Paper Reference(s)

WAC02/01

Pearson Edexcel

International Advanced Level

Accounting (Modular Syllabus)

Unit 2 – Corporate and Management Accounting

Wednesday 11 June 2014 – Morning

Source booklet for use with Questions 1 to 7.

Do not return the insert with the question paper.

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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1. Wavelength Asia plc produces satellite dishes at its factory. The satellite dishes are then delivered to the company's warehouse before sale to customers.

At 31 March 2014, the following balances were in the books.

	Debit £	Credit £
Bad debts	77 000	
Bank	125 000	
Bank loan interest	20 000	
Cash	27 000	
7.5% Debenture 2016		2 000 000
Direct materials	4 121 000	
Factory buildings at cost	2 800 000	
Factory buildings depreciation		112 000
Goodwill	800 000	
Interest on debenture	150 000	
Inventory at 1 April 2013	326 000	
Land at cost	3 100 000	
Marketing costs	759 000	
Motor vans at cost	124 000	
Motor vans depreciation		48 000
Office expenses	184 000	
Ordinary shares £1		2 258 000
Rent on warehouse premises	209 000	
Retained earnings		1 121 000
Revenue		8 653 000
Shipping costs	521 000	
Short-term bank loan		500 000
Trade payables		645 000
Trade receivables	556 000	
Wages	1 438 000	
	15 337 000	15 337 000

Additional information at 31 March 2014:

- Inventory £389 000
- Interest owing on bank loan £4 000
- Marketing costs include £250 000 paid in advance
- Wages include

	£
Direct factory labour	988 000
Office staff	294 000
Motor van drivers	156 000

- Assuming a nil residual value and using the straight line method
  - the factory buildings are to be depreciated over a 50 year life
  - the motor vans are to be depreciated over a four year life
- A Corporation tax provision to be made for £399 000, payable by 30 April 2014

Required:

(a) Showing all workings clearly, prepare for Wavelength Asia plc, in accordance with International Accounting Standard 1 (Revised), the:

(i) Statement of Comprehensive Income for the year ended 31 March 2014

(23)

(ii) Statement of Financial Position at 31 March 2014.

(17)

(b) Evaluate the financial performance of Wavelength Asia plc for the year ended 31 March 2014 and the financial position at 31 March 2014.

(12)

(Total 52 marks)

Answer space for question 1 is on pages 2 to 9 of the question paper.

Q1a Mark Scheme

Statement of Comprehensive Income for Wavelength Asia plc for Y/e 31st March 2014

Revenue	8653000	√
Cost of sales	5102000	√ o/f
Gross profit	3551000	√ o/f
Distribution costs	1426000	√ o/f
Administrative expenses	555000	√ o/f
Financial cost	174000	√ o/f
Profit on ordinary activities before tax	1396000	√ o/f
Corporation tax	399000	√
Profit on ordinary activities after tax	997000	√o/f
	9 x √	

Total 23 x √

W1 Cost of Sales

Direct Materials	4121000	√	
Factory Depreciation	56000	√	
Direct factory labour	988000	√	
Inventory Adjustment FG	-63000	√	
	5102000		**4 x** √

W2 Distribution Costs

Marketing	509000	√	
Rent on warehouse premises	209000	√	
Depreciation on motor vans	31000	√	
Shipping costs	521000	√	
Van driver wages	156000	√	
	1426000		**5 x** √

W3 Administrative Expenses

Bad Debts Written Off	77000	√	
Office expenses	184000	√	
Office staff	294000	√	
	555000		**3 x** √

W5 Financial cost

Interest on debenture	150000	√	
Interest on bank loan	24000	√	
	174000		**2 x** √

Statement of Financial Position of Wavelength Asia plc as at 31 March 2014

ASSETS						
Non-current assets						
Property, Plant & Equipment						
Land	3100000	√				
Buildings	2632000	√				
Motor vans	45000	√				
			5777000			
Goodwill			800000	√		
					6577000	
Current Assets						
Inventories			389000	√		
Trade and Other Receivables						
Trade receivables	556000	√				
Prepayments	250000	√				
			806000			
Cash and Cash Equivalents						
Bank	125000	√				
Cash	27000	√				
			152000			
					1347000	
Total Assets					7924000	
EQUITY AND LIABILITIES						
Equity						
Share Capital						
Ordinary shares of £1			2258000	√		
Retained Earnings			2118000	√ o/f		
					4376000	
Non-Current Liabilities						
Long Term Borrowings						
Debenture 7.5% 2016	2000000	√				
					2000000	
Current Liabilities						
Trade and other Payables						
Trade Payables	645000	√				
Loan Interest	4000	√				
			649000			
Short Term Borrowings						
Bank loan			500000	√		
Current Tax Payable						
Corporation Tax Payable			399000	√		
					1548000	
Total Equity and Liabilities					7924000	√o/f

Total 17 x √

1b Mark scheme

Strengths
Gross Profit is good √ at 41% of sales. √ (own figure applies)
Net Profit before tax is good √ at 16% of sales. √ (own figure applies)
Profit for this year added to retained earnings is £1million, √ nearly as much as all previous retained earnings. . √ (own figure applies)
Gearing is good . √ at 31.4% . √ (own figure applies)
ROCE = 25% √ which is very good √ (own figure applies)

Weaknesses
Current ratio is poor at 0.87:1 √ (own figure applies)
Acid ratio is poor √ at 0.62:1 √ (own figure applies)
Working capital is negative/poor √ at £ (201 000) √ (own figure applies)
Company has taken out a short term loan of £500 000 √ perhaps due to liquidity problems. √
Company has tax bill of £399 000 to pay in 30 days, √ but only £125 000 in the bank √

Maximum of 8 marks for arguing only one side.

Conclusion – 2 marks
Should relate to points made above.
Eg Wavelength Asia plc has had a good trading year √ but has liquidity problems √

12 marks

Total 52 marks

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Grecian Glass Limited has a factory, producing four glass products: vases, bowls, dishes and ornaments. Production is planned according to demand, and Grecian Glass Limited has seen demand increase. When production is planned for Week 16, Grecian Glass Limited does not have enough resources to meet all the orders in Week 16. Grecian Glass Limited is only able to operate the factory for 55 hours a week.

There are 11 skilled direct labour staff, each of whom could produce any of the four products and could each work a 55 hour week.

There are 14 machines each of which can produce any of the four products, each of which operate for 55 hours a week.

The same glass material is used for all four products. Glass materials for production are delivered in 10 kilogram blocks and placed on shelves in the stores. Three rows of five blocks are required to fill a shelf. At the start of Week 16, there are three shelves filled to capacity.

The following information is available for Week 16:

Product	Vases	Bowls	Dishes	Ornaments
Labour hours per unit	1.5	2	1	3
Machine hours per unit	1	2.5	1.5	3.5
Materials per unit (kilograms)	1.2	1.8	1.6	0.5
Variable costs per unit	£23	£35	£25	£30
Selling price per unit	£32	£45	£37	£41
Sales units	120	70	60	90

Required:

(a) If Grecian Glass Limited were to meet all the demand for Week 16, calculate the amount of input required for each product and in total for **each** of the following factors of production:

(i) Labour hours

(ii) Machine hours

(iii) Materials (kilograms)

(6)

(b) Calculate the total amount available for production in Week 16, for **each** of the following factors of production:

(i) Labour hours

(ii) Machine hours

(iii) Materials (kilograms)

(5)

(c) For **each** of the three factors of production (labour hours, machine hours and material in kilograms) calculate the shortage or excess for Week 16. State whether **each** factor of production is a limiting factor, or not a limiting factor, for Week 16.

(6)

(d) Calculate the optimum units of production in Week 16 of vases, bowls, dishes, and ornaments, to give the maximum contribution.

(15)

(e) Calculate the forecast profit for Week 16 at the optimum production level if fixed costs for Week 16 are £1 950.

(8)

At the start of Week 16 another business, Hellenic Design Limited, asks Grecian Glass Limited if it is interested in a regular contract.

Hellenic Design Limited will supply 50 ornaments a week to Grecian Glass Limited, at a price of £35 per item, for one year.

(f) Evaluate whether the directors of Grecian Glass Limited should accept the offer from Hellenic Glass Limited.

(12)

(Total 52 marks)

Answer space for question 2 is on pages 10 to 16 of the question paper.

Q2 Mark Scheme					
(a) Required for Production					
	Vases	Bowls	Dishes	Ornaments	Total
Labour hours required	180	140	60	270 √	650 √ o/f
Machine hours required	120	175	90	315 √	700 √ o/f
Materials required	144	126	96	45 √	411 √ o/f
					6 marks
(b) Available for Production					
Labour hours	11 x 55	605	√		
Machine hours	14 x 55	770	√		
Materials	3x5x3x10	√ √ 450	√		**5 marks**
	any two √				
(c) Limiting Factor	Required	Available	Difference		
Labour hours	650	605	-45	o/f √	Limiting √
Machine hours	700	770	70	o/f √	Not limiting √
Materials	411	450	39	o/f √	Not limiting √
					6 marks
(d) Optimum Production	Vases	Bowls	Dishes	Ornaments	
Selling price per unit	32	45	37	41	
Variable cost per unit	23	35	25	30	
Contribution	9 √	10 √	12 √	11 √	
Labour hours	1.5	2	1	3	
Contribution/Labour hours	6 √ o/f	5 √ o/f	12 √ o/f	3.67 √ o/f	
Order	2 o/f	3 √ o/f	1 o/f	4 √ o/f	
Production					
	Hours	Output			
Dishes	60	60	√ o/f		
Vases	180	120	√ o/f		
Bowls	140	70	√ o/f		
Ornaments	225 √	75	√ o/f		
	605				**15 marks**
(e) Forecast Profit		Contribution	Total		
Dishes	60	12	720	√ o/f	
Vases	120	9	1080	√ o/f	
Bowls	70	10	700	√ o/f	
Ornaments	75	11	825	√ o/f	
			3325	√ o/f	
		Fixed Costs	1950	√	
		Profit	1375	√o/f √ C	**8 marks**

Alternative Answer to 2e					
Sales	**Qty**	**Price**	**Revenue**		
Dishes	60	37	2220		
Vases	120	32	3840	√ o/f any two	
Bowls	70	45	3150		
Ornaments	75	41	3075	√ o/f any two	
				12285	
Var Costs					
Dishes	60	25	1500		
Vases	120	23	2760	√ o/f any two	
Bowls	70	35	2450		
Ornaments	75	30	2250	√ o/f any two	
				8960	
				3325	√ o/f
	Less	Fixed	Costs	1950	√
			Profit	1375	√ o/f √ C

2(f) Mark Scheme

For Accepting Offer
Grecian could buy for £35 and sell for £41 so making a profit / positive contribution √ of £6 per item. √ This may realise a total profit of £300 √ if all are sold. √
May allow Grecian to meet ALL orders promptly √ which keeps customers happy. √
Demand may increase still further, √ and Grecian can meet this increase. √
Avoid possible production problems √

Against Accepting Offer.
Marginal costing theory √would say do not accept buying for £35 when business can make for £30 √ as this would be £5 more expensive. √
Grecian are only 15 items short on meeting an order, √ so do not need 50 items, √ as this gives an extra 35 items. √
There may not be any demand for the extra 35 items. √
There may not be any storage space for the extra 35 items. √
The increase in demand for week 16 may be temporary√ so more than 35 items may be left unsold.√
Possible quality issues √
Hellenic are interested in a regular/long term contract which may be problematic √

Maximum of 8 marks available for giving one side of the argument.

Conclusion
Grecian Glass should / should not accept contract.

(12 marks)

Total 52 marks

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. The Statement of Changes in Equity of Barisal Industrials plc for the year ended 31 March 2014 is being prepared and is shown below.

Figures are in £ millions

	Ordinary Shares £1 Capital £	Share Premium £	Capital Redemption Reserve £	Retained Earnings £	General Reserve £	Foreign Exchange Reserve £	Total Equity £
Balance at 1 April 2013	1 100	300	50	623	85	20	2 178
(i)							
(ii)							
(iii)							
(iv)							
(v)							
(vi)							
Balance at 31 March 2014							

You are the Finance Director for Barisal Industrials plc.

Required:

(a) Complete the Statement of Changes in Equity in the Answer Booklet to show the figures for the following changes for the year ended 31 March 2014. You should show your workings in the lined space available.

(i) Comprehensive Income for the year ended 31 March 2014 was £348 million.

(ii) A sum of £35 million was transferred to the General Reserve from Retained Earnings.

(iii) The balance on the Foreign Exchange Reserve was transferred back to Retained Earnings.

(iv) In May 2013, the final dividend of 2.8 pence per Ordinary Share for the year ended 31 March 2013 was paid.

(v) In July 2013 80 million Ordinary Shares of £1 each, issued at a premium of 30 pence per share, were redeemed at the same price at which they were issued.

(vi) In October 2013, an interim dividend of 0.7 pence per Ordinary Share was paid.

(22)

Barisal Industrials plc redeemed some shares during the year.

(b) Explain:

(i) **two** advantages to a company of redeeming Ordinary Shares.

(ii) **two** disadvantages to a company of redeeming Ordinary Shares.

(8)

Over lunch, a new member of the Finance Department asks "What are the differences between reserves, provisions, and liabilities?"

Required:

(c) Explain the following terms, including how each is created:

(i) reserves

(ii) provisions

(iii) liabilities

(10)

At a board meeting, the Human Resources Director asked "Do you think the payment of the total dividend of 3.5 pence per share in the last financial year was generous?"

Required:

(d) On behalf of **the company**, evaluate whether the total dividend of 3.5 pence per share paid in the last financial year was generous.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 18 to 24 of the question paper.

Q3 Mark Scheme
(a)
Figures are in £ millions

	Ordinary Share £1 Capital	Share Premium	Capital Redemption Reserve	Retained Earnings	General Reserve	Foreign Exchange Reserve	Total Equity
Balance at 1 April 2013	1 100	300	50	623	85	20	2 178
(i)Comprehensive Income for the Year				348 √			348
(ii) Transfer				(35) √	35 √		- -
(iii) Transfer				20 √		(20) √	- -
(iv) Final dividend				(30.8)√√			(30.8) √ both
(v) Redemption of Shares	(80) √	(24) √	104 √√	(104) √√			(104)
(vi) Interim dividend				(7.14)√√			(7.14) √ both
Balance at 31 March 2014	1 020 o/f	276 √ both o/f	154 o/f	814.06 √o/f	120 √ both o/f	- -	2 384.06 √o/f √C

(22)

There are four occasions where the word 'both' is used in the mark scheme for Q3a.
The couplings are:

- Balance of share premium 276 goes with balance of ordinary share capital 1,020;
- Balance of general reserve 120 goes with balance of capital redemption reserve 154;
- Final dividend (30.8) in total equity column goes with comprehensive income 348 in total equity column; and
- Interim dividend (7.14) in total equity column goes with redemption of shares (104) in total equity column.

(b)

Advantages of redeeming shares:

Company may have excess/large amounts of cash, √ which they feel would be best used / no better use than redeeming shares. √
Less funds will have to be paid out in the future √ in terms of dividends. √
Certain ratios will improve, √ eg Return on Capital Employed, Earnings per share.√ (need one)
This will make managers and directors and company look better. √
The share price will rise√ as less shares are on the market. √

Disadvantages of redeeming shares:

Drain on company's liquid resources. √ ie cash and cash equivalents. √
Liquidity ratios will worsen. √ eg Current ratio, and Acid ratio √
Gearing ratio will worsen. √ as Debts is a larger percentage of capital employed. √
The company's Statement of Financial Position has a smaller equity base √ which gives the impression of a smaller company √

Maximum of 2 marks for each advantage and disadvantage.

(8)

(c)

Reserves

Revenue reserves √ are appropriation of retained profit ie created after net profit has been calculated. √ Eg General reserve √
Capital reserves √ may arise for a specific reason.√ Eg issuing shares at a premium, √ or revaluing a non-current asset, √ or redeeming own shares without an issue of new shares. √ (max 2 examples).

Provisions

Provisions are amounts set aside before arriving at net profit √ eg for depreciation.√ Provisions reduce the value of assets. √ The reason for the provision will be specific √ eg for damages in a court case, √ but the amount of the provision would be an estimate. √
Provisions follow the concept of prudence √
Provisions enable a true and fair view to be shown/using matching concepts √

Liabilities

Liabilities are debts that have been incurred by the business √ and must be paid. √
Short term (current) liabilities must be paid back within one year. √ Eg trade payables to suppliers.√
Long term liabilities are to be repaid in a term greater than one year. √ Eg long term bank loan. √

Maximum of 4 marks for each term, maximum of 10 for the section.

(10)

(d)

Dividend payment is generous
3.5% return on nominal value of share £1 √ may be higher than interest rate in a bank. √
May be higher than other companies. √
May be a good return for this industry. √

Dividend payment is not generous
3.5p may be a lower return than what could have been gained on a debenture √ or bond.√

Other factors (could appear on either side or argument)
Need to know the price paid/market price for the share, √ which will tell us the yield √ie true return on investment. √
Need to know the state of the world/national economy. √ If a boom year, then 3.5p is low. √ If a recession, 3.5p could be regarded as high. √
How does 3.5p compare to previous year's dividends? √ May be seen as higher or lower. √

Maximum of 8 √s for arguing one side.

Conclusion
3.5p dividend is/is not generous. √√

(12)

Total 52 marks

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. You are the Management Accountant for The Alexandria Sweet Company Limited, and are responsible for producing budgets and the variance analysis.

The following information applied to the Budget for the month of April 2014.

- Production and sales of sweet packets were expected to be 220 000 packets
- Selling price per packet is £0.35 (35 pence)
- Direct labour costs are 19 workers paid £8.50 per hour
- Variable overheads are budgeted at £10 460 for the month
- After deduction of material cost, labour cost, and variable overheads, a gross profit margin of 30% is expected
- After deduction of fixed overheads, a net profit margin of 8% is expected
- The factory operates for 40 hours a week, for 4 weeks per month

Required:

(a) Complete the Budget Statement of Comprehensive Income in column (a) of the table in the answer booklet for the month of April 2014.

(9)

The following actual information was available for April 2014.

- Production and sales quantities were 220 000, as budgeted
- A special promotion was in operation for one week and 55 000 packets were sold for £0.30 (30 pence) each
- All costs were as budgeted, except for the following:
  - A fall in the world price of sugar resulted in material costs falling by 12%
  - Trade unions obtained a pay rise to £8.75 per hour, for the last two weeks of April
  - Variable overheads included electricity, budgeted at £0.18 (18 pence) per unit of electricity. The actual price of electricity rose by £0.02 (2 pence) per unit of electricity. The amount of electricity used was the same as the budgeted figure, at 14 500 units of electricity
  - Fixed overheads included the salary of an Assistant Manager, who worked for one week in April and was paid for one week. She then left and was not replaced. The Assistant Manager was paid £24 000 per year

Required:

(b) Prepare the Actual Statement of Comprehensive Income in column (b) of the table in the answer booklet for the month of April 2014.

(11)

(c) Complete a Variance column in column (c) of the table in the answer booklet for the month of April 2014.

(4)

A member of staff states "I do not know why we bother drawing up budgets, because most of the figures in the Statement of Comprehensive Income are out of our business's control."

(d) Evaluate budgets as a management tool for control.

(8)

(Total 32 marks)

Answer space for question 4 is on pages 26 to 28 of the question paper.

Q4 Mark Scheme							
	(a)		**(b)**		**c**		
	BUDGET		ACTUAL		VARIANCE		
Sales	77000	√	74250	√√	2750	ADV	
Material	17600	√√	15488	√	2112	FAV	√ o/f(any two)
Labour	25840	√	26220	√√	380	ADV	
Variable Overheads	10460	√	10750	√	290	ADV	√ o/f(any two)
COGS	53900	√	52458	√	1442	FAV	
GrossProfit	23100	√	21792	√ o/f	1308	ADV	√ o/f(any two)
Fixed Overheads	16940	√	15440	√√ o/f	1500	FAV	
Net profit	6160	√	6352	√ o/f	192	FAV	√ o/f (any two)
	Marks	**9**		**11**			**4**

(d)
FOR Budgets as a tool for management control
Some costs are under management control √ eg rate paid to direct labour. √
Budgets allow business to see how a level of costs eg direct labour √ impacts on profit. √ This may result in management deciding on an appropriate level of pay rise. √
Variances can be analysed √ and remedial action taken. √
Budgets are good motivators √ especially where staff meet targets/bonus payments etc √
Budgets help coordination within the business √

AGAINST Budgets as a tool for management control
Some costs are out of management control √ eg commodity prices such as sugar. √
Some figures/costs may change, √ so drawing up budgets is a waste of time and money. √
Need to employ a specialist so wage rises √

Maximum of 4 √'s for arguing one side of argument.

Conclusion
Budgets are a useful tool for management control √√

8 marks

Total 32 Marks

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. The Statement of Cash Flows for Chang Tao Stores plc has been drawn up according to International Accounting Standard 7 (IAS7) and is shown below.

Statement of Cash Flow for Chang Tao Stores plc for year ended 31 March 2014		
	£ 000's	£ 000's
Cash Flows from operating activities		
Profit from operations	15 987	
Add depreciation on non-current assets	459	
Less profit on sale of non-current asset	(35)	
Operating cash flow before working capital changes	16 411	
Increase in inventories	(313)	
Decrease in trade receivables	348	
Decrease in trade payables	(274)	
Cash generated from operations	16 172	
Less interest paid: Bank overdraft	(76)	
Debenture	(480)	
Less tax paid	(3 409)	
Net Cash from Operating Activities		12 207
Cash Flows from Investing Activities		
Payments to acquire tangible non-current assets	(13 248)	
Payments to acquire shares in other companies	(20 570)	
Dividends received from shares in other companies	126	
Net Cash Used in Investing Activities		(33 692)

Cash Flows from Financing Activities		
Issue of Ordinary Shares	9 000	
Issue of Debenture	12 000	
Dividends paid: Final 2013	(286)	
Interim 2014	(140)	
Preference	(100)	
Net Cash from Financing Activities		20 474
Net decrease in cash and cash equivalents		(1 011)
Cash and cash equivalents at the beginning of the year		2 106
Cash and cash equivalents at the end of the year		1 095
Net decrease in cash and cash equivalents		(1 011)

Required:

(a) Prepare answers to the following:

(i) Explain why an adjustment for depreciation charged is added in a Cash Flow statement.
(2)

(ii) Plant was the only non-current asset sold in the year, for £120 000. State the book value of the plant when sold.
(2)

(iii) At the start of the year on 1 April 2013, unsold goods were valued at £983 000. State the value of unsold goods at the end of the year.
(2)

(iv) Explain why the figure given for 'Decrease in Trade Receivables' is plus 348 and not minus 348.
(2)

(v) Suppliers were owed £1 084 000 at the end of the year. Calculate the amount owed to suppliers at the start of the year.
(2)

(vi) The debenture was issued on 1 August 2013. Interest is paid every six months, in January and July. Calculate the interest rate on the debenture.
(5)

(vii) The debenture is "secured on property" purchased on 1 August 2013. Explain what this means for Chang Tao Stores plc.

(2)

(viii) Explain why the Final Dividend for the year ended 31 March 2014 is **NOT** included in the Cash Flow statement for the year ended 31 March 2014.

(1)

(ix) At 1 April 2013, Chang Tao Stores plc had a bank balance of £209 000. Calculate how much cash Chang Tao Stores plc had at 1 April 2013.

(2)

(x) At 1 April 2014, Chang Tao Stores plc had an overdraft of £178 000. Calculate the exact movement on the cash balances during the year.

(4)

(b) Evaluate the performance of Chang Tao Stores plc concerning **liquidity**, over the financial year ended 31 March 2014.

(8)

(Total 32 marks)

Answer space for question 5 is on pages 29 to 32 of the question paper.

Q5 Mark Scheme
(a)
(i) Depreciation is a non cash item, √ which has been deducted from profit. √ **(2)**

(ii) (£120 000 - £35 000) √ = £85 000 √ **(2)**

(iii) (£983 000 + £313 000) √ = £1 296 000 √ **(2)**

(iv) The amount owed by customers has decreased,√ so this represents an increase in cash inflow √ **(2)**

(v) (£1 084 000 + £274 000) √ = £1 358 000 √ **(2)**

(vi) First interest payment made after 6 months, of £480 000√ Total for year would be £960 000 √

$\frac{£960\ 000\ \surd}{£12\ 000\ 000\ \surd} \times 100 = 8\%\ \surd$ **(5)**

(vii) If Chang Tao Stores plc fail to pay the interest due, or repay the debenture when due or go into liquidation √ , the debenture holders can take over the property. √ **(2)**

(viii) Because it has not been paid yet. √ **(1)**

(ix) (£2 106 000 - £209 000) √ = £1 897 000 √ **(2)**

(x) Year end cash balance = (£1 095 000 + £178 000) √ = £1 273 000 √
Yearly movement = (£1 897 000 - £1 273 000) √ = £624 000 decrease √ **(4)**

(b)
Liquidity handled well
Positive cash and cash equivalent balances √ at start and end of year. √
Payments to purchase shares in other companies,√ seemed to have been almost entirely financed by issue of shares and debentures √ (long term finance). √
Operations are making a profit and generating funds. √
Low level of dividends √ appear to have been paid, so cash not leaving the company. √

Liquidity not handled well
Cash and cash equivalents has decreased over the year. √ Fall in cash is worrying √ , especially as company has stores, which should be taking in cash. √
Issue of shares and debentures √ not quite enough to finance purchase shares in other companies. √
All of Net cash from Operating activities may have been used buying non-current assets√

Maximum of 4 marks for arguing one side.

Conclusion
Liquidity has been handled well/badly √√

8 marks

Total 32 marks

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. You are the accountant for Wilson Onyango Tailoring, which rents four shops, selling made-to-measure suits. The made-to-measure suits are a luxury item, and trade may fluctuate according to the state of the economy. The last year has seen difficult trading conditions, and next year is expected to be the same. As a result, the owner of the business, Wilson Onyango, has asked you to carry out a financial review for the year ended 31 March 2014.

For the year ended 31 March 2014, the four shops have identical costs, which are:

- Material costs per suit £78
- Direct labour costs per suit £95
- Rent for each shop £3 375 per quarter (three months)
- Other fixed costs £1 115 per month per shop
- Insurance for the **whole business** £184 per month

Other information available for the year ended 31 March 2014:

- Suits are only made to order. All suits made are sold, and no inventories of suits are held
- Each suit sells for £250
- Total number of suits for all four stores sold in year is 1 400

Required:

(a) As part of the financial review, prepare:

(i) the Statement of Comprehensive Income for the **whole business** for the year ended 31 March 2014.

(4)

(ii) calculations to find the break-even point, in sales units, for the year ended 31 March 2014.

(4)

Wilson Onyango decided to close one of the shops on 1 April 2014. The effects of this were:

- Rent and other fixed costs **for the store closed** would no longer apply
- No extra fixed costs would be allocated to the remaining three stores
- Insurance for the whole business would be £170 per month
- Sales in all three stores would fall to 1 350 per year in total
- All other costs and revenues remain the same

Required:

(b) As a further part of the financial review, prepare:

(i) the forecast Statement of Comprehensive Income for the year ended 31 March 2015
(4)

(ii) calculations to find the forecast break-even point, in sales units, for the year ended 31 March 2015
(4)

(iii) calculations to find the forecast margin of safety, measured in sales units, for the year ended 31 March 2015
(2)

Wilson Onyango likes to see the figures presented graphically.

Required:

(c) On the grid in your answer booklet, mark on the following for the year ended 31 March 2015:

- Fixed costs
- Total costs
- Sales revenue
- Break-even point
- Margin of safety, measured in sales units, if sales are 1 350 units
- Indicate the area of profit if sales are 1 350 units

(6)

(d) Evaluate the decision of Wilson Onyango to close one of the stores for the year ended 31 March 2015.
(8)

(Total 32 marks)

Answer space for question 6 is on pages 33 to 38 of the question paper.

Q6 Mark Scheme

(a) (i)

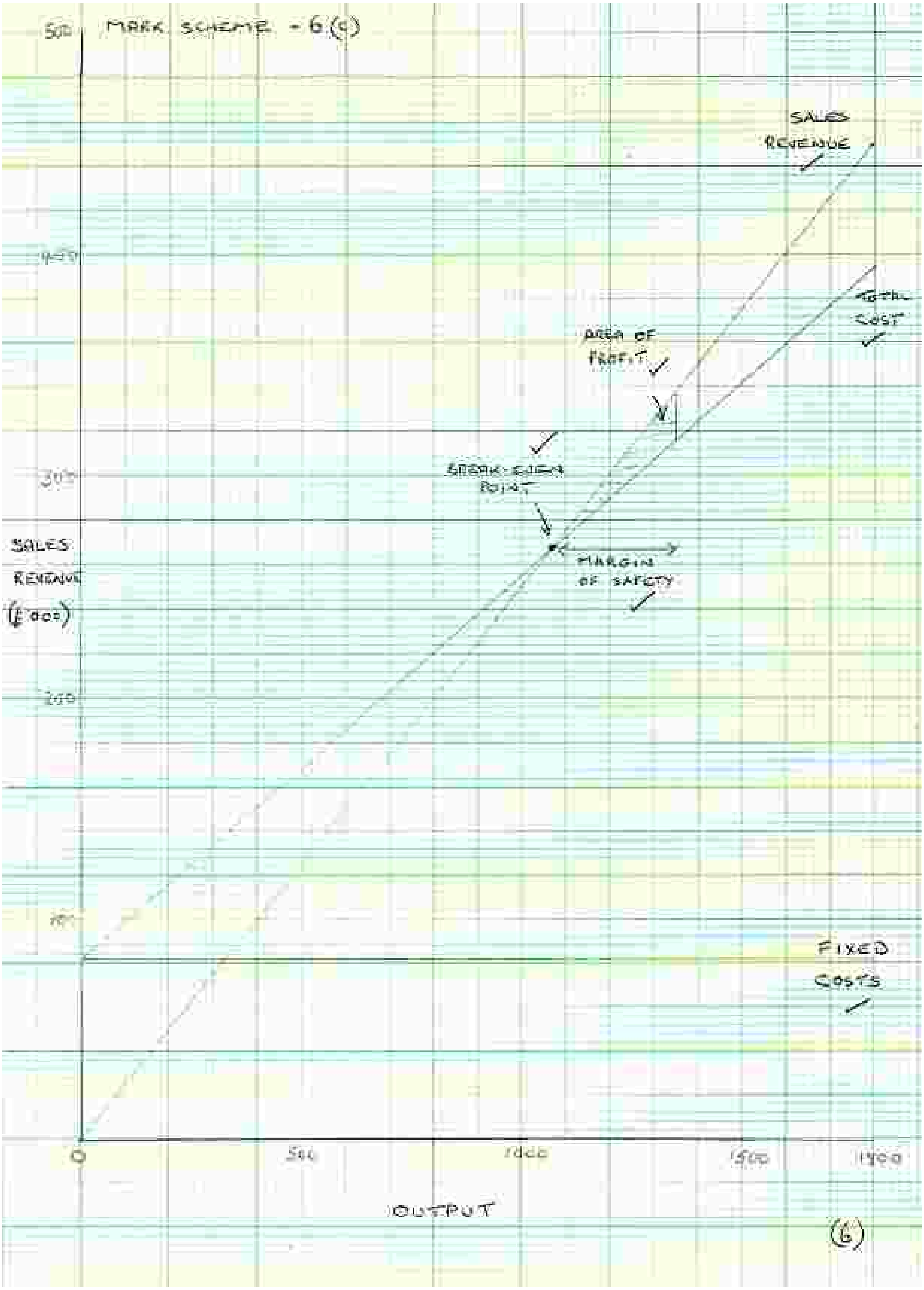
Statement of comprehensive Income					
Sales	250		1400	350000	
Less					
Material Costs	78		1400	109200	√ any two
Direct Labour	95		1400	133000	
Rent	3375		16	54000	√ any two
Other Fixed Costs	1115		48	53520	
Insurance	184		12	2208	√ any two
Total Costs				351928	
Profit/(Loss)				-1928	√ o/f
(a) (ii)					4 marks
BEP	109728	√o/f	1425	√√ o/f	
	77	√			4 marks

(b) (I)

Statement of comprehensive Income					
Sales	250		1350	337500	
Less					
Material Costs	78		1350	105300	√ any two
Direct Labour	95		1350	128250	
Rent	3375		12	40500	√ any two
Other Fixed Costs	1115		36	40140	
Insurance	170		12	2040	√ any two
Total Costs				316230	
Profit/(Loss)				21270	√ o/f
					4 marks

(b) (ii)

BEP	82680	√o/f	1074	√√ o/f	
	77	√			4 marks
(b) (iii)					
Margin of Safety	1350		-1074	√ o/f 276	√ o/f
					2 marks


MARK SCHEME - 6 (c)
500
400
300
200
100
0
SALES REVENUE (£ 000)
SALES REVENUE
TOTAL COST
AREA OF PROFIT
BREAK-EVEN POINT
MARGIN OF SAFETY
FIXED COSTS
500
1000
1500
1900
OUTPUT
(6)

6d Mark scheme

FOR Closing store
Loss turns into a profit, √ an improvement of £23 198 √ on the bottom line.
Break even point is lower √ by 351 units. √
Business may be leaner/lower fixed cost base √ which helps when trading is difficult. √
Margin of safety is now 276 units whereas before breakeven point was not reached √

AGAINST Closing Store
Sales in units have fallen √ by 50 units. √
Business has less store outlets √ to take advantage of upturn in trading conditions. √
Possible redundancy costs √
Figures are only predictions √

Maximum of 4 √'s for arguing one side.
Conclusion
Store should close √√

(8)

Total 32 marks

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. The Bengal Bay Metal Company plc produces tin cans. The directors have decided to build a new factory, and have to choose between two possible locations, Amillakat and Barigong. The directors have decided to evaluate the forecast figures for the next five years, in order to choose the better location.

The following information is available concerning the two locations.

Amillakat

- Location is in an industrial area, away from housing
- Cost of factory £22 million
- Running costs per year £5 million, which includes £800 000 of depreciation per year

Barigong

- Location is in the city centre, near housing area
- A grant is available which reduces the cost of the factory to £16 million
- Running costs per year £6.7 million, which includes £900 000 of depreciation per year

Sales will be 565 million tin cans per year, at a price of £0.02 (2 pence) per can, regardless of which location is selected.

The cost of capital for the factory will be 7%. A table of discount factors for 7% is given below.

Year	Discount Factor
1	0.935
2	0.873
3	0.816
4	0.763
5	0.713

Required:

(a) Explain the following accounting terms:

(i) payback period

(ii) accounting (average) rate of return

(iii) internal rate of return.

(6)

(b) Calculate the Net Present Value of the factory at each location after five years of operation.

(18)

(c) Evaluate the two possible locations on which to build the new factory.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 39 to 42 of the question paper.

Q7a Mark scheme

(i) the payback period is the length of time taken to recover √ the initial cost of an investment √

(ii) the accounting (average) rate of return is the profit as a percentage of the cost of the investment √ over the life of the investment √

(iii) the internal rate of return shows the true return of the investment √ expressed as a percentage √ OR
the cost of capital √ when the net present value is equal to zero √

(6)

(b)									
					Net cash		Discount	Discounted	
Amillakat	Inflow		Outflow		flow		Factor	Cash Flow	
Year 0			22		-22		1	(22.0000)	√
Year 1	11.3	√√	4.2	√√	7.1	√ o/f	0.935	6.6385	
Year 2	11.3		4.2		7.1		0.873	6.1983	√ o/f (2)
Year 3	11.3		4.2		7.1		0.816	5.7936	
Year 4	11.3		4.2		7.1		0.763	5.4173	√ o/f (2)
Year 5	11.3		4.2		7.1		0.713	5.0623	√ o/f
Total								7.1100	√ o/f
					Net cash		Discount	Discounted	
Barigong	Inflow		Outflow		flow		Factor	Cash Flow	
Year 0			16		-16		1	(16 0000)	√
Year 1	11.3		5.8	√√	5.5	√ o/f	0.935	5.1425	
Year 2	11.3		5.8		5.5		0.873	4.8015	√ o/f (2)
Year 3	11.3		5.8		5.5		0.816	4.4880	
Year 4	11.3		5.8		5.5		0.763	4.1965	√ o/f (2)
Year 5	11.3		5.8		5.5		0.713	3.9215	√ o/f
Total								6.5500	√ o/f
								18 marks	
-									

Q7c Mark scheme

For Amillakat

Profitability Index						
Amillakat	7.11	√ o/f x	100		32.32	√ o/f
	22	√				

Has largest NPV √ by £0.56 million. √

Location of Barigong in city centre √ but Amillakat more environmentally friendly. √

Does company have to follow any obligations due to grant at Barigong? √

For Barigong

Profitability Index						
Barigong	6.55	√ o/f x	100		40.94	√ o/f
	16	√				

Has greater Profitability Index √ by 8.62 √
Grant is available so cost reduced.√

Other points
Figures are only predictions √
Other investment appraisal methods should be applied eg payback period √
What happens after five years? √

Maximum of arguing one side only 4 √

Conclusion (2 √√'s)
P.I. index states should choose Barigong √√ OR
Other factors may favour Amillakat √√

8 marks

Total 32 marks