



# Mark Scheme (Results)

January 2016

Pearson Edexcel IAL in Accounting  
(WAC02) Paper 01

## Edexcel and BTEC Qualifications

Edexcel and BTEC qualifications are awarded by Pearson, the UK's largest awarding body. We provide a wide range of qualifications including academic, vocational, occupational and specific programmes for employers. For further information visit our qualifications websites at [www.edexcel.com](http://www.edexcel.com) or [www.btec.co.uk](http://www.btec.co.uk). Alternatively, you can get in touch with us using the details on our contact us page at [www.edexcel.com/contactus](http://www.edexcel.com/contactus).

## Pearson: helping people progress, everywhere

Pearson aspires to be the world's leading learning company. Our aim is to help everyone progress in their lives through education. We believe in every kind of learning, for all kinds of people, wherever they are in the world. We've been involved in education for over 150 years, and by working across 70 countries, in 100 languages, we have built an international reputation for our commitment to high standards and raising achievement through innovation in education. Find out more about how we can help you and your students at: [www.pearson.com/uk](http://www.pearson.com/uk)

January 2016

Publications Code IA042984

All the material in this publication is copyright

© Pearson Education Ltd 2016

## General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

## SECTION A

## 1(a)

	Debit	Credit
	£m	£m
(2) Property	40 ✓	
Revaluation Reserve		40 ✓
(3) Statement of Comprehensive Income (SOCl) / Retained Earnings	7 ✓	
Ordinary Share Dividend/Dividend Payable		7 ✓
Ordinary Share Dividend/Dividend Payable	7 ✓	
Bank		7 ✓
(4) General Reserve	25 ✓	
SOCl / Retained Earnings		25 ✓
(5) SOCl / Retained Earnings	30 ✓	
Capital Replacement Reserve		30 ✓
(6) SOCl / Retained Earnings	14 ✓	
Ordinary Share Capital £1		14 ✓

(12)

(b)

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	Revaluation Reserve ✓ £m	Total Equity £m
<b>Balance at 1 January 2015</b>	700	140	35	25		144		1 044 ✓
Comprehensive Income for the Year			(8) ✓					
Revaluation of property							40 ✓	
Final 2014 Dividend Paid in year			(7) ✓					
Transfer			25 ✓	(25) ✓				
Transfer			(30) ✓		30 ✓			
Bonus Issue of Ordinary £1 shares	14 ✓		(14) ✓					
<b>Balance at 31 December 2015</b>	714 of	140 ✓ (need 2) of	1 ✓ of	0 of	30 ✓ (need 2) of	144 of	40 ✓ (need 2) of	1 069 ✓ of

(16)

(c) Shares issued at premium of  $\frac{(140\text{m} \times 100)}{700\text{m}} \checkmark = 20\% \checkmark$

So X shares at 20% premium to give £144m

ie  $X \times 1.2 = £144\text{m}$   $X = \frac{£144\text{m}}{1.2} \checkmark = 120\text{m shares of } \checkmark$

(6)

(d) Answers could include:

(i) Increase in value of factory cannot be added to profit, ✓ because it is an unrealised gain. ✓ This would go against the concept/principles of realisation ✓ i.e. gain has not been realised until property is sold. ✓ Also goes against prudence. ✓ (4)

(ii) Cannot be used to distribute as a dividend ✓ as in a capital reserve. ✓ (2)

(e) Answers may include

For Bonus Issue

Company has few funds available for dividends. ✓ Only £15m o/f in the Retained Earnings available. ✓

Shareholders are kept happy / quiet ✓ as they would have received free shares ✓ and these shares are eligible for dividends in the future. ✓

Maximum in Revenue reserves ✓ available for dividend is

£15m o/f + £30m = £45m o/f ✓ but reluctant to pay the £30m in Capital Replacement ✓ as this is set aside to replace worn out machinery. ✓

Company may be short of liquid funds ✓ especially if they have made a loss. ✓

May attract new investors (if they hear about the bonus shares). ✓

Bonus shares could be lower in total than the dividend payable. ✓

Makes the company look stronger (SOFP) if shares issued from revenue reserves. ✓

Against Bonus Issue

Bonus shares bring in no cash for the company. ✓

Issue of bonus shares sees share price fall ✓ Shareholders will be unhappy. ✓

Bonus shares will result in more shares eligible for dividends in the future ✓ so greater future payouts, ✓ or dividend per share may fall. ✓

The £14m could be used to give a dividend ✓ of 2 pence per share. ✓

It is possible to pay 6.43 pence per share maximum ✓ as a dividend from Revenue Reserves. ✓

If bonus shares are paid from revenue reserves ✓ this means there will be less funds available for future dividends/emergencies. ✓

Shares may fall in value in the future due to e.g. economic reasons ✓ so shareholders will be unhappy.

Administration/professional costs will rise. ✓

Maximum of 8 ✓ for arguing one side.

Conclusion

Bonus issue may/may not be best option for company ✓✓

(12)

(Total: 52 marks)

<b>2(a)(i)</b>			<b>W1 Cost of Sales</b>			
<b>Statement of Comprehensive Income for</b>			Direct factory labour	1 007 000		
<b>Jessorre Carpets plc for y/e 31 December 2015</b>			Direct Materials	988 000	✓	need 2
			Less Discount Received	(42 000)	✓	
Revenue	5 472 000	✓	Factory Depreciation	39 000	✓	
			Machinery Depreciation	142 400	✓	
Cost of sales	(2 176 400)	✓ o/f	Inventory Adjustment	42 000	✓	
				2 176 400		<b>5 x ✓</b>
Gross profit	3 295 600	✓ o/f				
			<b>W2 Distribution Costs</b>			
Distribution costs	(2 539 320)	✓ o/f	Advertising	175 000	✓	
			Discount Allowed	105 000	✓	
Administrative expenses	(677 000)	✓ o/f	Rent on shop premises	424 000	✓	
			Depreciation on motor vans	39 600	✓	
Financial cost	(43 000)	✓ o/f	Sales Commission	54 720	✓	
			Transport costs	165 000	✓	
Profit on ordinary activities before tax	36 280	✓ o/f	Shop staff wages	135 7000		
			Transport staff wages	219 000	✓	need 2
Corporation tax	(10 000)	✓		2 539 320		<b>7 x ✓</b>
Profit on ordinary activities after tax	26 280	✓o/f	<b>W3Administrative Expenses</b>			
			Bad Debts Written Off	23 000	✓	
			Head office expenses	272 000	✓	
<b>Total 25 x ✓</b>	<b>9 x ✓</b>		Head office staff	382 000	✓	
				677 000		<b>3 x ✓</b>
			<b>W5 Financial cost</b>			
			Bank interest	43 000	✓	<b>1 x ✓</b>

<b>(a)(ii) Statement of Financial Position of</b>				
<b>Jesorre Carpets plc as at 31 December 2015</b>				
<b>ASSETS</b>				
<b>Non-current assets</b>				
Property, Plant & Equipment				
Buildings		1 474 000	✓ of	
Machinery		569 600	✓ of	
Motor vans		59 400	✓ of	
			2 103 000	
<b>Current Assets</b>				
Inventories		889 000	✓	
Trade and Other Receivables				
Trade receivables	241 000	✓		
Prepayments	24 000	✓		
		265 000		
Cash and Cash Equivalents				
Cash	38 000	✓		
		38 000		
			1 192 000	
<b>Total Assets</b>			<b>3 295 000</b>	
<b>EQUITY AND LIABILITIES</b>				
<b>Equity</b>				
Share Capital				
Ordinary shares of £0.25		2 000 000	✓	
Retained Earnings		786 500	✓ of	
			2 786 500	
<b>Non-Current Liabilities</b>				
Long Term Borrowings				
Long term bank loan	200 000	✓		
			200 000	
<b>Current Liabilities</b>				
Trade and other Payables				
Trade Payables	274 000	✓		
Other payables	19 000	✓		
		293 000		
Short Term Borrowings				
Bank		5 500	✓	
Current Tax Payable				
Corporation Tax Payable		10 000	✓	
			308 500	
<b>Total Equity and Liabilities</b>			<b>3 295 000</b>	✓ C

**Total 15 x ✓**



**2 (b)**

Answers may include:

Case For Directors' Report

- Report gives information to e.g. shareholders which they could use to make a decision ✓ e.g. invest more funds in the company. ✓
- Shareholders / readers may be assured the company is acting in an ethical manner. ✓
- Other stakeholders e.g. pressure group ✓ may use information in the Report to bring about change in company policy ✓ e.g. treatment of disabled. ✓
- Disclosures may be required under Stock Exchange regulations, ✓ which may be appropriate in the Directors' Report ✓ e.g. legislation pending. ✓
- The Director's Report could be considered part of the corporate governance. ✓
- Information is given to shareholders which allows them to see in some detail how the company is performing ✓
  - E.g. company performance/principal activities, ✓ review of the position of the business ✓
  - Post balance sheet events, ✓ future developments ✓
  - Names of directors, ✓ interests of directors ✓
  - Employee involvement, ✓ disabled employees policy ✓
  - Political ✓ and charitable donations ✓
  - Creditor payment policy, ✓ creditor payment days ✓

**(Maximum of 4 marks for listing of items contained in Report)**

Case Against Directors' Report

- Report costs personnel time ✓ to prepare and money to print etc. ✓
- Directors may use Report to "window dress" the accounts, ✓ ie give an inaccurate/unrealistic positive view of the company, ✓ as it is in their interest to do so. ✓
- There is a time delay before the Directors Report is published so events may have changed. ✓

Maximum 8 Marks for arguing one side only

Conclusion 2 Marks

Should relate to above points. E.g. Directors' Report is useful. ✓✓

**(12)**

**(Total: 52 marks)**

3

(a)

$$(i) \text{ Budgeted tap production} = (10 \times 40 \times 4 \times 3) \checkmark = 4\,800 \checkmark \quad (2)$$

$$(ii) \text{ Actual brass used in production} = \frac{\pounds 74\,664 \checkmark}{\pounds 3.05 \checkmark} = 24\,480 \text{ kgs } \checkmark \quad (3)$$

(iii) Total direct production labour cost :

Normal time	=	10 x 40 x 4 x £6.60	=	£10 560 $\checkmark$
Overtime	=	10 x 1 x 4 x £9.90	=	<u>£396 <math>\checkmark</math></u>
Total				£10 956 $\checkmark$ o/f

(3)

(b) (i)

$$\text{Materials usage variance} = (24\,000 \checkmark - 24\,480 \checkmark \text{ o/f}) \times \pounds 3.20 \checkmark$$

$$= \pounds 1\,536 \text{ Adverse } \checkmark \text{ o/f} \quad (4)$$

$$\text{Materials price variance} = (\pounds 3.20 \checkmark - \pounds 3.05 \checkmark) \times 24\,480 \checkmark \text{ o/f}$$

$$= \pounds 3\,672 \text{ Favourable } \checkmark \quad (4)$$

$$\text{Total materials variance} = (\pounds 1\,536 \text{ Adverse} + \pounds 3\,672 \text{ Favourable}) \checkmark \text{ o/f}$$

$$= \pounds 2\,136 \text{ Favourable } \checkmark \text{ o/f} \quad (2)$$

(ii)

$$\text{Labour efficiency variance} = (1\,600 \checkmark - 1\,640 \checkmark) \times \pounds 6.60 \checkmark$$

$$= \pounds 264 \text{ Adverse } \checkmark \quad (4)$$

$$\text{Labour rate variance} = (\pounds 6.60 \checkmark - \frac{\pounds 10\,956 \checkmark}{1\,640}) \times 1\,640 \checkmark$$

$$= \pounds 132 \text{ Adverse } \checkmark \quad (4)$$

$$\text{Total labour variance} = (\pounds 264 \text{ Adverse} + \pounds 132 \text{ Adverse}) \checkmark \text{ o/f}$$

$$= \pounds 396 \text{ Adverse } \checkmark \text{ o/f} \quad (2)$$

(c)

Sales	=	4 800 o/f x 39.96	=	£191 808 $\checkmark$ o/f
Less				
Materials Cost	=	£74 664 $\checkmark$		
Labour Cost	=	£10 956 $\checkmark$ o/f		
Fixed Cost	=	<u>£19 200 <math>\checkmark</math></u>		
				104 820
Profit	=	£86 988 $\checkmark$ o/f		

(5)

(d) Cost of producing one tap :

$$\text{Material cost} = 5 \times £3.20 = £16.00 \checkmark$$

$$\text{Labour cost} = \frac{£6.60}{3} = £2.20 \checkmark$$

$$\text{Fixed cost} = \frac{£19\,200}{4\,800 \text{ o/f}} = £4.00 \checkmark$$

$$\text{Total cost per tap} = £22.20 \checkmark \text{ o/f}$$

$$\text{Selling price per tap} = £39.96$$

$$\text{Mark-up per tap} = £17.76 \checkmark \text{ o/f}$$

$$\text{Mark-up percentage} = \left( \frac{£17.76 \text{ o/f}}{£22.20} \times 100 \checkmark \right) = 80\% \checkmark \text{ o/f}$$

(7)

(e)

Keeping the same percentage mark-up

FOR:

- Result will be a fall in price  $\checkmark$  of £0.65  $\checkmark\checkmark$  and this may lead to more customers  $\checkmark$  and an overall increase in sales revenue.  $\checkmark$
- New price may be below that of rival firms  $\checkmark$  which may be crucial if market is competitive.  $\checkmark$

AGAINST:

- The profit measured in £s per item sold will decrease  $\checkmark$  and this may reduce overall profit  $\checkmark$  even if more items are sold.  $\checkmark$
- Demand may be price inelastic,  $\checkmark$  and there may be only a small rise in demand if price falls.  $\checkmark$
- Price will be lower so consumers may think quality is lower.  $\checkmark$

Keeping the same selling price

FOR:

- Customers will not be aware of fall in production costs  $\checkmark$  so are unlikely to feel unhappy  $\checkmark$  especially given inflation/rising prices  $\checkmark$
- Profit will be higher  $\checkmark$  because costs are lower  $\checkmark$
- Easier to keep same selling price, inertia  $\checkmark$

AGAINST:

- Price could mean firm's price higher than rivals  $\checkmark$  so there may be a fall in customers  $\checkmark$

Maximum of 8  $\checkmark$  for one side of argument.

Conclusion

Keeping same percentage mark up is correct/incorrect  $\checkmark\checkmark$

(12)

(Total: 52 marks)

## SECTION B

4

<b>(a)</b>	
Fixed Costs	$\pounds(620 \times 12) + 560 \checkmark(\text{both}) + (275 \times 12) + (65 \times 12) \checkmark(\text{both})$ $= \pounds 12\,080 \checkmark$
Variable Costs	$= \pounds 30 \checkmark$
Contribution	$(\pounds 110 - \pounds 30) = \pounds 80 \checkmark \text{ o/f}$
Break-even point	$\frac{12\,080}{80} \checkmark \text{ o/f}$ $= 151 \checkmark \text{ o/f}$
	<b>8 marks</b>
<b>(b)</b> Sales	$240 \times \pounds 110 = \pounds 26\,400 \checkmark$
Less Fixed Costs	$= (\pounds 12\,080) \checkmark \text{ o/f}$
Less Variable Costs	$(240 \times \pounds 30) = (\pounds 7\,200) \checkmark \text{ o/f}$
= Profit	$= \pounds 7\,120 \checkmark \text{ o/f}$
<b>OR</b>	
Contribution x Sales	$(\pounds 80 \times 240) \checkmark = \pounds 19\,200 \checkmark \text{ o/f}$
Less fixed Costs	$(\pounds 12\,080) \checkmark \text{ o/f}$
= Profit	$\pounds 7\,120 \checkmark \text{ o/f}$
	<b>4 marks</b>

<b>(c)</b>	
Fixed Costs	$(\pounds 400 + \pounds 720) \checkmark + (40 \times 12) \checkmark = \pounds 1600 \checkmark \text{ o/f}$
Variable Costs	$= \pounds 30 \checkmark$
Contribution	$(\pounds 110 - \pounds 30) = \pounds 80 \checkmark \text{ o/f}$
Break-even point	$\frac{1600}{80} \checkmark \text{ o/f}$ $= 20 \checkmark \text{ o/f}$
	<b>8 marks</b>
<b>(d)</b> Sales	$96 \times \pounds 110 = \pounds 10\,560 \checkmark$
Less Fixed Costs	$= (\pounds 1\,600) \checkmark \text{ o/f}$
Less Variable Costs	$(96 \times \pounds 30) = (\pounds 2\,880) \checkmark \text{ o/f}$
= Profit	$= \pounds 6\,080 \checkmark \text{ o/f}$
<b>OR</b>	
Contribution x Sales	$(\pounds 80 \times 96) \checkmark = \pounds 7\,680 \checkmark \text{ o/f}$
Less fixed Costs	$(\pounds 1\,600) \checkmark \text{ o/f}$
= Profit	$\pounds 6\,080 \checkmark \text{ o/f}$
	<b>4 marks</b>

(e)

For closing shop and working from home

Break-even point is lower ✓ by 131 units o/f ✓ because fixed costs are much lower. ✓

It may be possible to build up sales ✓ by advertising and word of mouth recommendations etc. ✓

Flexibility/relax etc. working from home. ✓

For keeping shop open

Profit is higher (using 2015 figure) ✓ by £1 040 ✓ o/f.

Because the loan is paid off ✓ £3 300 interest will not be paid ✓ so profit is would be higher by £4 340 in 2016 ✓ which is more realistic.

Will need to buy a van for £4 000 if working from home. ✓

More chance of passing trade/ higher footfall ✓ as shop presence acts as an "advert" itself. ✓

Profit is more important than break-even. ✓✓

Margin of safety falls ✓ from 89 in 2015 (240-151) in the shop, to

76 (96-20) o/f if working from home in 2016 ✓

Maximum of 4 marks for argument of one side.

Conclusion

Should keep shop open ✓✓

(8)

(Total: 32 marks)

**5(a)** Budget Statement of Comprehensive Income for February

OUTPUT	<b>1400</b>	<b>1500</b>	<b>1600</b>	
Revenue	168 000 ✓	171 000 ✓	173 280 ✓	
Materials	33 600 ✓	30 600 ✓	27 744 ✓	
Labour	25 200 ✓	29 700 ✓	34 848 ✓	
Delivery	4 170 ✓	4 325 ✓	4 480 ✓	
Power	2 660 ✓	2 750 ✓	2 840 ✓	
Fixed Costs	26 800	26 800	26 800 ✓ (all three)	
Total Costs	92 430 ✓ o/f	94 175 ✓ o/f	96 712 ✓ o/f	
Profit	75 570 ✓ o/f	76 825 ✓ o/f	76 568 ✓ o/f	
				<b>22 marks</b>

**(b)**

Possible answers could include:

Allow good decision making ✓ as "like compared to like" e.g. similar output levels. ✓

May save time and money by allowing ✓ "Management by Exception" i.e. action only if a variance at that output level. ✓

Allows workforce to meet target for given output level ✓ so motivates workforce. ✓

**(2)****(c)**

Output of 1500 units may be the best ✓ as it gives the highest profit o/f ✓  
However, output of 1600 units probably means greatest market share ✓ and competitors will suffer. ✓

Output of 1 400 units gives the lowest figures for costs o/f ✓

1600 units gives lowest costs per unit ✓ at £60.45 o/f ✓ with 1400 the highest ✓ at £66.02 o/f ✓

1400 units gives the highest profit per ✓ unit at £53.98 o/f ✓ with 1600 the lowest ✓ at £47.86 o/f ✓

1600 units gives the highest factory capacity utilisation figure, ✓ which means not so many assets are being left idle ✓

Output may simply be determined by demand. ✓

Output at 1 600 may see benefits of economies of scale. ✓ for example, spreading the fixed costs over a larger output. ✓

Maximum of 4 marks for arguing for only one output level.

Conclusion

1500 units is the best output level as it gives the most profit – 2 marks

**(8)****(Total: 32 marks)**

## 6 (a) (i)

## Provision for Depreciation account

Date	Details	£000		Date	Details	£000	
Dec 31	Disposals	360	✓	Jan 1	Balance b/d	1 346	✓
Dec 31	Disposals	210	✓	Dec 31	Statement of Comprehensive Income	493	✓ o/f
Dec 31	Balance c/d	1 269	✓				
		1 839				1 839	✓ o/f

(6)

## (a) (ii)

Statement of Cash Flow for y/e 31 December 2015		
Cash Flows from operating activities		
Profit from operations (273 ✓ + 12 ✓ + 24 ✓)	309 000	
Add Depreciation	493 000	✓ o/f
Less Profit on Sale of Non-current Asset	(42 000)	✓
Add Loss on Sale of Non-current Asset	35 000	✓
Operating cash flow before working capital changes	795 000	✓ o/f
Decrease in inventories	31 000	✓
Less Increase in trade receivables	(66 000)	✓
Less Decrease in trade payables	(27 000)	✓
Cash generated from operations	733 000	✓ o/f
Less Interest Paid (12 ✓ + 24 ✓)	(36 000)	
Less Tax Paid	(323 000)	✓
Net Cash from Operating Activities	374 000	✓ o/f

(15)

## (b)

Items found in the Financing Activities section include:

Issue of shares, premium on share issue, issue of debenture, taking out a bank loan, redemption of shares, repayment of a bank loan, repayment of a debenture, dividends paid, (and can include interest paid). One ✓ per correct item.

(3)

(c)

**For statement**

Profit after interest was £273 000 ✓

Company has generated £374 000 o/f from Operating activities. ✓

Cash and cash equivalent has risen from (£121 000) to £139 000✓, a rise of £260 000✓

Financing activities show an inflow of £44 000. ✓

2014 current ratio is 1.69:1, acid ratio is 0.76:1 ✓

2015 current ratio is 2.05:1, acid ratio is 1.06:1 ✓ i.e. improved ✓

(or both current ratios correct = ✓ and both acid ratios = ✓)

**Against statement**

Financing activity shows a loan of £400 000 was taken out, ✓ which goes a long way to explain the improvement in liquidity in the year.✓

Cash flow used in Investing Activities was an outflow of £158 000 ✓, however this could generate future inflows. ✓

Cash and cash equivalents at the end of 2015 are not enough to pay the current tax bill, ✓ although the position was worse in 2014. ✓

Maximum of arguing for one side 4 marks

Conclusion

Company has done well and liquidity position has improved. – 2 marks

(8)

**(Total: 32 marks)**



## 7 (a)

<u>Sales</u>	<u>Flights</u>	<u>Passengers</u>	<u>Weeks</u>	<u>Sales Price</u>	<u>Total Revenue</u>
Year 1	220	X 150	X 52	X 0.52	=892 320 ✓
Year 2	240	X 150	X 52	X 0.52	=973 440 ✓
Year 3	240	X 150	X 52	X 0.55	=1 029 600 ✓
Year 4	260	X 150	X 52	X 0.55	=1 115 400 ✓
Year 5	260	X 150	X 52	X 0.58	=1 176 240 ✓
<u>Running costs</u>	<u>Cost</u>	<u>Weeks</u>	<u>Depreciation</u>	<u>Meal Cost</u>	<u>Cash Outflow</u>
Year 1	(6 750	X 52)	-235 000	+ 429 000	=545 000 ✓
Year 2	(6 750	X 52)	-235 000	+ 468 000	=584 000 ✓
Year 3	(6 950	X 52)	-235 000	+ 468 000	=594 400 ✓
Year 4	(6 950	X 52)	-235 000	+ 507 000	=633 400 ✓
Year 5	(6 950	X 52)	-235 000	+ 507 000	=633 400 ✓
<u>Net Cash Flow</u>	<u>Total</u>	<u>-</u>	<u>Net</u>		<u>Cumulative</u>
	<u>Revenue</u>	<u>Outflow</u>	<u>Cash Flow</u>		<u>Cash Flow</u>
Year 0					-2 000 000
Year 1	(892 320	-545 000)	=347 320	✓ o/f	-1 652 680
Year 2	(973 440	-584 000)	=389 440	✓ o/f	-1 263 240
Year 3	(1029 600	-594 400)	=435 200	✓ o/f	-828 040
Year 4	(1 115 400	-633 400)	=482 000	✓ o/f	-346 040
Year 5	(1 176 240	-633 400)	=542 840	✓ o/f	196 800

Payback period = 4 years  $(346\,040 \text{ o/f} \times 12) \div (542\,840) \checkmark = 4 \text{ years o/f } \checkmark 7.65 \text{ months } \checkmark \text{ o/f}$

(20)

## (b)

Gearing ratio =  $\frac{\text{Prior Charge Capital} \times 100}{\text{Capital Employed}} \checkmark = \frac{£1\,500\,000 \times 100}{£2\,000\,000} \checkmark = 75\% \checkmark \text{ o/f}$

(4)

(c)

For statement

The contract shows a positive cash flow every year. ✓

The contract makes a profit every year, ✓ even when depreciation is taken into account. ✓

The contract pays back in the fifth year. ✓

The contract has fixed prices agreed with the airline. ✓

As long as the airline stays in business the contract must be honoured by the airline ✓ therefore giving security to Gulf Catering. ✓

Against statement

Some figures are only estimates ✓ e.g. cost of producing meals. ✓

The gearing ratio at 75% is very risky ✓ because it is over 50%. ✓

The airline could go out of business, so contract will be worthless. ✓

Payback is after more than four years, which may be considered quite lengthy. ✓

Maximum 4 marks for arguing only one side of the contract.

Conclusion

Company probably is taking a risk ✓✓

(8)

(Total: 32 marks)

