RECOGNISING ACHIEVEMENT

GCE

Business Studies

Advanced GCE

Unit **F294:** Accounting

Mark Scheme for June 2012

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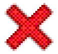
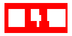
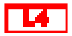
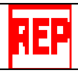
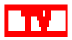
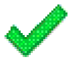
Annotations

Annotation	Meaning
	Unclear
	Benefit of doubt
	Cross
	Level 1
	Level 2
	Level 3
	Level 4
	Not answered question
	No use of text
	Own figure rule
	Repetition
	Noted but no credit given
	Too vague
	Tick

Subject-specific Marking Instructions

Highlighting is also available to highlight any particular points on the script.
Please ensure that, wherever possible, annotations are placed in the margins and not over the candidate's answer. This makes it very difficult to read when the paper is printed out in black and white.
Only the calculation question(s) should be annotated with ticks to show where marks have been awarded in the body of the text.

IT IS VITAL THAT YOU SHOW AS MUCH ANNOTATION ON EACH PAGE AS POSSIBLE. IN PARTICULAR, WHERE LEVELS ARE REACHED. EVERY PAGE, INCLUDING BLANK PAGES (use the SEEN annotation), MUST HAVE SOME ANNOTATION.

Question			Answer	Mark	Guidance
1	(a)		Long term borrowings = £5,230,000 Equity = £4,190,000 (1) (£5,230,000/£4,190,000) x 100 = 124.8% (2)	2	Accept £5,230,000/£4,190,000 + £5,230,000 = 55.5% Up to two marks One mark for correct formula
	(b)		Net profit after taxation= £481,000 Number of Shares=3,120,000 (1) £481,000/3,120,000 = £0.1542 or 15.42p (2)	2	Accept net profit before taxation = £ 489,000/3,120,000 = £0.1567 or 15.67p Accept 15p if formula and workings are shown Up to two marks One mark for correct formula

Question			Answer	Marks	Guidance: Content	Guidance: Levels of response
2			Earnings per share = Net profit after taxation/number of ordinary shares in issue Earnings per share enable shareholders to put LP's net profit after taxation into context. EPS enables a fair comparison to be made between one year's earnings and another by relating the earnings to a tangible measurement (number of issued ordinary shares). The EPS ratio enables shareholders to calculate the Price/earnings ratio (Market price/Earnings per share). Earnings per share will enable investors to decide whether to retain, buy or sell their shares <u>Contextual Analysis:</u> Earnings per share have risen from 14.97p in 2010 to 15.42p in 2011 and therefore there has been a marginal improvement in EPS. The major shareholder is the USA multinational and hold a 25% shareholding stake, this equates to 780,000 shares and so their earnings in 2011 were £120,276 and in 2010 were £116,766	6	For earning per share accept either: • net profit after taxation or • net profit before taxation 2 factors analysed = 6 marks 1 factor analysed = 5 marks 2 factors explained = 4 marks 1 factor explained = 3 marks 2 factors stated = 2 marks 1 factor stated = 1 mark	**Level 3 (5 – 6)** Discussion analyses one/two reasons why shareholders would be interested in LP's earnings per share. **Level 2 (3 – 4)** Answer shows understanding of earnings per share. **No context required.** **Level 1 (1 – 2)** Answer shows knowledge of earnings per share.

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Marks</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td>Content</td><td>Levels of response</td></tr>
<tr><td>3</td><td></td><td></td><td>
<u>Table 2 Ratios</u>
<table>
<tr><td></td><td>2011</td><td>2010</td></tr>
<tr><td>Gross profit margin</td><td>20.29%</td><td>18.29%</td></tr>
<tr><td>Profit on trading before interest and tax
Net profit margin</td><td>3.21%</td><td>2.92%</td></tr>
<tr><td>Profit on trading after interest and tax
Net profit margin</td><td>2.03%</td><td>1.86%</td></tr>
<tr><td>Return on Equity (before taxation)</td><td>11.67%</td><td>12.91%</td></tr>
<tr><td>Current</td><td>1.31:1</td><td>1.33:1</td></tr>
<tr><td>Acid Test</td><td>0.44:1</td><td>0.65:1</td></tr>
<tr><td>Gearing</td><td>124.8%</td><td>64.2%</td></tr>
<tr><td>Earnings per share</td><td>15.42p</td><td>14.97p</td></tr>
<tr><td>Debtors days</td><td>49.5 days</td><td>64.0 days</td></tr>
<tr><td>Stock turnover</td><td>3.26 times</td><td></td></tr>
<tr><td>Interest Cover</td><td>1.76 times</td><td>1.82 times</td></tr>
</table>
The ratios show a mixed picture on LP’s financial performance. The slight improvement in profit margins has not been matched with improvement in profitability where ROE has fallen by over 1%. On the other hand, EPS has seen a marginal improvement.

Liquidity is stable and there has been a significant reduction in debtors days. However, there has been a significant decline for the acid test ratio.
Interest cover has decreased and what will happen in 2012 once the AQT interest charges begin to accrue?

The fall in revenue to £23,702,000 from £25,158,000 will be a concern for all stakeholders and the sales/marketing department will need to justify the 5.8% decrease.
</td><td>13</td><td>Accept rounding-down of ratios.

OFR rule applies</td><td>
Level 4 (9 – 13)
Candidate demonstrates evaluative skills when considering how stakeholders might view the level of success achieved by LP in 2011.

Level 3 (6 – 8)
Candidate demonstrates analytical skills when considering how stakeholders might view the level of success achieved by LP in 2011.

Level 2 (3 – 5)
Candidate demonstrates knowledge and understanding when considering how stakeholders might view the level of success of a business. No context required.

Level 1 (1 – 2)
Candidate offers only theoretical knowledge of measuring success/ stakeholders.
</td></tr>
</table>

Question			Answer	Marks	Guidance	
					Content	Levels of response
			On the other hand, the overall operating profit is encouraging, especially when one takes into account that the 2010 figures include a huge gain on foreign currency transactions. The Chairman's statement on the focus on cost savings will be welcomed by shareholders with an eye on their returns. However, there is no reference to any dividend proposal and this will largely determine how major shareholders will judge LP's success. However, his statement might concern UK employees who will be worried about the security of employment. Will the closure of the Scottish factory be followed by other cuts? Is the acquisition of AQT the beginning of a strategy to move manufacturing out of the UK? The stakeholders of AQT including employees, community, suppliers and government might view LP as a successful company offering security, training and wealth generation. Customers will be encouraged by the Chairman's statements and especially the investment strategy from which customers would anticipate cost gains and better quality.			

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Marks</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td>Content</td><td>Levels of response</td></tr>
<tr><td>4</td><td></td><td></td><td>
<u>Table 3</u>
<table>
<tr><td></td><td>A</td><td>B</td><td></td></tr>
<tr><td></td><td>Actual £</td><td>Actual £</td><td>Standard £</td></tr>
<tr><td>Direct labour</td><td>3.71</td><td>4.00</td><td>3.00</td></tr>
<tr><td>Direct materials</td><td>17.25</td><td>17.80</td><td>16.25</td></tr>
<tr><td>Indirect costs</td><td>0.95</td><td>1.00</td><td>0.71</td></tr>
<tr><td>Total cost</td><td>21.91</td><td>22.80</td><td>19.96</td></tr>
<tr><td>% difference from standard</td><td>9.8%</td><td>14.2%</td><td></td></tr>
<tr><td>% difference on output from standard</td><td>17.4%</td><td>21.1%</td><td></td></tr>
<tr><td></td><td>A</td><td>B</td><td></td></tr>
<tr><td></td><td>Variance</td><td>Variance</td><td></td></tr>
<tr><td>Hours</td><td>10 A</td><td>5 A</td><td></td></tr>
<tr><td>Output</td><td>244A</td><td>295A</td><td></td></tr>
<tr><td>Direct labour</td><td>£84A</td><td>£216A</td><td></td></tr>
<tr><td>Direct materials</td><td>£2809F</td><td>£3081F</td><td></td></tr>
<tr><td>Indirect costs</td><td>100A</td><td>100A</td><td></td></tr>
</table>

Standard costing is a sophisticated means of planning and controlling a company’s operations. The system is time consuming to prepare, and costly to produce and run.
The technique requires a huge amount of detailed information and, employees need to be convinced of its value.

Employees need to understand its purpose (they will be providing the information).

For LP there are several issues to address:

• The workers are blaming the performance on the variability of materials
</td><td>13</td><td>L3 requires an analysis of Table 3</td><td>
Level 4 (9 – 13)
Candidate demonstrates evaluative skills when Considering how might the use of standard costs would help the sports gloves department improve its financial performance.

Level 3 (6 – 8)
Candidate demonstrates analytical skills when considering how might the use of standard costs would help the sports gloves department improve its financial performance.

Level 2 (3 – 5)
Candidate demonstrates knowledge and understanding of the use of standard costs.
No context required.

Level 1 (1 – 2)
Candidate offers only theoretical knowledge of standard costs.
</td></tr>
</table>

Question			Answer	Marks	Guidance: Content	Guidance: Levels of response
			• The nature of the work implies that a 'standard' unit of production does not exist. It will be difficult to establish a standard hour/minute at standard efficiency levels. • Erika has only just joined the company; although she has previous experience in the industry, can this knowledge be used in LP's situation? • Who calculated the standards? Was it a team effort with supervisors' involvement or Erika on her own? **However, there is a marked difference in the performance of the two shifts irrespective of the accuracy of the standards which Erika has calculated. Even if standard costing is rejected, an investigation into the variance in performance needs to be carried out.**			
5			The major difficulty for LP is in looking to purchase a business in another country with, potentially, different approaches to accounting procedures. LP's accountants have already identified an issue with wastage/stock shrinkage – this might imply an investigation into valuations of stock might be advisable to confirm that AQT has followed the ethical rules of prudence and consistency. The prospect of a buy out for AQT might have led to some degree of 'window dressing' and assets and profits are over-valued and liabilities under-valued. The measurement rules of realisation and matching might apply in this context. The boundary rule – going concern would also be essential for LP to explore. Having said all this, it should be noted that AQT is a supplier of LP and, therefore, it is likely that LP already has an accurate view of AQT's financial position.	6	Reward answers which either discuss accounting conventions in a generic or on a specific basis. Conventions include: • consistency • going concern • matching • materiality • objectivity • prudence • realisation	**Level 3 (5 – 6)** Discussion how one accounting convention might have applied during the purchase negotiations for AQT. **Level 2 (3 – 4)** Answer shows understanding of how one accounting convention might have applied during the purchase negotiations. **No context required.** **Level 1 (1 – 2)** Answer shows knowledge of one accounting convention.

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Marks</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td>Content</td><td>Levels of response</td></tr>
<tr><td>6*</td><td></td><td></td><td>

Table 1		
Gross Profit Margin	(352142 /853098) x 100	41.28%
Net Profit Margin	(105977/853098) x 100	12.42%

Compares with LP's 2011 ratios as follows:

GPM = 20.3%
NPM = 3.2%

Other information (AQT cost £3.25m) and so:

Return on investment =
£136,026/£3,250,000 = 4.2%

This compares with LP's 2011 figure of 9.1% (return on equity).

Does this return indicate that LP has paid a high price for AQT?

The cost savings claimed by the accountants will improve all the ratios:

Savings:

Direct labour = 40% of £364,750 = £145,900
Materials = 20% of £136,206 = £27,241

Total Savings = £173,141
'Forecast ratios' (assuming no change in sales revenue) are:

GPM = (525,283/853,098) x 100 = 61.6%
NPM = (279,118/853,098) x 100 = 32.7%
ROE = (279,118/3,250,000) x 100 = 8.6%</td><td>18</td><td>NB. An answer which only includes or does not include accounting issues should only be awarded the lowest mark in the appropriate level.

A one-sided answer cannot achieve a L4.</td><td>Level 4 (13 – 18)
Candidate demonstrates evaluative skills when considering LP's decision to purchase AQT. 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.

Level 3 (7 – 12)
Candidate demonstrates analytical skills when considering when considering LP's decision to purchase AQT. 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.</td></tr>
</table>

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Other information: Unknowns: Cost of training programme for workers Cost of capital investment in new technology There is an indication from the UK finishing department that the quality of the African leather is inconsistent, will LP's management and control of AQT improve the quality? Will control over a major supply source guarantee reliable deliveries and secure supplies? How will AQT's community react to the plans to reduce the workforce and how will LP reconcile this strategy with its corporate social responsibility? Is it ethical to purchase AQT and then make such drastic labour cuts? Would there be an impact on LP's corporate image? How would shareholders/customers react? Other external influences to consider might be fluctuations in exchange rates, potential political instability in Ethiopia and an unpredictable global economic outlook.			**Level 2 (3 – 6)** For demonstrating knowledge and understanding when considering LP's decision to purchase AQT. Some simple ideas have been expressed in an appropriate context. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive. **No context required**. **Level 1 (1 – 2)** For showing knowledge when considering LP's decision to purchase AQT. 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.

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