Paper Reference(s)

6002/01

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary/Advanced Level

Unit 2 – Corporate and
Management Accounting

Thursday 16 June 2011 – Morning

Source booklet for use with Questions 1 to 7.

Do not return the insert with the question paper.

Printer's Log. No.
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Turn over

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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1. Orion plc produces mobile phones at its factory. The mobile phones are then delivered to Orion plc shops, where they are sold to customers.

At 31 March 2011, the following were some of the balances in the books:

	Debit £	Credit £
Advertising and promotions	147 500	
Bad debts	16 000	
Canteen net income		189 320
12.5% Debentures 2017		1 250 000
Direct labour	985 430	
Direct materials	734 250	
Directors' salaries	226 000	
Discount on sales	414 750	
Factory rent	442 000	
Factory machinery at cost	685 000	
Motor lorries expenses	176 400	
Income received from shares and securities		23 450
Interest on bank balance		7 250
Research and development	760 000	
Shop premises at cost	2 300 000	
Rent received		27 000
Revenue (sales) turnover		5 723 000
Inventory (stock) of finished goods at 1 April 2010	121 000	
Inventory (stock) of work in progress at 1 April 2010	79 500	
Wages	555 000	

Additional information at 31 March 2011:

(i) Directors' salaries include:

Finance director	£74 000
Sales director	£81 000
Production director	£71 000

(ii) Assuming a nil residual value in each case and using the straight line method:
- factory machinery is to be depreciated over an 8 year life
- shop premises are to be depreciated over a 50 year life.

(iii) Factory rent includes £34 000 paid in advance.

(iv) Inventory (Stock) of finished goods £116 250
Inventory (Stock) of work in progress £86 700

(v) Wages include:

Office staff	£246 000
Shop sales staff	£187 000
Lorry drivers	£122 000

(vi) A provision for corporation tax is to be made for £275 000.

Required:

(a) Prepare for Orion plc, for the year ended 31 March 2011, **EITHER**:

- The profit & loss account using Format 1 as required by the Companies Act 1985 **OR**
- The statement of comprehensive income as required by International Accounting Standards (IAS 1)

You must clearly state which one of the methods you have chosen.

You must show all workings clearly labelled in arriving at your figures.

Note:
- There is no need to show any of the notes required by the Companies Act 1985 or International Accounting Standards.
- Ignore all the exemptions permitted for small and medium sized companies.

(40)

(b) Evaluate the importance of sending a copy of the financial statements of a public limited company to shareholders at the end of the financial year.

(12)

(Total 52 marks)

Answer space for question 1 is on pages 2 to 7 of the question paper.

Question Number	Answer							Mark
1(a)	**Q1 Mark Scheme** **Profit and Loss Account for Orion plc for Y/e 31st March 2011**			**W1 Cost of Sales**				
				Direct Labour	985430	√		
				Direct materials	734250	√		
	Turnover	5723000	√	Factory Rent	408000	√√	**12 x** √	
				Machinery Depreciation	85625	√√		
	Cost of sales	3041855	√ o/f	Production Director	71000	√		
				Research and Development	760000	√		
	Gross profit	2681145	√ o/f	Stock Adjustment Finished Goods	4750	√√		
				Stock adjustment WIP	-7200	√√		
	Distribution costs	1174650	√ o/f		3041855			
	Administrative expenses	336000	√ o/f	**W2 Distribution Costs**				
				Advertising and promotions	147500	√		
	Other operating income	216320	√ o/f	Discount on sales	414750	√		
				Motor Lorries expenses	176400	√		
	Other Investment Income	23450	√	Shop Premises Depreciation	46000	√√		
				Lorry Drivers Wages	122000	√		
	Interest Receivable	7250	√	Shop staff wages	187000	√	**8 x** √	
				Sales Director	81000	√		
	Interest payable	156250	√ o/f		1174650			
	Profit on ordinary activities before tax	1261265	√ o/f	**W3Administrative Expenses**				
				Bad Debts Written Off	16000	√		
	Corporation tax	275000	√	Office staff wages	246000	√	**3 x** √	
				Finance Director	74000	√		
	Profit on ordinary activities after tax	986265	√o/f√C		336000			
				W4 Other Operating Income				
		13 x	√	Canteen sales	189320	√		
				Rent Received	27000	√	**2 x** √	**(40)**
					216320			
				W4 Interest Payable				
				Debenture	156250	√√	**2 x** √	
				TOTAL 40 marks				

Income Statement for Orion plc for Y/e 31 March 2011√

Turnover	5723000	√
Cost of sales	3041855	√ o/f
Gross profit	2681145	√ o/f
Other Income	247020	√ o/f
Distribution costs	1174650	√ o/f
Administrative expenses	336000	√ o/f
Other expenses		
Financial cost	156250	√ o/f
Profit on ordinary activities before tax	1261265	√o/f √C
Corporation tax	275000	√
Profit on ordinary activities after tax	986265	√o/f √C

Question Number	Answer	Mark
1(b)	**FOR Usefulness/ Importance** Legally the shareholders must receive a copy/or have copy made available of the accounts √ and they can see how the funds they have invested are being used/ how company is performing √ Shareholders may be happy (or unhappy) with the performance of the company √ and may decide to buy more (sell) shares. √ Accounts are prepared in standard format √ which allows shareholders to compare the accounts of one company with another.√ E.g for investment potential. √ **AGAINST Usefulness/Importance** Preparing the accounts is time consuming, √ and time means money. √ Expenses associated with preparation and sending eg printing costs √ and postage. √ However shareholders could be sent an abridged (smaller) version of the accounts √ which are much cheaper. √ Some figures are estimates √ e.g. Depreciation √ Some shareholders will not understand the accounts √ as they have little accounting knowledge √ The accounts may not be totally reliable √ e.g. due to ‘window dressing’, fraud etc √ Maximum of 8 √ marks for argument on one side **CONCLUSION** Should relate to points made above. Eg It is important they receive a copy of the accounts. √√	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Lifecare plc provides private nursing homes for elderly people. The directors are considering the possibility of opening a new nursing home, at a cost of £2.5 million.

The finance director is considering two possible options to finance the new nursing home. The details are shown below.

Option A	£	Interest rate/ Expected return
Debenture	500 000	15%
Bank loan	200 000	12.5%
Preference shares	300 000	10%
Ordinary shares	1 500 000	8%
Total	2 500 000	

Option B	£	Interest rate/ Expected return
Debenture	1 000 000	14%
Bank loan	500 000	11%
Preference shares	500 000	9%
Ordinary shares	500 000	7%
Total	2 500 000	

Required:

(a) For each option, calculate the weighted average cost of capital.
(12)

(b) (i) Select the best finance option for the directors of Lifecare plc.
(2)

(ii) State **one** reason for your choice of finance option.
(2)

(c) Explain to a potential investor the difference between ordinary shares and preference shares.
(8)

The following figures are estimated for the nursing home:

- In the first year, the home will care for 40 people a week, each paying £650 a week.
- In years 2, 3 and 4, the home will care for 50 people a week, each paying £675 a week.
- In years 1 and 2, running costs (including depreciation) will be £30 000 a week.
- In years 3 and 4, running costs (including depreciation) will be £33 000 a week.
- Depreciation will be £750 000 per year for the first four years.
- Assume 52 weeks in a year
- Lifecare plc has a company policy that requires investments to have a positive net present value within four years.

Required:

(d) Calculate the Net Present Value of the project at the end of year 4.

(16)

A table showing the discount factors is given.

Year	8%	9%	10%	11%	12%	13%
1	0.926	0.917	0.909	0.901	0.893	0.885
2	0.857	0.842	0.826	0.812	0.797	0.783
3	0.794	0.772	0.751	0.731	0.712	0.693
4	0.735	0.708	0.683	0.659	0.636	0.613

(e) Evaluate the opening of the new nursing home for Lifecare plc, using the calculations made, and considering any other relevant factors.

(12)

(Total 52 marks)

Answer space for question 2 is on pages 8 to 11 of the question paper.

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>2(a)</td><td>
<table>
<tr><th>Option A</th><th>£</th><th>Interest Rate/ Expected return</th><th>Interest</th><th></th></tr>
<tr><td>Debenture</td><td>500 000</td><td>15.0%</td><td>75 000</td><td>need</td></tr>
<tr><td>Bank Loan</td><td>200 000</td><td>12.5%</td><td>25 000</td><td>✓ both</td></tr>
<tr><td>Preference Shares</td><td>300 000</td><td>10.0%</td><td>30 000</td><td>need</td></tr>
<tr><td>Ordinary Shares</td><td>1 500 000</td><td>8.0%</td><td>120 000</td><td>✓ both</td></tr>
<tr><td>Total</td><td>2 500 000</td><td></td><td>250 000</td><td>✓</td></tr>
</table>
WACC = $\frac{\pounds 250\,000 \checkmark}{\pounds 2\,500\,000 \checkmark}$ x 100 = 10% ✓
<table>
<tr><th>Option B</th><th>£</th><th>Interest Rate/ Expected return</th><th>Interest</th><th></th></tr>
<tr><td>Debenture</td><td>1 000 000</td><td>14.0%</td><td>140 000</td><td>need</td></tr>
<tr><td>Bank Loan</td><td>500 000</td><td>11.0%</td><td>55 000</td><td>✓ both</td></tr>
<tr><td>Preference Shares</td><td>500 000</td><td>9.0%</td><td>45 000</td><td>need</td></tr>
<tr><td>Ordinary Shares</td><td>500 000</td><td>7.0%</td><td>35 000</td><td>✓ both</td></tr>
<tr><td>Total</td><td>2 500 000</td><td></td><td>275 000</td><td>✓</td></tr>
</table>
WACC = $\frac{\pounds 275\,000 \checkmark}{\pounds 2\,500\,000 \checkmark}$ x 100 = 11% ✓
</td><td>(12)</td></tr>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>2(b)</td><td>(i) Lifecare plc should choose Package A ✓✓ o/f
(ii) This is because the Cost of Capital is lower than B ✓✓</td><td>(4)</td></tr>
</table>

Question Number	Answer	Mark
2(c)	**Answers could include:** **Ordinary shares** Usually one vote per ordinary share held. √ at AGM /shareholders meetings. √ Dividend per year is not fixed, √ but varies according to performance. √ Last in the queue when dividends paid out of profits. √ Last in the queue for payments √ if a company is wound up. √ **Preference shares** Usually no votes to preference shareholders. √ Dividend per year is usually fixed, √ despite performance √ Before Ordinary shareholders in the queue when dividends paid out of profits. √ Before Ordinary shareholders in the queue for payments √ if a company is wound up. √ **Max 4 marks each**	**(8)**

Question Number	Answer	Mark
2(d)	Year 1 Inflow = 40 x 650 x 52 = £1 352 000 √ Year 2 Inflow = 50 x 675 x 52 = £1 755 000 √	**(16)**

				Discount	Discounted Net	
Year	Inflow	Outflow	Net Cash Flow	factor	Cash flow	
0		(2500000)		1	(2500000)	√
1	1352000	810000 √√	542000 √o/f	0.909	492678	√ /of
2	1755000	810000	945000 √o/f	0.826	780570	√ o/f
3	1755000	966000 √√	789000 √o/f	0.751	592539	√ o/f
4	1755000	966000	789000	0.683	538887	√ o/f
					(95326)	√ o/f √ C

Question Number	Answer	Mark
2(e)	**Apply own figure rule throughout** **Case For Project** Figures are estimates √ could be greater profits. √ Need to apply other Investment Appraisal techniques √ eg Payback method √ Positive cash flow in every year √ NPV will be positive in Year 5 √ Could challenge the company policy √ of positive NPV after 4 years √ **Case Against Project** NPV is negative after 4 years √ so do not invest. √ in accordance with company policy. √ Figures are only estimates √ could be less profits. √ Maximum of 8 √ for arguing one side only **Conclusion** 2 √√ Should (not) go ahead with project	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. Arkotari Limited is a car hire company. It has a fleet of cars for customers to hire. The statements of financial position (balance sheets) of Arkotari Limited at 31 March 2010 and 31 March 2011 were as follows:

	31 March 2010 £	31 March 2011 £
Non-Current (Fixed) Assets		
Non-Current (Fixed) assets at cost	900 000	600 000
Provision for depreciation	(320 000)	(200 000)
Non-Current (Fixed) assets net book value	580 000	400 000
Current assets		
Inventories (Stock)	43 000	37 750
Trade receivables (Debtors)	5 100	6 200
Bank	-------------	------------
Cash	5 460	4 975
	53 560	48 925
Current liabilities		
Trade payables (Creditors)	(16 720)	(21 340)
Taxation due	(6 750)	(2 345)
Proposed dividends	(5 000)	(4 000)
Bank overdraft	(12 880)	(18 780)
	(41 350)	(46 465)
Non-Current (Long term) liabilities		
12% Bank loan	(100 000)	-----------
Net assets	492 210	402 460
Equity (Share capital and reserves)		
Ordinary shares of £1 each	300 000	200 000
6% Preference shares of £1 each	100 000	100 000
Capital redemption reserve	----------	100 000
General reserve	50 000	----------
Profit and loss reserve	42 210	2 460
Total Equity (Share capital and reserves)	492 210	402 460

Balances contained in the profit & loss appropriation account for the year ended 31 March 2011 included the following:

	£
Net operating profit	22 595
Taxation	(2 345)
Profit after tax	20 250
Transfer from General reserve	50 000
Transfer to Capital redemption reserve	(100 000)
Dividends	(10 000)
Retained earnings b/f	42 210
Retained earnings c/f	2 460

Additional information relating to the year ended 31 March 2011:

(i) At 31 March 2010, dividends of £3 000 were owed to preference shareholders. These were paid during May 2010.

(ii) On 1 April 2010, motor cars which cost £350 000, with a book value of £200 000, were sold for £150 000.

(iii) On 30 June 2010, the bank loan was repaid in full.

(iv) A transfer from the General reserve of £50 000 was made.

(v) A computer system worth £50 000 was bought and paid for.

(vi) On 1 October 2010, 100 000 £1 Ordinary shares were redeemed.

- An interim dividend of £3 000 was paid to Preference shareholders during October 2010.
- An interim dividend was paid to Ordinary shareholders during October 2010.
- No final dividends for the year ended 31 March 2011 have been paid to any shareholders.

(vii) Interest on the bank overdraft for the year was £3 270.

Required:

(a) A statement reconciling the net operating profit to the net cash flow from operating activities for the year ended 31 March 2011.

(12)

(b) A cash flow statement for the year ended 31 March 2011 EITHER in accordance with
- Financial Reporting Standard (FRS) 1 Cash Flow Statements (revised) OR
- International Accounting Standard (IAS 7)

(22)

(c) An analysis of the changes in bank and cash balances for the year ended 31 March 2011.
(6)

(d) Evaluate how well the directors of Arkotari Limited have managed the liquidity of the business during the year ended 31 March 2011.
(12)

(Total 52 marks)

Answer space for question 3 is on pages 12 to 16 of the question paper.

Question Number	Answer	Mark
3(a)	Reconciliation of operating profit to net cash flow from operating activities	**(12)**

Net Operating Profit	22 595	√
Add Interest : Bank overdraft	3 270	√
Bank loan	3 000	√√
Loss on Sale of fixed assets	50 000	√
Depreciation	30 000	√√
Decrease in Stock	5 250	√
Increase in Debtors	(1 100)	√
Increase in Creditors	4 620	√
Net Cash Inflow from Operating Activities	117 635	√ o/f √C

Cash Flow Statement for y/e 31 March 2011

Cash Flows from operating activities√

Profit from operations	28865	√√√√		(W1)
Add Depreciation	30000	√√		
Add Loss on Sale of Fixed Asset	50000	√		
Operating cash flow before working capital changes√	108865	√		
Decrease in inventories	5250	√		
Increase in trade receivables	-1100	√		
Increase in trade payables	4620	√		
Cash generated from operations√	117635	√		
Less Interest Paid:Bank overdraft	-3270	√		
Bank Loan	-3000	√√		
Less Tax Paid	-6750	√		
Net Cash from Operating Activities			104615	√

Cash Flow from Investing Activities√

Payments to acquire tangible fixed assets	-50000	√		
Proceeds from sale of tangible fixed assets	150000	√		
Net Cash Used in Investing Activities			100000	√

Cash Flow from Financing Activities√

Redemption of Ordinary shares	-100000	√		
Repayment of Bank Loan	-100000	√		
Dividends Paid : Final 2010	-2000	√		
Interim	-3000	√√		
Preference	-6000	√√		
Net Cash Used in Financing Activities			-211000	√
Net decrease in cash and cash equivalents			-6385	√ o/f √C
Cash and cash equivalents at the beginning of the year	-7420	√√		

Cash and cash equivalents at the end of the year	-13805	√√
Net decrease in cash and cash equivalents	-6385	√√

Total 40 x √

W1 22 595 √ + 3 270 √ + 3 000 √√
Operating Profit + Overdraft interest + Loan interest

Question Number	Answer	Mark
3(b)	Wording is required to obtain the mark(s). Item also needs to be in correct place.	**(22)**

Net Cash Inflow from Operating Activities		117 635 √ o/f
Returns on Investment and Servicing of Finance √		
Interest Paid		(6 270) √ o/f
Preference Dividend Paid (3 000 + 3 000)		(6 000) √√
Taxation		
Tax Paid		(6 750) √
Capital Expenditure + Financial Investment √		
Payments to acquire tangible fixed assets	(50 000) √	
Receipts from sales of tangible fixed assets	150 000 √	
Net Cash Flow from Investing Activities		100 000 √
Equity Dividends Paid		
Final Dividend 2010	(2 000) √	
Interim Dividend	(3 000) √√	
		(5 000)
Net Cash Inflow before Financing √		193 615 √ o/f
Financing		
Redemption of Ordinary shares	(100 000) √	
Repayment of Bank loan	(100 000) √	
Net Cash Outflow from Financing √		(200 000) √
Decrease in Cash √ o/f		(6 385) √ o/f √ C

Question Number	Answer	Mark
3(c)	Analysis of Changes in Cash and Bank Balances during year ended 31 March 2011	**(6)**

	31 March 2010	31 March 2011	Change in Year
Cash	5 460	4 975 √	(485) √
Bank	(12 880)	(18 780) √	(5 900) √
Total	(7 420)	(13 805) √	(6 385) √ o/f

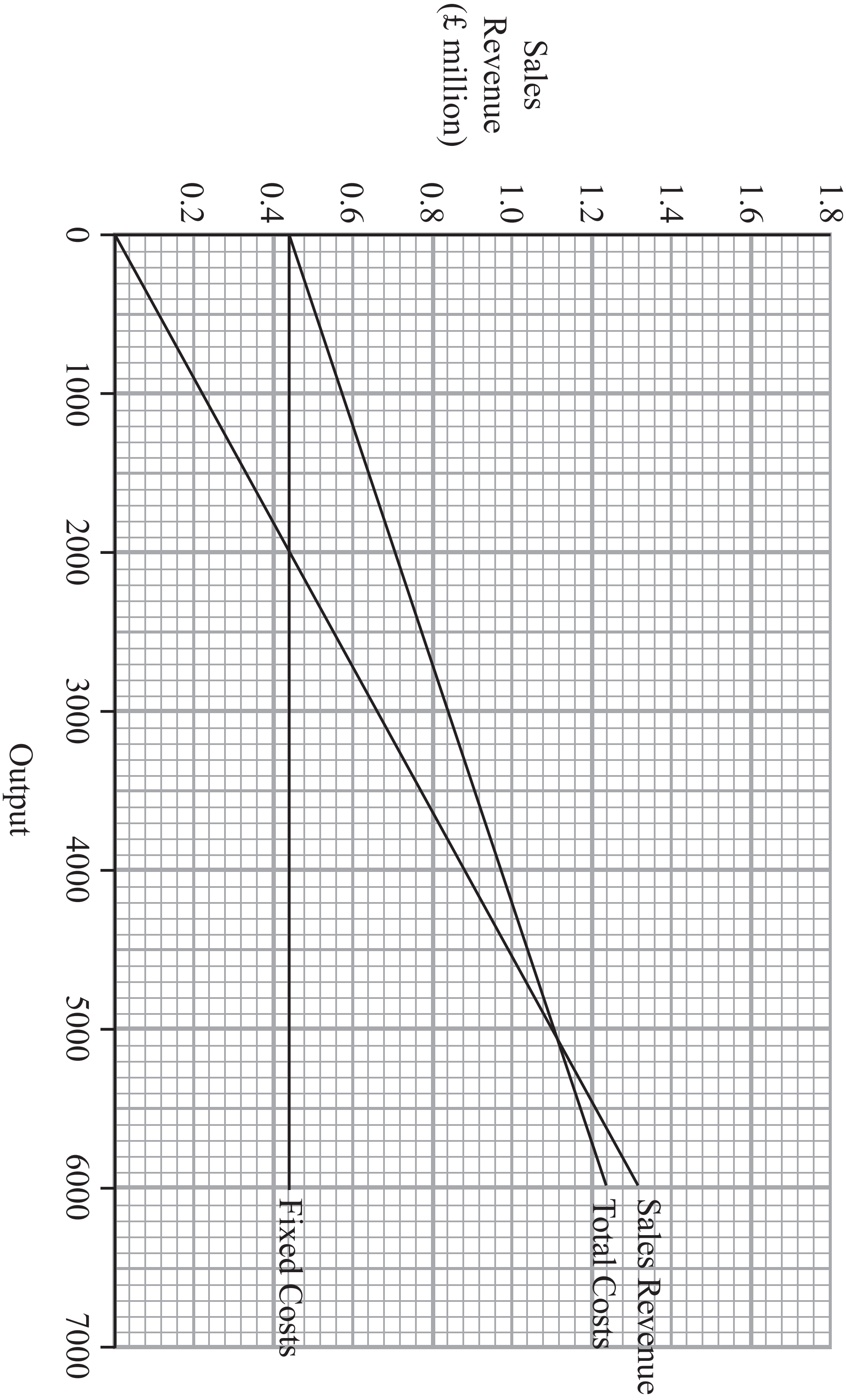
Need first two columns for first √
Other layouts for reconciliation are acceptable.

Question Number	Answer	Mark
3(d)	**Max 8 marks available for arguing only one side.** **Handled poorly** Working capital has decreased ✓ from £12 210 ✓ to £2 460 ✓ ie by £9 750 ✓ Working capital ratio has worsened ✓ from 1.29:1 ✓ to 1.05 : 1 ✓ Acid ratio has decreased ✓ from 0.26 : 1 ✓ to 0.24 : 1 ✓ Bank + Cash has decreased ✓ by £6 385 ✓ OR overdraft increased ✓ by £5 900 ✓ Creditors have increased. ✓ by £4 620 ✓ A number of vehicles have been sold off and generated funds. ✓ Are these vehicles required for the business ✓ or are they surplus to requirements? ✓ (could be in "handled well") Some Ordinary shares have been redeemed which must be a drain on liquid resources. ✓✓ However, this may mean a reduction in future dividends. ✓✓ **Handled well** Bank loan has been repaid in full ✓ and this should avoid future interest payments which helps future liquidity ✓ but this may be a problem now ✓ Dividends paid have been very modest. ✓✓ Ordinary shareholders based on year end figure have only received 2% dividend. ✓✓ **Conclusion 2 marks** Liquidity has been handled poorly/well by the directors through the year. ✓✓	**(12)**

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. As the Finance Director of Goldstar Refrigerators plc, you report the financial position of the company at a board meeting. Included in the report is a break-even analysis, which presents the information on a graph. The figures for last year, the year ended 31 March **2010**, are shown on the graph below.



The figures for the current year ended 31 March **2011** are as follows:

Fixed costs	£ 480 000
Variable costs per refrigerator	£160
Selling price per refrigerator	£240
Number of refrigerators sold	6 500

You must present these figures at the next meeting, using the break even chart.

Required:

(a) Draw the figures for the year ended 31 March **2011** on the blank break even chart in the answer booklet, for output between 0 and 6 500:

- fixed costs
- total costs
- sales revenue

(4)

Label the following on the break even chart in the answer booklet, for the year ended 31 March **2011**:

- break even point, in £ (pounds) **and** output
- margin of safety (output)
- angle of incidence

(8)

Shade in the area of profit.

(2)

(b) **Calculate** for the year ended 31 March **2011** the:

- profit or loss
- number of refrigerators sold to break even

(10)

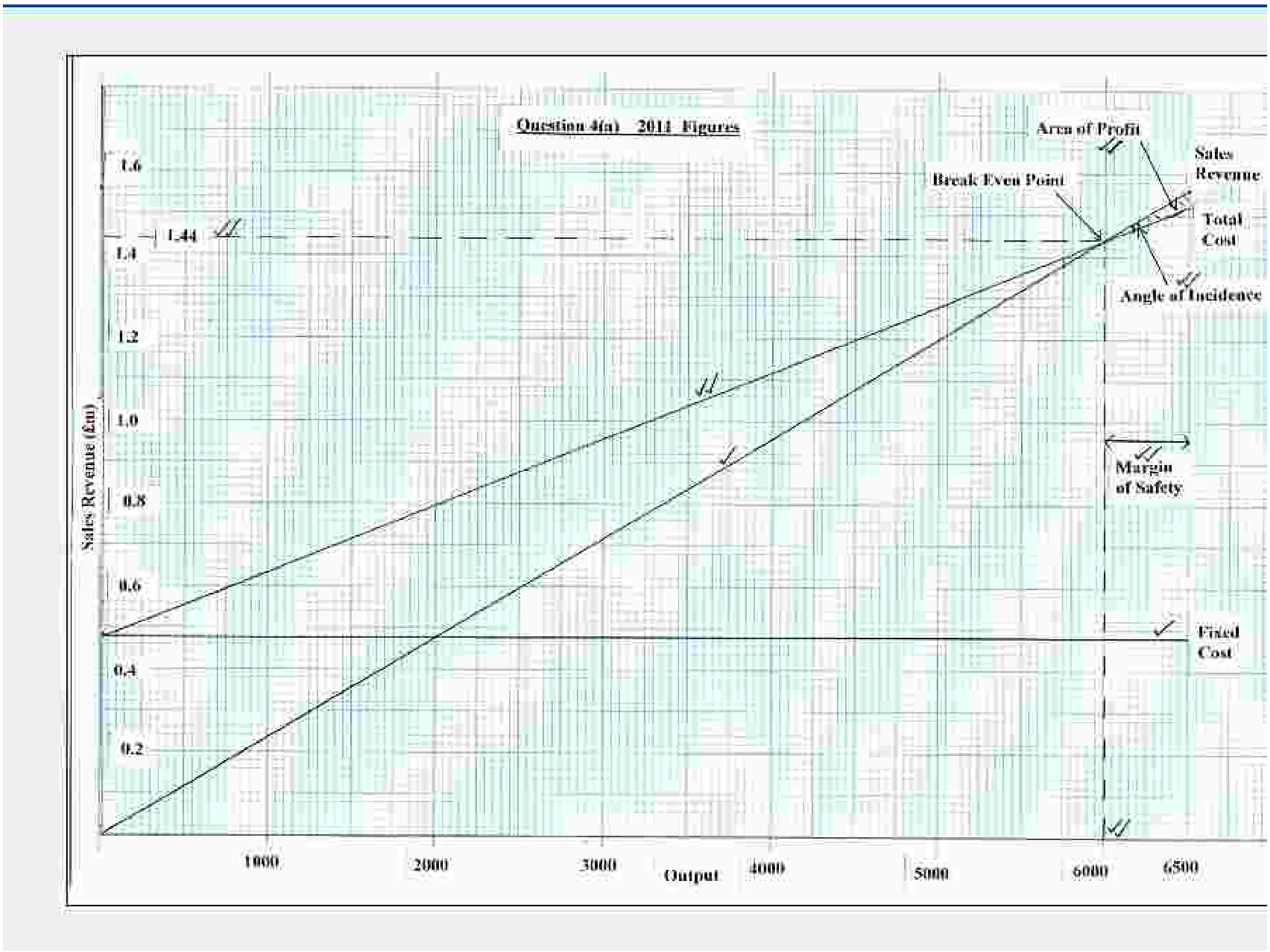
(c) Evaluate the performance of Goldstar Refrigerators plc during the year ended 31 March 2011 by comparing the performance to the year ended 31 March 2010.

(8)

(Total 32 marks)

Answer space for question 4 is on pages 18 to 20 of the question paper.

Question Number	Answer	Mark
4(A)	Answers shown on graph.	**(14)**



Question Number	Answer						Mark
4(b)	**Calculation of Profit**						
				£			
	Sales Revenue	6 500	X 240	1 560 000	√		
	Variable Costs	6 500	X 160	(1 040 000)	√		
	Fixed Costs			(480 000)	√		
	Profit			40 000	√√		
	Break Even Point						
		480 0000	√ =	480 000	6 000	Units √ o/f √ C	
		(240√-160√)		80			
							(10)

Question Number	Answer	Mark
4(c)	Answers may include : Maximum of 4 marks per side of argument. **Better than last year** Sales units figure is better √ 6 500, than last years figures by 500 √ Sales price per unit is better √ £240, than last year by £20 √ Sales Revenue is better √ £1.56 m than last years £1.32 m √ by £240 000 √ **Worse than last year** Profit of £40 000 o/f is worse than last year √ of £88 000 √ (by £48 000 o/f). √ Variable costs of £160 per unit are higher √ than last year of £132 √ by £28 o/f √ Fixed costs of £480 000 are higher √ than last year by £40 000 √ Break even figure for units is higher √ 6000 o/f, compared to last years 5 000 √ Angle of Incidence worse √ Margin of Safety is worse √ (last year 1000, this year 500) √ so 500 worse √ Total costs have risen √ from £1 240 000 to £1 520 000 √ **Conclusion** (does not have to be at end) 2 marks available. Should relate to above points. Profit is lower so this year is worse than last year. √√	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. SE Asia Rubber plc is a new company which produces tyres for cars. SE Asia Rubber plc has a two year contract to supply a major car producer, Byby plc, with 80 000 tyres per year.

The following information is available for the year ended 31 March 2011:

Opening inventory (stock)	Nil
Production	90 000 tyres per year
Semi variable costs	£264 000 per year plus £3 per tyre
Fixed overheads	£8 000 per month
Direct materials	£5 per tyre
Direct labour	2 hours work per tyre at a wage rate of £6.50 per hour
Selling price	£28 per tyre
Closing inventory (stock)	10 000 tyres

Required:

(a) Prepare for management, an income statement (profit & loss statement) for the year ended 31 March 2011. Closing inventory (stock) is to be valued using **absorption costing**.

(12)

On 1 April 2011, FitFast Limited, a large chain of garages, requested SE Asia Rubber plc to supply 18 000 tyres during April at a price of £24 per tyre.

Required:

(b) Advise management whether or not to sell the 10 000 tyres in the inventory (stock) to FitFast Limited at a price of £24 per tyre, to meet part of the order.

(6)

If SE Asia Rubber plc decides to sell the inventory (stock) of 10 000 tyres to Fitfast Limited, the company has two options to supply the remainder of the order:

Option 1
SE Asia Rubber plc will produce the 8 000 extra tyres needed to fulfil the order. This would require workers to work overtime at a wage rate of £10.50 an hour. Other costs remain the same.

Option 2
SE Asia Rubber plc can buy the 8 000 extra tyres at a price of £22 each from another firm.

Required:

(c) Using the financial information above, advise which **one** of the three following possibilities SE Asia Rubber plc should select:

- Option 1
- Option 2
- reject the order

Use **marginal costing** in your answer.

(6)

(d) Evaluate non-financial factors that may be considered by SE Asia Rubber plc in making the decisions in (b) and (c).

(8)

(Total 32 marks)

Answer space for question 5 is on pages 21 to 24 of the question paper.

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>5(a)</td><td>
<table>
<tr><td>Sales</td><td>2 240 000 √</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Direct Materials</td><td>450 000 √</td></tr>
<tr><td>Direct Labour</td><td>1 170 000 √</td></tr>
<tr><td>Semi-Variable Costs</td><td>534 000 √</td></tr>
<tr><td>Fixed Factory Overheads</td><td>96 000 √</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Less Closing stock</td><td>(250 000) √√√√√</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Cost of Goods Sold</td><td>2 000 000</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Profit</td><td>240 000 √ o/f √C</td></tr>
</table>
Calculation of Stock ie 5 √√√√√ shown above
Valuation of Closing Stock $\frac{\underline{2,250\,000}\ √\ o/f}{90\,000\ √}$ = £25 per unit √ o/f
£25 o/f x 10 000 √ = £250 000 √ o/f
</td><td>(12)</td></tr>
</table>

Question Number	Answer	Mark
5(b)	The marginal cost of producing the units is (£5 + £13 + £3) √√ = £21 √ o/f Therefore the 10 000 tyres should be sold. √ as there is a positive contribution √ of £3 per tyre. √	**(6)**

Question Number	Answer	Mark
5(c)	The marginal cost of producing another 8 000 is(£5 + £21 + £3) = £29 √ o/f Therefore the units should not be produced.√ as there is a negative contribution √ of £5 per tyre √ The offer to supply from the other firm (option 2) should be accepted √ as a profit can be made √	**(6)**

Question Number	Answer	Mark
5(d)	**Answers may include: (Maximum of 6 √'s for one side of argument)** **Non-Financial Factors to Consider** Contract with FitFast could lead to further business in the future √ and this could be at a higher price √ with a greater profit margin √ Enables their tyres to be sold in a different market √ which should raise profile of company √ Contract with supplier may lead to further business in future √ perhaps with a keener price √ or in times of high demand √ Selling at the lower price √ may upset the Byby plc√ who may demand a lower price √ or find a different supplier √ Quality of the products supplied √ may be better/worse than products produced themselves √ Workers earn a higher rate if overtime is paid √ and this increases motivation √ **Case Against considering Non-Financial Factors** Directors' duty is to the shareholders √ who want a return on their investment. √ Loss making firms will go out of business √ in the long term. √ **Conclusion (√√)** SE Asia Rubber plc should/should not consider non-financial factors.	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. HotSpot plc produces ovens, which are then sold and delivered around the country. The Sales teams are split into 4 regions: North, South, East and West. HotSpot plc is preparing budgets for the next trading period July to December 2011.

The following information is available for the period July to December 2011.

(i) Sales in the North are forecast to be constant at 600 ovens per month.

(ii) Sales in the South are steadily rising. Sales are expected to be 200 ovens in July. Sales are then forecast to rise 10% each month compared to the previous month.

(iii) Sales in the East are steadily declining. Sales are expected to be 500 in July. Every month, sales are then forecast to fall 5% each month compared to the previous month.

(iv) Sales in the West are variable, with a figure of 240 in July. Sales then fall at a constant rate to a minimum of 195 in October. Sales then start to rise in November, at a constant rate, to reach 215 in December.

Required:

(a) Prepare the total sales budget, in ovens, for HotSpot plc for the six month period July to December 2011. Within the total sales budget, show the forecast sales for the North, South, East and West regions for each month. Round your answers to the nearest whole number.

(13)

Hotspot plc produces ovens to meet the expected future sales figures for each region.
There is usually a delay between producing and selling the ovens.

- Production for the North and the East is one month before sales.
- Production for the West is two months before sales.
- Production for the South is in the same month as sales.

At 30 June 2011 there are 100 unsold ovens in the inventory (stock). HotSpot plc will reduce this inventory (stock) by 50 ovens per month, starting in July.

Required:

(b) Prepare the total ovens production budget for HotSpot plc for the four month period July to October 2011. Within the total ovens production budget, show the forecast production for the North, South, East and West regions for each month.

(11)

(c) Evaluate the company’s policy of producing ovens for expected sales, rather than producing ovens to match actual orders.

(8)

(Total 32 marks)

Answer space for question 6 is on pages 25 to 27 of the question paper.

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>6(a)</td><td>
<u>Sales Budget for July to December</u>
<table>
<tr><th></th><th>July</th><th>Aug</th><th>Sept</th><th>Oct</th><th>Nov</th><th>Dec</th><th></th></tr>
<tr><td>North</td><td>600</td><td>600</td><td>600</td><td>600</td><td>600</td><td>600</td><td>√</td></tr>
<tr><td>South</td><td>200</td><td>220</td><td>242</td><td>266</td><td>293</td><td>322</td><td>√√√</td></tr>
<tr><td>East</td><td>500</td><td>475</td><td>451</td><td>429</td><td>407</td><td>387</td><td>√√√</td></tr>
<tr><td>West</td><td>240</td><td>225</td><td>210</td><td>195</td><td>205</td><td>215</td><td>√√√</td></tr>
<tr><td>Total</td><td>1540</td><td>1520</td><td>1503</td><td>1490</td><td>1505</td><td>1524</td><td>√√√ o/f</td></tr>
</table>
Apply pro rata for each row eg 2 correct for South = √
Need 4 correct for √√
Apply o/f rule to table
</td><td>(13)</td></tr>
</table>

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>6(b)</td><td>
<table>
<tr><th colspan="6"><u>Production Budget for July to October</u></th></tr>
<tr><td></td><td>July</td><td>Aug</td><td>Sept</td><td>Oct</td><td></td></tr>
<tr><td>North</td><td>600</td><td>600</td><td>600</td><td>600</td><td>√ o/f</td></tr>
<tr><td>South</td><td>200</td><td>220</td><td>242</td><td>266</td><td>√√ o/f</td></tr>
<tr><td>East</td><td>475</td><td>451</td><td>429</td><td>407</td><td>√√ o/f</td></tr>
<tr><td>West</td><td>210</td><td>195</td><td>205</td><td>215</td><td>√√ o/f</td></tr>
<tr><td>From Stock</td><td>-50</td><td>-50</td><td></td><td></td><td>√√</td></tr>
<tr><td>Total</td><td>1435</td><td>1416</td><td>1476</td><td>1488</td><td>√√ o/f</td></tr>
</table>
Apply pro rata for each row eg 2 correct for South = √
Need 4 correct for √√
Apply o/f rule to table
</td><td>(11)</td></tr>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>6(c)</td><td>
For Policy
Customers do not have to wait for their orders.√ Waiting for orders could mean customers go elsewhere.√
Production may fluctuate if only for actual orders, √ especially if demand is seasonal √
If sudden increase in demand √ stock is available √
If delays in production this is not a problem √ as order can be met promptly √

Against Policy
Producing for expected orders means some stock may be unsold √ which is risky √
Unsold stock may build up √ and this involves a number of costs eg rent, insurance, √ and ties up working capital √√

Maximum of 4 marks for arguing one side only

Evaluation
2 marks available for overall conclusion, should relate to points made above. i.e. policy is good/bad.
</td><td>(8)</td></tr>
</table>

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. Benhilton Construction plc was a company set up on 1 January 2010 to build a major new national sporting stadium. The funds provided by the shareholders were not sufficient to complete the stadium. The company therefore borrowed large sums of money from the banks.

The following is the Statement of financial position (Balance sheet) at 31 December 2010.

		£ million
Non-current (Fixed) assets		895
Current assets	120	
Current liabilities	(95)	
Net current assets		25
Non-current (Long term) liabilities – 16% Bank loans		(600)
Net assets		**320**
Equity (Share capital and reserves)		
Ordinary shares of £1		200
Share premium		100
Profit & loss reserve		10
General reserve		10
Total equity (share capital and reserves)		**320**

During the year ended 31 December 2010, Benhilton Construction plc made only a small profit after paying interest on the bank loans.

Required:

(a) In January 2011, the directors decided to pay the maximum dividend possible to the ordinary shareholders.

Calculate the

(i) dividend per share, expressing your answer in pence per share.

(4)

(ii) dividend yield based upon a market price of £0.40 per share

(3)

Benhilton Construction plc was unable to make the capital repayments due on the bank loans in the year. Following discussions with the banks, it was decided to convert £500 million of 16% bank loans to £500 million of £1 ordinary shares at par, on 1 March 2011.

Required:

(b) Prepare the:

(i) Journal entry to record this conversion

(6)

(ii) Ordinary share capital account for 2011, recording the conversion.

(4)

(c) Calculate the gearing ratio for the company **after** the conversion of the bank loans into shares, clearly showing the formula used.

(7)

(d) Evaluate the position of the original shareholders, after the conversion of the bank loans into ordinary shares.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 28 to 31 of the question paper.

Question Number	Answer	Mark
7(a)(i)	Dividend per share 20√√ = 10 pence per share √ o/f 200√	**(4)**

Question Number	Answer	Mark
7(a)(ii)	Dividend yield 10√ o/f x 100 = 25% o/f √ 40√	**(3)**

Question Number	Answer	Mark
7(b)(i)	Journal Entry i) March 1st √ DR 16% Bank loans √ 500√ 2011 CR Ordinary shares of £1 √ 500√ Being conversion of 16% Bank loans into £1 Ordinary Shares √	**(6)**

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>7(b)(ii)</td><td>£1 Ordinary Shares Account
<table>
<tr><td></td><td></td><td></td><td>1 Jan 2011</td><td>Bal b/d √</td><td>200 √</td></tr>
<tr><td></td><td></td><td></td><td>1 Mar 2011</td><td>16% Bank Loan √</td><td>500 √</td></tr>
</table></td><td>(4)</td></tr>
</table>

Question Number	Answer	Mark
7(c)	Gearing ratio Debt √ x 100 = 100 √ x 100 = 11.1% √o/f √C Capital Employed √ 900√√ OR Debt √ = 100 √ x 100 = 12.5 % √o/f √C Equity √ 800 √√	**(7)**

Question Number	Answer	Mark
7(d)	Valid points may include : **Better Position** As less interest to pay √ of £80 million √√ (and less capital repayments to make √) so annual profits will be higher √ so more available for dividends√ Gearing ratio has improved √ falling from 200% to 12.5% (from 66.6% to 11.1%) √ o/f, so less risk √ Net Book Value of business rises √ so share price in theory may rise √ **Worse Position** Ownership diluted √ so smaller share of votes√ More shareholders now to receive dividends√ so dividends per share may be less √ Share price will fall √√ as more shares/on the open market √ Interest on loan meant a lower profit √ so tax bill may now be higher on higher profit √ Maximum of 4 marks available for arguing one side. **Conclusion** Two marks for conclusion. Ie Better or worse off √√	**(8)**