OCR
Oxford Cambridge and RSA

GCE

Business Studies

Unit **F294:** Accounting

Advanced GCE

Mark Scheme for June 2017

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This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which marks were awarded by examiners. It does not indicate the details of the discussions which took place at an examiners' meeting before marking commenced.

All examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

OCR will not enter into any discussion or correspondence in connection with this mark scheme.

Annotations

Annotation	Meaning
✓	Correct
✗	Incorrect
?	Not sure what the candidate is trying to say or it does not make sense.
BOD	Benefit of doubt given
L1 L2 L3 L4	Levels of response awarded at this point
OFR	Own figure rule
TV	Too vague
NAQ	Not answered the question
NUT	Not used the context (generic)
REP	Repetition. The candidate has merely restated what has already been said and so no further credit given.
SEEN	The page has been seen. This can be used on pages where no other annotation is appropriate.

EVERY PAGE, INCLUDING BLANK PAGES (use the BP annotation), MUST HAVE SOME ANNOTATION

Question			Answer	Mark	Guidance	
					Content	**Levels of response**
1			Shareholders are the owners of a company and SSL may be concerned over a loss of control. There could also have been a concern over the possibility of a takeover, if a shareholder owns more than 50% of the shares and becomes a majority shareholder. Some shareholders may not be interested in the long term growth of the company and may buy shares with the intention of reselling and making a quick capital gain. Although it must be remembered that shares could go down in value. SSL may not be making sufficient profit to enable it to confidently pay dividend to shareholders or it may reinvest profit back into the business. If shareholders do not receive dividend they will become upset. When a company needs to raise more long term capital the cost of a public share issue can be high (prospectus, marketing, legal). This may have been a concern to SSL. An alternative could have been to invite existing shareholders to apply for more shares through a rights issue. The legal requirements and cost would be less.	6	2 concerns analysed = 6 marks 1 concern analysed = 5 marks 2 concerns understood = 4 marks 1 concern understood = 3 marks 2 concerns stated = 2 marks 1 concern stated = 1 mark	**Level 3: 6-5 marks** Candidate demonstrates analytical skills when considering concern(s) to SSL of making a share issue to fund the investment. **Level 2: 4-3 marks** Candidate demonstrates understanding of concern(s) of making a share issue. **No context required.** **Level 1: 2-1 marks** Candidate demonstrates only theoretical knowledge of this source of finance.

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<tr><th colspan="3">Question</th><th>Answer</th><th>Mark</th><th colspan="2">Guidance</th></tr>
<tr><td>2</td><td></td><td></td><td>

Profitability

	Griffton plc	Franco Srl
ROCE: NP x 100 / CE	470,000 x 100 / 2,400,000 = 19.58%	470,000 x 100 / 2,400,000 = 19.58%
NP x 100 / Sales	470,000 x 100 / 3,300,000 = 14.24%	470,000 x 100 / 8,700,000 = 5.4%
Sales / CE	3,300,000 / 2,400,000 = 1.38 times	8,700,000 / 2,400,000 = 3.63 times
GP x 100 / Sales	1,130,000 x 100 / 3,300,000 = 34.24%	3,310,000 x 100 / 8,700,000 = 38.05%

Liquidity

CA / CL	590,000 / 290,000 = 2.03:1	1,030,000 / 830,000 = 1.24:1
CA- S / CL	590,000 – 260,000 / 290,000 = 1.14:1	1,030,000 – 520,000 / 830,000 = 0.61:1
Debtors x 365 / Sales	280,000 x 365 / 3,300,000 = 31 days	490,000 x 365 / 8,700,000 = 21days
Creditors x365 / Purch	220,000 x 365 / 2,110,000 = 39 days	535,000 x 365 / 5,310,000 = 37 days
Cost of sales / Average stock	2,170,000 / 290,000 =7.48 times (49 days)	5,390,000 / 560,000 =9.63 times (38 days)

</td><td>13</td><td>

Top of L4 for demonstrating evaluative skills.

L3 for effective use of ratio analysis.

Reward at L4 for an answer which compares and contrasts the difference between profitability and liquidity for both suppliers and relates to traditional measures.

Reward at L3 for an answer which considers profitability and/or liquidity for either supplier but does not make any comparison between them.

</td><td>

Level 4: 13–9 marks
Candidate demonstrates evaluative skills when considering how SSL might view financial measures for each supplier.

Level 3: 8–6 marks
Candidate demonstrates analytical skills when considering how SSL might view financial measures.

Level 2: 5–3 marks
Candidate demonstrates understanding of financial measures.
No context required.

Level 1: 2–1 marks
Candidate demonstrates only theoretical knowledge of financial measures.

Default marks
L4 – 11
L3 – 7
L2 – 4
L1 - 2

</td></tr>
</table>

Question			Answer	Mark	Guidance	
			Both suppliers are achieving a similar ROCE, however by different means. Griffton is achieving a higher net profit margin, and not turning over as much as Franco. Franco has a lower npm and turning over at a higher rate. The movement from gpm to npm suggests Franco is not managing expenses as well as Griffton. Traditionally, a current ratio of between 1.5:1 and 2:1 is considered satisfactory. Griffton is just above and could be considered satisfactory. Franco is just below and could be acceptable but would need monitoring. Traditionally, a liquid ratio of 1:1 to 1.5:1 is considered satisfactory. Griffton could be considered satisfactory. Franco is below and this could be a concern and need monitoring. Debtors are paying Franco earlier. Franco is also paying creditors earlier. It would help to know details of the terms of all contracts and if similar it would suggest that Franco is more efficient in the collection and payment of trade debts. Franco does have higher ‘other current liabilities’ and there would be need to investigate how these are made up. Stock turnover is greater for Franco and this would be consistent with lower npma and greater turnover of capital. Overall, both companies appear solvent and going concerns, although aspects of liquidity with Franco need monitoring (note any subsequent spares). On the financial evaluation SSL would be able to use either supplier for the new equipment.			

Question			Answer	Mark	Guidance	
3			SSL has a range of fixed assets including land, property, equipment and motor vehicles. The two methods of calculating depreciation which should be discussed are straight line and declining (reducing) balance. The policy not to depreciate land is appropriate as land tends not to go down in value and has an infinite life. A key advantage of using the straight line method is its simplicity and errors in calculation are less likely. The same amount is charged each year and the impact on profit is consistent. The method is suited to fixed assets that lose value evenly over life and traditionally this has been used on buildings and also furniture and fittings. If the equipment reduces in value at a greater rate in earlier years then this may not be the most appropriate method. The method used for the proposed investment is based on a residual value which is some time in the future. The longer the time period the greater the difficulty in estimating an accurate residual value. For low residual values it may be appropriate to assume a nil residual value. The declining balance method charges a different amount each year. A greater charge is made in earlier years, declining over the life of an asset. It is best suited to fixed assets that lose more value in earlier years. As some fixed assets get older, maintenance costs increase and the declining balance method will ensure a more even charge to the Profit and Loss Account.	13	Top of Level 3 for both sides of the argument which demonstrate analytical skills. Top of Level 4 for both sides of the argument which demonstrate evaluative skills.	**Level 4: 13-9 marks** Candidate demonstrates evaluative skills when considering the methods of depreciation of SSL's fixed assets. **Level 3: 8-6 marks** Candidate demonstrates analytical skills when considering the method(s) of depreciation of SSL's fixed assets. **Level 2: 5-3 marks** Candidate demonstrates understanding of the method(s) of depreciation. **No context required.** **Level 1: 2-1 marks** Candidate demonstrates only theoretical knowledge of method(s) of depreciation. **Default marks** L4 – 11 L3 – 7 L2 – 4 L1 – 2

Question			Answer	Mark	Guidance	
			The declining balance method is more complicated than the straight line method and therefore errors are more likely. Traditionally, the declining balance method has been appropriate to equipment and motor vehicles. The policy adopted should be that deemed the most appropriate to the circumstances and nature of the fixed assets. It can be difficult to apply different methods to different fixed assets and SSL may be using the straight line method because of its ease and it tends to be more popular. For greater simplicity one rate could be applied for all fixed assets within a particular category.			
4			The prudence concept requires that final accounts should report a conservative value for profit and for the valuation of fixed assets. This ensures the final accounts do not give an over optimistic profit or overstate the valuation of the business. This should not mean that a negative view is given; rather the accounts present a 'true and fair view' of the business. By applying depreciation we have an additional expense in the Profit and Loss Account, this will show a lower value for profit and ensure it is not overstated. If depreciation was not shown in the Profit and Loss Account, then a higher profit would be reported. In the Balance Sheet the total depreciation to date is deducted from the cost of the fixed assets and therefore fixed assets are not overstated. Fixed assets will be shown at a written down value. If depreciation was not deducted the fixed asset value would be overstated.	6	Reference may be made to Profit and Loss Account or Balance Sheet.	**Level 3 (6-5 marks)** Candidate demonstrates analytical skills when considering the accounting concept of prudence, specifically related to depreciation, with reference to final accounts. **Level 2 (4-3 marks)** Shows generic understanding of accounting concept of prudence with reference to final accounts. **No context required.** **Level 1 (2-1 marks)** Generic understanding of accounting concept of prudence.

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Mark</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>5</td><td></td><td></td><td>Product B
<table><tr><td>Year</td><td>Net cash flow (£)</td><td>Discount factor</td><td>Present value (£)</td></tr><tr><td>1</td><td>60,000(1)</td><td>0.909</td><td>54,540</td></tr><tr><td>2</td><td>60,000</td><td>0.826</td><td>49,560</td></tr><tr><td>3</td><td>60,000</td><td>0.751</td><td>45,060</td></tr><tr><td>4</td><td>60,000</td><td>0.683</td><td>40,980</td></tr><tr><td>5</td><td>7,000</td><td>0.683</td><td>4,781(1OFR)</td></tr><tr><td></td><td></td><td></td><td>194,921</td></tr><tr><td>Capital cost</td><td></td><td></td><td>75,000(1)</td></tr><tr><td>Net present value</td><td></td><td></td><td>119,921(1OFR)</td></tr></table></td><td>4</td><td>Allow 45,761 for year 4.
The OFR mark allowed if residual 7,000 added to an OFR cash flow.</td><td></td></tr>
<tr><td>6*</td><td></td><td></td><td>Accounting issues
Using the payback method of capital expenditure evaluation, Franco (product B), with a payback of 1.25 years would be selected as this gives the quickest payback. Griffton (product A) gives a longer payback of 1.43 years. The difference is 0.18 year, this being just over 2 months. Both meet the SSL criteria of payback within 3 years.

Points to note using payback:
• no account is taken that earnings accrue after payback and we are not considering the full period.
• no account is taken of timing.
• companies may work to short payback only, therefore excluding more profitable investments.
• useful in technological industries where a short payback is preferred.</td><td>18</td><td>An answer which only includes or does not include accounting should only be awarded the lowest mark in the appropriate level.

A one-sided argument cannot achieve a L4 mark.

Allow references to Griffton or product A, and Franco or product B.

Poor QWC cannot prevent</td><td>Level 4: 18-13 marks
Candidate demonstrates evaluative skills when considering whether SSL should manufacture product A or product B.

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: 12-7 marks
Candidate demonstrates</td></tr>
</table>

Question				Answer	Mark	Guidance	
				Jack Watkins, the Finance Director favours a method using discount factors and the net present value method for each product is shown below.		a candidate from accessing any level, but within any individual level QWC can affect, by up to 2 marks, the final mark given.	analytical skills when considering whether SSL should manufacture product A or product B. *Relatively straight forward 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: 6-3 marks** Candidate demonstrates understanding of factors when a business is considering new product development. **No context required.** *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.* **Level 1: 2-1 marks** Candidate offers relevant knowledge only. *Some simple ideas have been expressed. There are likely to be some errors of spelling, punctuation and grammar of which*

Product A

Year	Cash flow (£)	Discount factor	Present value (£)
1	70,000	0.909	63,630
2	70,000	0.826	57,820
3	70,000	0.751	52,570
4	70,000	0.683	47,810
5	70,000	0.621	43,470
5	10,000	0.621	6,210
			271,510
Capital cost			100,000
Net present value			171,510

From Q5 (not required to present in full) Product B's NPV is £119,921 **(OFR)**

Using the net present value method of capital expenditure evaluation, Griffton (product A), with a net present value of £171,510 would be selected as this gives the highest net present value. Both give a positive net present value.

Points to note using net present value:
- all earnings are taken into account.
- timing is taken into account

The two methods give different outcomes and other factors to note:
- both methods use cash flow, which is not subjective.
- the longer the time period (product A) the less likely that

Question			Answer	Mark	Guidance	
			estimates will be accurate. • product A has a higher capital cost of £25,000 and if this was invested over the period, interest earned would make up some of the difference in net present value. • both products have a residual value but as time progresses this may change. • product B makes greater use of the company motor vehicles. • all data is estimated and may not materialise. • will new technology be developed in next few years prior to the 4/5 years on which net present value calculations are made. • the ease of supply of any spare/replacement parts. • gearing will increase with the use of a bank loan. <u>People</u> Product A would lead to the possibility of redundancy costs, with technology replacing labour and SSL may need to consider: • redundancy compensation. • education and retraining for work in other departments. • enhanced pensions for employees taking early retirement. • effects on morale with remaining workforce. There is a toxic waste with product B, and need to consider any hazardous materials or processes. There will be need for consultation with workforce. With new equipment workforce will need training. There could be conflict amongst management if other			*some may be noticeable and intrusive. Writing may also lack legibility.* **<u>Default marks</u>** L4 – 16 L3 – 10 L2 – 5 L1 – 2

Question			Answer	Mark	Guidance	
			director's do not agree with Jack Watkins on choice of capital expenditure evaluation method. <u>Marketing</u> If SSL pick product A then the possible redundancies could lead to adverse publicity for the company and loss of orders. Product B may lead to adverse publicity with possible protests from residents on the route being taken to dispose of the toxic waste. There are aspects in both product A and product B that could result in adverse publicity for SSL. It may consider not undertaking either product and look for other developments. Customers may have a preference for non-toxic products and prefer product A. <u>External</u> There is a toxic waste with product B which will be disposed 50 miles away. Impact of traffic noise and congestion. Residents on the route will be concerned especially risk and consequences of any road traffic accident. This disposal could lead to adverse publicity for the company and loss of orders. Franco (product B) would be sourced from Italy and there could be transport delays and communication problems. The supply of spares also needs consideration. Financial data for Franco (product B) is subject to currency exchange fluctuations and this could push values up or down.			

APPENDIX 1 - GRID FOR EXAMINATION

Question	**AO1**	**AO2**	**AO3**	**AO4**	**Total**
1	2	2	2	-	6
2	2	3	3	5	13
3	2	3	3	5	13
4	2	2	2	-	6
5	2	2	-	-	4
6	2	4	6	6	18
Total	12	16	16	16	60

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