ASSESSMENT and QUALIFICATIONS ALLIANCE

Mark scheme
January 2004

GCE

Accounting

Unit ACC6

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:** ***12 m…***

REQUIRED

(a) Explain **two** reasons why public limited companies publish their accounts.

To provide information (1) for users (e.g. investors/shareholders (1), potential investors (1), creditors (1)) to assess the performance of the business (1) to allow them to make decisions (1) e.g. to continue investing (1), to invest or not (1) or to trade or not (1).

To provide publicity (1) + (0-2) for development e.g. using the accounts to advertise products, and present information in its best light.

Legal requirement (1) + (0-2) for development e.g. required by law because of the divorce of ownership and control, and to inform potential investors.

<u>Overall max 6 marks</u>

(b) Discuss **two** limitations for potential investors of using published accounts.

Based on historical information (1) + (0-2) for development e.g. figures may not reflect current trading position, impact of inflation etc.

Total figures (1) + (0-2) for development e.g. figures may not reveal the performance of parts of the business or individual products.

Published some months after the year end (1) + (0-2) for development e.g. figures may be out of date.

Potential for window dressing (1) + (0-2) for development e.g. accounts shown in their best light and do not reflect the real trading position.

Lots of other relevant information not revealed (1) + (0-2) for development e.g. product range, product life cycle, quality of workforce/management.

Two limitations only

max 6 marks

2 **Total for this question:** ***16 mar[ks]***

REQUIRED

(a) Define a rights issue of shares.

A rights issue is a means of raising finance (1) where existing shareholders (1) are given the right to buy new shares (1). The shareholders can re-sell the "right"(1). It is usually cheaper than a public issue of shares (1) and does not affect the control of the business (1). max 4 marks

(b) Explain the phrase "a 49% discount to the share price".

This means that the shares are being offered for sale (1) at less than the market price (1). In this case the market price is almost double the discount price e.g. the market price is approximately 820p (1) whilst the rights issue price is 412p (1). max 2 marks

(c) Explain why rights issues of shares are frequently offered at a discounted price.

The discount makes the share more attractive (1) to the shareholders, (1) thus persuading them (1) to take up their rights (1). The deeper the discount (1), the better the offer appears (1) and the more likely the shareholder is to take up his/her rights(1). max 4 marks

(d) Assess the relative merits of a rights issue of shares and a public issue of shares as a means of raising finance.

A rights issue will maintain the current control (1) of the business if the rights are taken up (1), however, if issued at a discount (1) then less cash is raised (1).
It is generally a cheaper way (1) of raising finance than a public issue and is more flexible (1) than other sources of finance such as debentures and loans (1). 0-2 for examples.

0-3 for analysis of rights issue
0-2 for comparison
1 for judgement
max 6 marks

<u>Overall max 16 marks</u>

3 **Total for this question:** ***22 m…***

REQUIRED

(a) Calculate the market price of an ordinary share at 31 October 2003.

80p (4)

Workings

Share price / EPS = P/E ratio (1) using formula $\dfrac{\textbf{80 (1)}}{\textbf{20 (1)}}$ **= 4 (1)**

or

Div per share x 100 / Share price = Dividend yield (1) $\dfrac{\textbf{10 (1)}}{\textbf{80 (1)}}$ $\dfrac{\textbf{x 100}}{}$ **= 12.5% (1)**

max 4 marks

(b) Calculate the total annual dividend Shewley would receive if she invests in the ordinary shares, assuming the dividend per share remains constant.

£3 125 (4)

Workings

25 000 (1) /.8 (1) OF = 31 250 shares x 10p (1) = £3 125 (1) OF

4 marks

(c) Advise Shewley, based on the ratios and the calculations in (a) and (b), whether she should invest in the shares.

The earnings per share ratio is constant (1) as is the dividend per share (1) – this should indicate constant income (1) as the company seems to be able to generate sufficient profit to pay its dividends (1).
The dividend yield is rising (1), which appears to be good and is better than returns earned currently in banks etc (1).
The P/E ratio is falling (1), this reflects the stock market attitude to the business (1).
Together the constant EPS and falling P/E ratio (1) indicate a falling share price (1) – this could be worrying (1).

max 7 marks

Judgement/advice **1 mark**

<u>Overall max 8 marks</u>

(d) Evaluate **two** limitations of using ratios to make investment decisions.

Ratios based on historical information.
Based on accounts which are total and do not show the relative performance of parts of the business.
Focuses on those things that can be measured in money terms and ignores other factors such as workforce, management etc.
Different accounting policies.
Window dressing.

(1) for identification + (0-2) for development **max 5 marks**
(1) for judgement **1 mark**

<u>Overall max 6 marks</u>

4 **Total for this question:** ***50 m…***

REQUIRED

(a) Prepare the profit and loss account and balance sheet, for internal use, after making adjustments fo… items 1-3, where appropriate.

Hughes Hotels plc **(1) for heading**

Profit and loss account for the year ended 30 November 2003

	£ 000	£ 000	
Gross profit		66 010(1)	
Less expenses			
Administration	16 850(1)		*Workings*
Marketing	36 080(2)		28 580 (1) + 7 500 (1)
Financial	2 265(1)		
Depreciation	1 185(2)		685 (1) + 500 (1) OF OR + 300 if property not revalued.
		56 380	
Net profit for the year		9 630(1)	

Balance sheet as at 30 November 2003

	£ 000	£ 000	£ 000	
Fixed assets	**Cost/Valuation**	**Dep'n**	**NBV**	**Workings**
Freehold land and buildings	25 000 (1)	500 (1)	24 500(1)OF	15 000+10 000 (1) : 25 000*.02 (1)
OR	15 000 (1)	300 (1)	14 700(1) OF	if no revaluation
Other fixed assets	8 085	1 270 (2)	6 815(1) OF	685 (1) + 585 (1)
	33 085	1 770	31 315	
Current assets				
Stock		865	(1)	
Debtors		550		
		1 415		
Creditors' amounts falling due within one year				
Trade creditors		655		
Bank overdraft		200		
		855		
Working capital			560	
			31 875	
Capital and reserves				
Ordinary shares of £1 each			10 000(1)	*Workings*
Profit and loss account			11 875 (2) OF	2 245 (1) + 9 630 (1) OF
Revaluation reserve			10 000(1)	(1) for no reserve if assets not revalued
			31 875	

20 marks

REQUIRED

4 (b) For **each** item, 1-3, state the Accounting Standard involved and explain the correct accounting treatment for each item.

1 FRS 10 Goodwill and intangible assets (1)

Only purchased brands (1) should be capitalised (1) and then they should be amortised over their economic life (1).
Internally generated brands should not be capitalised (1) as they do not have a market value (1).
Therefore the intangible asset should be treated as an expense (1) in the profit and loss account (1).

max 6 marks
(General comments – max 5 marks)

2 FRS 15 Tangible fixed assets (1)

When assets have a greater market value (1) than the net book value, they can be revalued (1). This is done by debiting the asset account (1) and crediting a revaluation reserve (1).
The revalued amount should be depreciated (1) – buildings should be depreciated (1).
Therefore the asset value should be increased by £10 000 000 (1) and a revaluation reserve created (1). Depreciation at 2% per annum (1) should be charged on the revalued amount (1).

max 6 marks
(General comments – max 5 marks)

3 SSAP 9 Stock and long term contracts (1)

Closing stock should be valued at the lower of cost (1) and net realisable value (1).
Therefore the stock should be maintained at cost (1) (£20 000) (1) as this is lower than the estimated net realisable value (1) (£25 000) (1).

max 6 marks
(General comments – max 5 marks)
Overall max 15 marks

(c) Explain, giving examples, why despite making a profit a business may have a shortage of cash.

Timing differences (1).
The profit and loss account is produced using the accruals basis (1) which does not necessarily reflect actual cash flows: (1) + (1) for example.
Purchase of fixed assets (1).
When a company buys fixed assets this can result in an outflow of cash (1) which would not be reflected in the profit and loss account: (1) + (1) for example.
Other payments (1).
The company may make other payments such as tax, loan repayments or dividends – these will not be reflected in the profit and loss account: (1) for example.

0-2 development/explanation per point

max 10 marks

4 (d) Evaluate **one** source of finance that Hughes Hotel plc could use to pay the dividend.

Sources include:
Bank loan
Loan
Issue shares
Issue debenture

Overdraft
Working capital

(1) for identifying source – (the source of funds may not be appropriate e.g. working capital)
0-2 for analysis e.g. advantages and disadvantages
0-2 for evaluation/judgement

max 5 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

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.