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ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Accounting 6121

ACC6 Published Accounts of Limited Companies and Accounting Standards

Mark Scheme

2005 examination - June series

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.

June 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** 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 questio…**

REQUIRED

(a) State the relevant Accounting Standard for each of items (1) to (5).

1	**SSAP 9**	**(1)**
2	**FRS 10**	**(1)**
3	**FRS 10**	**(1)**
4	**FRS 15**	**(1)**
5	**FRS 18**	**(1)**

5 marks

(b) Prepare a statement showing the effect of items (1) to (5) on the draft profit.

		£	
Draft net profit		**1 355 675**	
	Workings		
1 Stock	**NRV 5 500 – 500 (1) = 5 000**	**(10 000)**	**(3)**
	Adjustment 15 000 – 5 000 = 10 000 (1)		
2 Brands		**(500 000)**	**(1)**
3 Goodwill	**200 000 x 1/10 (1)**	**(20 000)**	**(2)**
4 Depreciation	**400 000 x 2% (1)**	**(8 000)**	**(2)**
5 Provision	**180 000 x 3% (1)**	**(5 400)**	**(2)**
		812 275	

10 marks

(c) Explain the role of an auditor.

An auditor is an independent accountant (1), appointed by the shareholders (1) to verify (1) the accounts prepared by the directors (1) and report to the shareholders (1). An auditor ensures that the accounts comply with the Companies Acts (1) and Accounting Standards (1) and that they show a true and fair view (1).

max 5 marks

2 **Total for this question: 3**

REQUIRED

(a) Prepare a revised cash flow statement to include transactions (1) to (3).

Prioram plc Cash Flow Statement (1)

	£000	£000	Workings
Net cash inflow from operating activities		**33 761**	
Returns on investment and servicing of finance			
Interest received	**828**		
Interest paid	**(327)**		
Net cash outflow from returns on investment and servicing of finance		**501**	
Taxation paid		**(7 328)**	
Capital expenditure and financial investment			
Receipts from sale of fixed assets	**1 000 (1)**		*761+239*
Payment to acquire fixed assets	**(37 185) (1)**		*33 685+3 500*
Net cash outflow from capital expenditure and financial investment		**(36 185)**	
Equity dividends paid		**(5 000) (2)**	*2 000+3 000W₁*
Cash outflow before management of liquid resources and financing		**(14 251)**	
Financing			
Issue of shares	**15 000 (2) W₂**		
Repayment of loan	**(8 500) (1)**		
		6500	
Decrease in cash in year (must have correct label)		**(7 751) (1) OF**	
+ 1 mark for layout			

10 marks

W₁

40 m (1) x 0.075 (1) = 3 000 000

W₂

40m ÷ 4 = 10m (1) x £1.50 (1) = £15 000 000

(2)

(b) Explain why public companies publish cash flow statements.

Cash flow statements are published to comply with FRS1 (1).
Cash flow statements provide information that is not contained in the profit and loss account (1) plus example (1) and balance sheet (1) plus example (1). They are necessary to provide a fuller understanding of business performance (1).

Cash is seen as a more certain figure (1) than profit (1) as it is easier to verify (1) and less subject to estimation (1) plus example (1).

Cash flow statements focus on cash, which is essential to the short-term survival of business (1).
They show the uses of finance (1), explanation (0-2).
They show the sources of finance (1) – internal and external (1) and long and short term (1); they show how much cash is generated from trading (1) and how much from other sources (1).
They show the uses of finance (1), explanation (0-2).
This allows the users of accounts to make more informed judgements (1) about business performance (1).

max 8 marks

(c) Evaluate the use of a rights issue as a means of raising finance for Prioram plc.

A rights issue means that existing shareholders (1) are given the right to buy (1) new shares (1) in the company.
It is a means of raising long term finance (1) without increasing gearing (1) or changing control of the business (1). It is an effective way of raising finance, provided the shareholders are willing to take up their rights (1). Rights issues are often made at a discount (1) to encourage the shareholders to subscribe (1). However, this may mean that less cash is raised (1).

Rights issue have the benefits of any share issue (1), that there is no repayment (1) and dividends do not have to be paid (1).

max 8 marks

Evaluation related to Prioram plc.
For example: as they are a long term source of finance they are not really appropriate (1) to meet short term cash (1) problems such as paying dividends. However, they would be appropriate to finance the purchase of fixed assets (1) and to repay loans (1) - this would have the effect of reducing gearing (1).

overall max 12 marks

3 **Total for this question: 3**

REQUIRED

(a) Calculate the following ratios for the year ended 31 March 2005. State the formulae used.

(i) Gross profit margin

(ii) Net profit margin

(iii) Return on capital employed

(iv) Current ratio

(v) Acid test ratio

(vi) Dividend per share

(vii) Dividend yield

(viii) Price/earnings ratio

Gross profit margin	**Gross profit / Turnover x 100**	**(1)**	**28.29%**	**(1)**	
Net profit margin	**Net profit / Turnover x 100**	**(1)**	**10.86%**	**(1)**	
ROCE	**Operating profit / Capital employed x 100**	**(1)**	**13.38%**	**(1)**	
Current ratio	**Current assets / Current liabilities**	**(1)**	**2.14:1**	**(1)**	
Acid test ratio	**Current assets – stock / Current liabilities**	**(1)**	**1:1**	**(1)**	
Dividend per share	**Dividends / No. of shares issued**	**(1)**	**5p**	**(1)**	
Dividend yield	**Dividend per share / Market price of share x 100**	**(1)**	**3.57%**	**(1)**	**OF**
Price/earnings ratio	**Market price of share / EPS**	**(1)**	**10.49**	**(1)**	

16 marks

(3)

(b) Assess the performance of Marjen plc over the five years with reference to:

(i) profitability;

(ii) liquidity;

(iii) investment potential.

(i) Profitability

The gross profit margin has fallen consistently (1) over the 5 years – this indicates that either (1) the cost of sales is rising in relation to sales (1) or the sales price is falling in relation to cost of sales (1) + development e.g. caused by market conditions (1).

The net profit margin has risen (1) during the period and then fallen back (1) to the same level (1) as 2001. The 2005 figure shows a significant improvement on that for 2004 (1) OF. This indicates that Marjen have controlled their expenses (1) + example/development (1).

ROCE has fallen to a low of 10.21% in 2004 (1), but returned to the same level of 13.38% (1) in 2005. This is a significant improvement on 2004 (1) OF. The ROCE seems to follow the pattern of net profit (1) which could (1) indicate that capital employed remains constant (1). This appears to be a reasonable return (1) when compared with risk free investments (1).

max 6 marks

Assessment

To make an assessment, it is necessary to compare (1) with other businesses in the same industry (1). However the fall in the gross margin is worrying (1) and if not halted will lead to problems in the future (1).

overall max 9 marks

(ii) Liquidity

The current ratio has fallen (1) from 2.79 to 2.14:1 over the period, although 2005 is better than 2004(1) OF (0-2) for explanation. These ratios indicate that the company has sufficient current assets (1) to meet its current liabilities (1).

The acid test ratio has also (1) fallen from 1.86 to 1:1. This shows that the company is able to pay all its current liabilities (1) using only liquid assets (1) if they become due.
However, the ratio has fallen significantly (1) OF over the period, which may be of concern (1).

max 4 marks

Assessment

The ratios need to be compared with others in the industry (1) as it may be that 1:1 is a safe ratio (1) in this particular industry (1). It does, however, cause some concern (1) – it may mean that the company has too much cash tied up in stock (1). Further investigation would be needed (1), such as calculating stock turnover figures (1).

overall max 6 marks

(3)

(iii) Investment potential
The dividend per share has grown (1) over the period – it is now 2.5 times the level 5 years ago (1). This means that every shareholder is receiving 5p per share (1).

The dividend yield has fallen (1) consistently (1) from 6.67% to 3.57%. This measures the return (1) the investor would get if he/she bought the shares at the current market price (1). As the dividend per share is rising (1), the fall in the dividend yield (1) must mean that the share price is rising (1). The yield of 3.57% could be obtained by a risk free investment (1).

The price/earnings ratio has risen consistently over the period (1). This ratio measures the stock market's view of the company (1): the higher the ratio, the better the prospects of the company (1).

max 6 marks

Assessment
The increasing dividend per share is good for the shareholders (1), but they must be sure that the company can afford the dividends (1) (calculation of dividend cover (1) approx 2.5 times (1) looks secure (1)).
The dividend yield looks worrying (1), but is offset by the rising share price and P/E ratio (1).

overall max 9 marks

(c) Advise Giuditta whether or not she should invest in the ordinary shares of Marjen plc. Your advice should be based in your assessment made in (b) and other relevant factors.

The ratios do not present a consistent picture (1).
Profitability is a concern, (1) particularly gross profit margin, (1) although ROCE (1) and net profit margin appear acceptable (1).
Liquidity again causes some concern (1) as the acid test ratio appears to be worsening (1).
The investor ratios are positive (1) as the dividend per share is rising (1), as is the share price (1) and P/E ratio (1). The yield does look worryingly low (1).

max 5 marks

Other factors
What is Giuditta's motive for investment (1)? Is she hoping for regular income (1)? – in which case, the rising dividend per share is positive (1). Is she intending to trade and make capital gains (1)? – in which case the rising share price is also positive (1).

Calculation of dividend

$$\frac{50\,000}{1.4} = 35\,714 \text{ shares}$$
$$\times \; 0.05$$
$$£1\,785 \quad (3)\ (1\ \text{OF})$$

Other ratios eg gearing (0-2)

Giuditta could also consider:
- **the products of the company (0-2)**
- **the state of the market (0-2)**
- **the state of the economy (0-2)**
- **motivation of workforce/management (0-2)**
- **ethical stance of company (0-2)**
- **environmental impact of the company (0-2)**

max 5 marks

Advice 0-2 marks
Without advice, max 8 marks

overall max 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

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.