its contribution to profit • if linked to a profit related pay scheme there could be an increase in profitability, eg less wastage, improved customer service, staff ideas on saving costs. Drawbacks include: • are the managers willing and/or able to take on the added responsibility? • an individual profit centre may start to put its interests above those of the whole business • not all financial performance is under the control of each profit centre, eg local external factors such as a major local employer closing or re-locating, impact of weather on tourism, impact of exchange rates on tourism, etc • difficulty in allocating some costs to specific profit centre, eg group overhead (see below). • inaccurate overhead allocation could lead to poor decision making over the future of profit centres (see below). The current method of overhead allocation has placed The Empire in a loss making position (£18,925). What happens to the position if the overhead allocation method is changed?		Reward L3 where there is reference to Empire's positive contribution. Subject to a good analytical discussion, reward L4 if- 'won't affect…….. because the net profit of CCL will remain unchanged'

Question			Expected Answer

Number of seats

	The Plaza	The Regal	The Metropole	The Empire	Total
Sales Revenue	240,439	291,432	116,243	33,825	681,939
Operating Profit	98,939	113,932	44,723	11,075	268,669
Group Overheads	33,240	37,440	30,000	19,320	120,000
Net Profit	65,699	76,492	14,723	(8,245)	148,669
Seats	310	350	280	180	1120
Percentage	27.7%	31.2%	25%	16.1%	100%

Number of employees

	The Plaza	The Regal	The Metropole	The Empire	Total
Sales Revenue	240,439	291,432	116,243	33,825	681,939
Operating Profit	98,939	113,932	44,723	11,075	268,669
Fixed Overheads	37,320	42,720	26,640	13,320	120,000
Net Profit	61,619	71,212	18,083	(2,245)	148,669
Employees	14	16	10	5	45
Percentage	31.1%	35.6%	22.2%	11.1%	100%

Sales revenue

	The Plaza	The Regal	The Metropole	The Empire	Total
Sales Revenue	240,439	291,432	116,243	33,825	681,939
Operating Profit	98,939	113,932	44,723	11,075	268,669
Fixed Overheads	42,310	51,283	20,455	5,952	120,000
Net Profit	56,629	62,649	24,268	5,123	148,669
Percentage	35.3%	42.7%	17.0%	5.0%	100%

<table>
<tr><th colspan="3">Question</th><th>Expected Answer</th><th>Mark</th><th>Additional Guidance</th></tr>
<tr><td></td><td></td><td></td><td>From this analysis one can see that, in two cases, the loss is reduced. However, when overheads are apportioned on the basis of sales revenue, the Empire becomes profitable.
Level 4
Candidate demonstrates evaluative skills when discussing the use of profit centre data and other factors. (9-13)
Level 3
Candidate demonstrates analytical skills when discussing the use of profit centre data and other factors. (6-8)
Level 2
Candidate demonstrates knowledge and understanding of profit centres.
No context required. (3-5)
Level 1
Candidate offers only theoretical knowledge of profit centres. (1-2)</td><td>[13]</td><td></td></tr>
<tr><td>6</td><td></td><td></td><td>Considering accounting and other issues, should CCL go ahead with the proposed investment in the new cinema? Justify your view.
NPV
<table>
<tr><th></th><th>Net cash flow</th><th>Discount factor</th><th>NPV</th></tr>
<tr><td>Year 0</td><td></td><td></td><td>(555,000)</td></tr>
<tr><td>Year 1</td><td>130,000</td><td>0.9091</td><td>118,183</td></tr>
<tr><td>Year 2</td><td>135,000</td><td>0.8264</td><td>111,564</td></tr>
<tr><td>Year 3</td><td>145,000</td><td>0.7513</td><td>108,938</td></tr>
<tr><td>Year 4</td><td>145,000</td><td>0.6830</td><td>99,035</td></tr>
<tr><td>Year 5</td><td>145,000</td><td>0.6209</td><td>90,031</td></tr>
<tr><td></td><td></td><td>NPV</td><td>(27,249)</td></tr>
</table></td><td></td><td><u>Case study evidence</u>
Line 48 objective – growth
Line 50 market information
Line 51 market research and information
Line 56-57 stakeholder support
Line 60 economies of scale
Line 60-61 grants
Line 62-63 secured loan/variable rate of interest
Line 65 payback and DCF criteria
T5
T2 and T3 (for comparison with performance of existing cinemas, eg Plaza and Regal)</td></tr>
</table>

Question			Expected Answer	Mark	Additional Guidance
			Payback period		L3 for calculation and interpretation of ARR. Accept ARR of 5.2% or 25.2%

	+	-	Cumulative cash flow
Year 0		(555,000)	(555,000)
Year 1	130,000		(425,000)
Year 2	135,000		(290,000)
Year 3	145,000		(145,000)
Year 4	145,000		0
Year 5	145,000		145,000

Conclusions:
Negative NPV implies project should be discontinued.
Payback is four years implying project should continue (on the edge of the directors' criteria).

Although NPV is negative, this investment will continue well beyond five years, the NPV from year six would definitely put the project into a positive NPV. In addition, how was the discount rate of 10% established?

There is clear support for the cinema from external stakeholders and the prospects of funding to enable the project to progress. However, what strings will be attached to the grants?
Will CCL have to compromise in terms of how it runs the complex?
Will the local community's initial enthusiasm be sustained in terms of using the cinema?
Will CCL's commitment to use local builders and provide employment create good publicity and have a 'spin-off' for all its cinema?

Is CCL expanding too quickly? How much has recent expansion been funded by external finance?
CCL's contribution to the project is externally funded by a secured loan at a variable rate of interest.

Question			Expected Answer	Mark	Additional Guidance
			What are the implications to CCL if interest rates rise? On the other hand, cinema audience numbers continue to grow especially for 16-24 year olds who make up a large number of the tourist visits to the town. What are the long- term prospects for cinema audience numbers and UK tourism? Should CCL carry out primary market research instead of relying too much on the cinema industry's secondary research? What are the implications for CCL's group overheads? If they do not increase it means there is an extra profit centre to absorb overheads. On the other hand, what are the implications for all the other cinemas if group overheads spiral? eg marketing (promotion), HRM (recruitment, training), interest charges, IT systems, support staff, etc. Will the continued growth of CCL help to motivate all departments/improve job security or will they view the growth as added burden for no remunerative gain?		
			Level 4 Candidate demonstrates evaluative skills when discussing the implications of the decision. **(13-18)** Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using appropriate technical terminology. There may be few, if any, errors of spelling, punctuation and grammar.		NB An answer which only includes or DOES NOT include accounting issue should only be awarded the lowest mark in the appropriate level. A one sided argument **cannot** achieve a level 4 mark.

Question			Expected Answer	Mark	Additional Guidance
			Level 3 Candidate demonstrates analytical skills when discussing the decision in terms of outcomes and resource requirements. **(7-12)** Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question. There will be some errors of spelling, punctuation and grammar, but these are unlikely to be intrusive or obscure meaning. **Level 2** Candidate demonstrates knowledge and understanding of issues. No context required. **(3-6)** Some simple ideas have been expressed. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive. **Level 1** Candidate offers only theoretical knowledge of issues in decision. **(1-2)** Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar, which will be noticeable and intrusive. Writing may also lack legibility.	**[18]**	
			Total	**[60]**	

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