

**Business Studies**

Advanced GCE F294

Accounting

**Mark Scheme for June 2010**

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Question	Expected Answer	Marks	Rationale
1	<p><b>Using Table 5, calculate each of the following variances.</b></p> <p><b>(a) Cost of sales</b>  <i>Budget = £10,775 actual = £10,440 (1)</i>  <i>Variance = £10,775 – £10,440 = £335 Favourable/Pos (1)</i>  <i>2 marks for correct answer</i></p> <p><b>(b) Profit</b>  <i>Budget = £2,600 actual = £1,075 (1)</i>  <i>Variance = £2,600 – £1,075 = £(1,525)Adverse (1)</i>  <i>2 marks for correct answer</i></p>	<p>[2]</p> <p>[2]</p>	<p>To be award 2 marks candidate must show positive/negative signs correct</p>
2	<p><b>Discuss possible reasons why Lemon Meringue Ice did <u>not</u> achieve its forecasted profit for April.</b></p> <p><i>Sales volume 7.6% below budget.</i>  <i>Sales value 10% below budget.</i>  <i>Selling price per litre budget was £1.95, actual was £1.90 equates to 2.6% below budget.</i>  <i>Cost of sales per litre budget was £1.27, actual was £1.33 equates to 4.7% above budget.</i>  <i>Overheads were £200 above budget.</i>  <i>Actual profit was 58.7% below budget.</i>  <i>The marketing department's research could have been inaccurate and led to the lower level of sales volume. In an attempt to boost sales volume, the sales team could have reduced prices.</i>  <i>The operation team's misgivings about capacity and/or quality control could have been proved correct. For example, in order to meet demand, overtime might have been required at higher than budgeted rates of pay. Another cause could have been higher levels of rejected end products due to the complexity of the recipe.</i></p>		

Question	Expected Answer	Marks	Rationale
	<p><i>Allocated overheads could have risen due to greater indirect staffing requirements and/or more promotional activities to boost demand.</i>  <i>On the other hand, candidates should ask whether other products have experienced similar levels of performance.</i>  <i>The relative dependency of ice cream sales on the weather could be a factor.</i>  <i>Cost of sales could be influenced by the rising cost of dairy ingredients.</i>  <i>It could simply be a case of poor budgeting techniques because the product is an unknown quantity.</i></p> <p><b>Level 4 (9-13)</b>  Candidate demonstrates evaluative skills when considering possible reasons why Lemon Meringue Ice did not achieve its forecasted profit for April.</p> <p><b>Level 3 (6-8)</b>  Candidate demonstrates analytical skills when considering possible reasons why Lemon Meringue Ice did not achieve its forecasted profit for April.</p> <p><b>Level 2 (3-5)</b>  For demonstrating knowledge and understanding of the possible reasons why Lemon Meringue Ice did not achieve its forecasted profit for April. Some simple ideas have been expressed in an appropriate context.</p>		<p><b>Do not accept answers stating ‘it should have been marketed in the summer’</b></p> <p><b>On L4 questions marks lower levels at the top of the range</b></p> <p><b>To achieve top L4 candidates must show complex analysis of variances (please refer to expected answer)</b></p> <p><b>Only top L3 if variance analysis (Table 5) is not used</b>  ‘Seasonality’ is not a valid answer  OFR if figures not actually correct but working out suggests understanding</p>

Question	Expected Answer	Marks	Rationale
2	<p><b>Level 1 (1-2)</b> For showing knowledge and understanding of forecasted profits Some simple ideas have been expressed.</p>		
3	<p><b>In 2008 The Real Ice Cream Company (TRICC) fixed asset utilisation ratio was 1.80 times and in 2009 was 2.10 times. Analyse two reasons for the change in TRICC's fixed asset utilisation.</b></p> <p><i>Fixed asset utilisation shows an upward trend meaning that TRICC is creating greater sales revenue from its fixed assets. However, the ratio does not show the units of sales and, therefore, might be misleading if the product was subject to high price inflation. Sales have increased by 26.1%, whilst fixed assets have increased by 8.1%.</i></p> <p><b>Level 3 (5-6)</b> Candidate demonstrates analytical skills when considering two reasons for the change in TRICC's fixed asset utilisation. Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question.</p> <p><b>Level 2 (3-4)</b> Candidate shows understanding of the change in TRICC's fixed asset utilisation. Some simple ideas have been expressed in an appropriate context.</p> <p><b>Level 1 (1-2)</b> Candidate offers theoretical knowledge only. Some simple ideas have been expressed.</p>		<p><b>One good reason limits mark to top of L2</b></p>

Question	Expected Answer	Marks	Rationale
4	<p><b>Analyse <u>two</u> implications of high dividend payments to shareholders of TRICC.</b></p> <p><i>With reference to the balance sheet, the dividend per share equates to £0.50.</i></p> <p><i>If all the £117350 increase in reserves between 2008 and 2009 is due to retained profit, the net profit after tax was £117350 + £100000 = £217350. Therefore the percentage taken as dividend = <math>(£100000/£217350) \times 100 = 46.0\%</math></i></p> <p><i>The level of reserves appears to be healthy. There is no long-term borrowing and liquidity is sound.</i></p> <p><i>Information about the shareholders, especially the semi-retired chairman, leads us to conclude that the shareholders use their dividends as a major source of income.</i></p> <p><i>High dividend payments could limit TRICC's access to funds for re-investment and so hamper the growth strategy.</i></p> <p><b>Level 3 (5-6)</b> Candidate demonstrates analytical skills when considering <u>two</u> implications of high dividend payments to shareholders of TRICC.</p> <p><b>Level 2 (3-4)</b> Candidate shows understanding of the implication(s) of high dividend payments to shareholders of TRICC. Some simple ideas have been expressed in an appropriate context.</p>		<p><b>Reward candidates who recognise 'short' and 'long-term' implications</b></p>

Question	Expected Answer	Marks	Rationale
	<p><b>Level 1 (1-2)</b> Candidate offers theoretical knowledge only.</p>		
5	<p><b>Discuss how TRICC could fund the proposed expansion strategy.</b></p> <p><i>Obviously TRICC could change its approach to borrowing and seek a loan to finance the project. The balance sheet and general financial performance indicate a healthy business. The gearing would go from zero to 31.0% and would certainly go against Gianni's attitude to risk. There are 50,000 shares available for issue and, based upon the current balance sheet, the shares should command a price of £8.325 each. So this strategy alone could raise the majority of finance for the expansion plans. The issue is who could buy these shares? Is this an opportunity for TRICC's functional directors to make an investment? Would this prove beneficial in terms of their motivation? Would this strategy create a change in the balance of shareholder power in TRICC? Is a combination of other internal sources of finance a better option? For example, reduce the level of dividend or indeed, for one year, persuade shareholders to take no dividend.</i></p> <p><i>Analysing debtors days, there does seem to be scope for improving debt collection (2008: 53.96 days and 2009: 58.92 days). Assuming normal credit terms are 30 days, there is definite room for improvement and so creating additional liquidity. Days of stock (2008:16.8 days and 2009:17.5 days) however, clearly indicate that the business is operating at full capacity and there is no scope for reducing stock.</i></p> <p><i>The liquidity position, in general, is sound and improving.</i></p>		

Question	Expected Answer	Marks	Rationale
	<p><i>Current ratio: 2008 1.08:1 2009 1.20:1</i></p> <p><i>Acid Test: 2008 0.88:1 2009 0.98:1</i></p> <p><i>Other alternatives include reducing stock levels and delaying, where practicable, creditor payments. However, even if all these tactics were implemented the amount required would still not be reached and so TRICC needs to look for external funding in terms of a loan and/or the issue of the balance of authorised shares.</i></p> <p><b>Level 4 (9-13)</b> Candidate demonstrates evaluative skills when considering how TRICC could fund the proposed expansion strategy.</p> <p><b>Level 3 (6-8)</b> Candidate demonstrates analytical skills when considering how TRICC could fund the proposed expansion strategy. Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question.</p> <p><b>Level 2 (3-5)</b> For demonstrating knowledge and understanding of how TRICC could fund the proposed expansion strategy.</p>		

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	<p><b>Level 1 (1-2)</b> For showing knowledge and understanding of funding methods. Some simple ideas have been expressed.</p>																																																																						
6*	<p><b>Considering accounting and other issues, should TRICC go ahead with the proposed investment in plant and machinery? Justify your view.</b></p> <p><i>Net Present value</i> <i>Cash flows £000</i></p> <table border="1" data-bbox="403 574 1232 845"> <thead> <tr> <th>Year</th> <th>+ve</th> <th>-ve</th> <th>DCF</th> <th>NPV</th> </tr> </thead> <tbody> <tr> <td>0</td> <td></td> <td>(450.000)</td> <td>x 1.00</td> <td>(450.000)</td> </tr> <tr> <td>1</td> <td>85</td> <td></td> <td>x 0.893</td> <td>75.905</td> </tr> <tr> <td>2</td> <td>95</td> <td></td> <td>x 0.797</td> <td>75.715</td> </tr> <tr> <td>3</td> <td>105</td> <td></td> <td>x 0.712</td> <td>74.760</td> </tr> <tr> <td>4</td> <td>110</td> <td></td> <td>x 0.636</td> <td>69.960</td> </tr> <tr> <td>5</td> <td>110</td> <td></td> <td>x 0.567</td> <td>62.370</td> </tr> <tr> <td></td> <td></td> <td></td> <td>NPV</td> <td>(91.290)</td> </tr> </tbody> </table> <p><i>Therefore, the project's net present value does not exceed 12% and does not meet Gianni's criteria for investments.</i></p> <p><i>Payback</i> <i>Cash flows £000</i></p> <table border="1" data-bbox="403 1037 1097 1292"> <thead> <tr> <th>Year</th> <th>inflow</th> <th>outflow</th> <th>Net Cash flow</th> </tr> </thead> <tbody> <tr> <td>0</td> <td></td> <td>(450)</td> <td>(450)</td> </tr> <tr> <td>1</td> <td>85</td> <td></td> <td>(365)</td> </tr> <tr> <td>2</td> <td>95</td> <td></td> <td>(270)</td> </tr> <tr> <td>3</td> <td>105</td> <td></td> <td>(165)</td> </tr> <tr> <td>4</td> <td>110</td> <td></td> <td>(55)</td> </tr> <tr> <td>5</td> <td>110</td> <td></td> <td>55</td> </tr> </tbody> </table>	Year	+ve	-ve	DCF	NPV	0		(450.000)	x 1.00	(450.000)	1	85		x 0.893	75.905	2	95		x 0.797	75.715	3	105		x 0.712	74.760	4	110		x 0.636	69.960	5	110		x 0.567	62.370				NPV	(91.290)	Year	inflow	outflow	Net Cash flow	0		(450)	(450)	1	85		(365)	2	95		(270)	3	105		(165)	4	110		(55)	5	110		55		
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	<p><i>Therefore, project's payback is 4.5 years and so meets Gianni's criteria for investment.</i></p> <p><i>These calculations give contrasting results and so the project needs to be subject to further analysis and discussion. Which investment appraisal technique is the more reliable from a technical perspective and which from a commercial perspective? Much depends upon the reliability of Luigi's calculations. If the investment only relies on the one major contract, then one might assume that the figures on sales revenue are accurate, however, everything depends on the success of the regional trial. How watertight is the contract? For example, is there an escape clause for either party? More problematic is the cost of sales; there are many potential reasons why costs might increase, eg materials, energy, distribution and wages. If TRICC has to borrow to fund the investment, what happens if interest rates rise? Why is the appraisal limited to five years? Will the plant and machinery continue well beyond five years? If TRICC has such a good product, then will further contracts follow? Can the decision be delayed until the end of the three-month trial and, in the short term, can TRICC supplement production capacity with additional shifts? The very low levels of stocks indicate that TRICC cannot cope with extra demand unless there is some major change (2009 stock days=17.5).</i></p> <p><i>Please note: An answer which only includes or does <b>not</b> include financial and accounting issues should only be awarded the lowest mark in the appropriate level.</i></p> <p><b>Level 4 (13-18)</b> Candidate demonstrates evaluative skills when considering whether TRICC should go ahead with the proposed investment in plant and machinery. 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.</p>		<p><b>Use of appraisal assessment techniques will secure a high L3</b></p> <p><b>If ARR is used and 'trial launch' discussed then 15 marks</b></p> <p><b>Bottom L4 if only accounting used</b></p>

Question	Expected Answer	Marks	Rationale
	<p><b>Level 3</b> <span style="float: right;"><b>(7-12)</b></span>  Candidate demonstrates analytical skills when considering whether TRICC should go ahead with the proposed investment in plant and machinery. 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.</p> <p><b>Level 2</b> <span style="float: right;"><b>(3-6)</b></span>  For demonstrating knowledge and understanding of the issues affecting TRICC's decision to go ahead with the proposed investment in plant and machinery. 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.</p> <p><b>Level 1</b> <span style="float: right;"><b>(1-2)</b></span>  For showing knowledge and understanding of investment decisions. 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.</p>		

## Assessment Objectives Grid (includes QWC)

Question	AO1	AO2	AO3	AO4	Total
1	2	2	-	-	4
2	2	2	2	-	6
3	2	2	2	-	6
4*	2	3	3	5	13
5*	2	3	3	5	13
6*	2	4	6	6	18
<b>Totals</b>	<b>12</b>	<b>16</b>	<b>16</b>	<b>16</b>	<b>60</b>

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