

# Examiners' Report June 2015

## IAL Accounting WAC02 01

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## **Introduction**

The level of responses by students for this paper was generally good. There was a wide range of marks but overall the standard was pleasing. Students have clearly learnt well some areas of the Specification, and were able to tackle questions on these topics. However, some topics were found more challenging and the marks for these questions were mixed.

## Question 1

This was a popular question, with the marks attained for answers around average. The general layout of the Statement of Cash Flow (IAS7) was good as were the calculations, the use of brackets, and the headings. Answers for (b) however, were often weak. Although a number of formulas were allowed for the gearing ratio, some students still struggled to produce a correct formula. Evaluation of the change in the gearing ratio was often "thin", with students merely repeating parts of the question such as "a bank loan was received".

Common errors were:

- Workings were not shown in some calculations, so a wrong answer meant zero marks were scored eg for depreciation, disposal of non-current asset, dividends, interest.
- Incorrect labelling of sub totals. A cash inflow must be labelled "Net cash **from**....", and a cash outflow labelled "Net cash **used** in....."
- Payment to acquire shares in other companies was often placed in Financing Activities instead of Investing Activities.
- Many students overlooked the debenture, which was in current liabilities for 2014 as it was about to mature, when calculating the gearing ratio.
- Using the misguided principle that a high number is always better than a low number, many answers stated that an increase in gearing was good.

**SECTION A**

**Answer TWO questions from this section.**

**If you answer Question 1 put a cross in the box  .**

**Source material for question 1 is on pages 2 and 3 of the source booklet.**

- 1 (a)** Prepare a Statement of Cash Flow for the year ended 31 March 2015 in accordance with International Accounting Standard (IAS) 7 Statement of Cash Flows (revised).

(40)

Dr	Non-current a/c (NBV)	Cr	Disposal a/c
Balance b/d	4863000	Disposal	540000
Bank	1200000	Depreciation	514000
		Balance c/d	5009000
	6063000		6063000
		Asset (NBV)	540000
		Income Statement	120000
			540000
		Bank	420000

Dr	Share capital a/c	Cr	Share premium a/c
Bank	500000	Balance b/d	3500000
Balance c/d	3000000	Bank	50000
	3500000	Balance c/d	650000
			700000
		Balance b/d	700000

Dr	provision for tax a/c	Cr	Income Statement
Bank	208000	Balance b/d	208000
Balance c/d	68000	Income Statement	68000
	276000		276000
		profit before tax	481600
		+ loan interest (1500000 x 6%)	
		90000 x 7/12	52500
		+ Debenture interest	
		(1000000 x 5.5% x 7/12)	32083
			566183

Cashflow Statement For the year ended 31 March 2015

Cashflow from operating activities		
Net profit before tax and interest		566183
+ Depreciation	514000	
+ loss on disposal	120000	634000
Cash flow before Working Capital changes	1200183	
Add: Decrease in inventories	88000	
Add: Decrease in trade receivables	84000	
less: Decrease in trade payables	(31000)	
Cash generated from Cash flow	1341183	
less: interest	(84583)	
less: tax	(208000)	
Net Cash Flow from operating activities		1048600
Cash Flow from investing activities		
less: payment acquired For Non-current Asset	(1200000)	
Add: Sale of Non-current Assets	420000	
Dividend received : final (3500000 x 0.02)	70000	
interim (3000000 x 0.01)	30000	
Net cash flow from investing activities		(680000)
Cashflow from financing activities		
Redeemed ordinary share (500000 + 50000)	(550000)	
Debenture redeemed	(1000000)	
Net cash flow from financing activities		(1550000)
Net decrease in cash and cash equivalents		(1181400)

(b) Evaluate the change in the gearing ratio of Maltese Construction plc from 31 March 2014 to 31 March 2015. State the formula that you have used.

(12)

$$\text{gearing ratio} = \frac{\text{Debt}}{\text{Capital employed}}$$

31 March 2014

$$\text{Debt} = 1000\,000 + 320\,000 \\ 1320\,000$$

$$\text{Capital employed} = 1320\,000 + 3500\,000 + 453\,000 + 700\,000 \\ 5973\,000$$

$$\frac{1320\,000}{5973\,000} \times 100$$

22.1 %

31 March 2015

$$\text{Debt} = 1900\,000 + 320\,000 \\ 2220\,000$$

$$\text{Capital employed} = 1820\,000 + 3000\,000 + 797\,000 + 610\,000 \\ 6227\,000$$

$$\frac{2220\,000}{6227\,000} \times 100$$

29.2 %

→ gearing ratio for 2014 and 2015 was not good, it was low, the acceptable figure is between 30 % and 50 %

→ Compare to 2014, gearing ratio was higher in 2015 by 7.1 %, which is acceptable

→ gearing ratio for 2014 was not achieved due to redeeming ordinary shares of £ 500 000

→ In 2015 it was improved than ~~2015~~ 2014 by redeeming preference shares and paying back of loans.

→ It can be improved by redeeming debentures in 2015.



## ResultsPlus

### Examiner Comments

This student has shown all workings clearly to calculate depreciation on page 1. In the Non-current assets account, the depreciation figure is not correct, but 3 marks out of 5, have been attained. One mark for balance b/f, one for disposal, and one for balance c/f.

The heading is not correct. It should say "Statement of Cash Flow for year ended 31 March 2015" as per IAS 7, not "Cash Flow Statement"

Investing Activities and Financing Activities have an outflow of cash, so the label should say eg "Net cash flow **used** in Investing Activities".

No workings shown for Interest, so wrong figure gains no marks. Good to see workings shown for Dividends.

A total of 19 marks were obtained for section (a), an average score.

On Page 6, it is good that the student has clearly shown the formula used for calculating the gearing ratio. This enables the examiner to tie in the figures to the formula chosen. This student has spotted the debentures in current liabilities and gearing calculations are correct for a full 6 marks.

In the written evaluation, the increase in the gearing ratio of 7.1% has been correctly identified for 2 further marks. The remainder of the answer is merely quoting parts of the question, or incorrect theory.

A total of 8 marks were attained for section (b).

## **Question 2**

This was the least popular question in Section A, and the least well answered. Section (a) was often completed correctly, but answers for (b) were variable. Students found calculating the closing inventory the most challenging part of (b). Answers to (c) were disappointing, as over half of students did not even attempt to use marginal costing theory to make a decision as to which orders to accept. Some even thought the question required a choice of one out of the three possible offers, instead of addressing each offer separately. However, there were some reasonably good attempts at discussing the relevant points in section (d).

Common errors were:

- Using the size of the order to calculate the production of t-shirts for the year, despite bullet point 6 in the source booklet stating this was not the case.
- When calculating revenue in (b), the production quantity was used, not the sales quantity.
- An incorrect 5 000 units was used for a quantity figure for closing inventory, forgetting about the 4 200 units of opening inventory that had to be added on.
- Inaccurate figures for the value of closing inventory, often with no workings.
- Using the size of the order, or the revenue figure, to decide which offers to accept, instead of marginal costing theory in (c).

If you answer Question 2 put a cross in the box .

Source material for question 2 is on pages 4 and 5 of the source booklet.

2 (a) Calculate the quantity of t-shirts produced in one year.

(6)

~~Opening Inventory~~  
~~Produced~~

~~Ans No. of units~~  
~~1200~~  
~~125,000~~

Each Staff

Works <sup>500</sup> mins a day

Produces 20 t-shirts a day.

100 t-shirts a week

5000 t-shirts a year (50 weeks in a year)

25 staff - <sup>500mins.</sup> 8hrs 20mins a day for 5 days a week.  
25mins @ £6.00 per hr.

Each staff would make 5000 t-shirts.

25 staff make 125,000 t-shirts.

$$= 25 \text{ workers} \times \left( \frac{500 \text{ mins}}{25} \times 5 \text{ days} \times 50 \text{ weeks} \right)$$

$$\text{Ans} = 125,000 \text{ t-shirts}$$

2 (b) Prepare for Nazir, a statement showing the net profit, for the year ended 31 March 2015, using:

- (i) marginal costing inventory valuation
- (ii) absorption costing inventory valuation

(20)

i) Statement of Income - Marginal Costing

	£	£
Sales		780,000
less: Marginal Cost		
Semi-variable Cost	27,500	
Direct Materials	118,750	
Direct Labour	<u>312,500</u>	
	458,750	
less: Closing Inventory	<u>(33,764)</u>	
	424,986	
Add: Opening Inventory	<u>16,800</u>	
		<u>(441,786)</u>
Contribution		338,214
less: Fixed Overhead		<u>(42,500)</u>
Net Profit		<u>295,714</u>

ii) Statement of Income - Absorption Costing

	£	£
Sales		780,000
less: Cost of Sales		
Semi-variable cost	70,000	
Direct Materials	118,750	
Direct Labour	<u>312,500</u>	
	501,250	
less: Closing Inventory	<u>(36,892)</u>	
	464,358	
Add: Opening inventory	<u>16,800</u>	
Cost of Sales		<u>481,158</u>
Net Profit		<u>298,842</u>

3126

(c) Advise Nazir Aiman whether to accept the offer from the:

- (i) shop owner
- (ii) market trader
- (iii) wholesaler

(14)

<u>Marginal Cost</u>	(i) (£)	(ii) (£)	(iii) (£)
Selling Price	4	5.50	3.50
<u>less: Marginal Cost</u>			
Semi-variable cost	(0.22)	(0.22)	(0.22)
Direct Material	(0.95)	(0.95)	(0.95)
Direct labour	(2.5)	(2.5)	(2.5)
Contribution /Tshirt	0.33	1.83	(0.17)
NO. of tshirts	3000	2000	4000
Total Contribution	990	3660	(680)
	Shop owner	Market trader	Wholesaler

20 Nazir Aiman should accept offer from Market trader as the total contribution is the highest of £3660.

He should decline offer from wholesaler as there is a negative contribution of £680.

However, he can also accept offer of Shop owner as the quantity is more by 1000 tshirts which will help reduce the stock levels more and he also gets a £990 contribution from it.

800 mins → 20 He should accept offer from Market trader.

60

(d) Evaluate this statement and advise Nazir whether he should use marginal costing or absorption costing to value his inventory.

(12)

Absorption costing is a costing system that takes into account all costs.

Marginal costing separates costs into Variable Costs and Fixed Costs.

Absorption costing is accepted by Tax authorities and accounting standards while Marginal costing is not as it ~~does~~<sup>under</sup> values profit.

Absorption costing takes into account of all costs i.e. the Cost of Production of one unit consists of it.

Marginal costing does not take into account Fixed Costs, therefore Fixed Costs are written-off after contribution.

It is not about making <sup>more</sup> the profit, but it is about writing off costs to the inventories for that batch of production.

He should use absorption costing as it takes into account all costs.



Section (a) shows all workings and arrives at the correct answer for full 6 marks.

In section (b), the student has an incorrect figure for closing inventory for absorption costing, but has shown no workings, so no marks. Fixed overheads of 122 500 have also been omitted, so a good score of 16 for this section.

It is possible to answer the calculations for (c) in table form, as this student has done. The table shows the unit figures for sales revenue, variable costs, and contribution. From here, the student can decide which offers are suitable to accept. The final conclusion of which is the "best offer" does not work against the marks awarded for a decision about each of the three offers. An excellent 13 out of 14 marks here.

For section (d), an average 5 marks were awarded. Much of the comment is quite general, but 2 marks were awarded for the third sentence about accounting standards etc. One mark was given for the penultimate sentence and two for the conclusion. The student could have made more specific points.

### Question 3

This was the most popular question on the whole paper, and answers were very good. Most students were able to calculate correctly the weighted average cost of capital in (a). A disappointing few, still wrongly selected Option B, on the basis that it had the highest figure. The calculations in (c), including depreciation, were handled extremely well, with many arriving at the correct net present value figure. A pleasing majority of students were able to calculate the average rate of return. Answers to (e) were fairly good, although many concentrated on generic answers such as "figures are estimates", rather than interpret figures found for net present value and average rate of return.

Common errors were:

- Choosing the wrong discount rate in (c), which did not agree with the decision in (b).
- Using the net present value calculated in (c) for the surplus of the project in (d).
- Not using the calculations from (c) and (d) in the evaluation in (e).

(e) Evaluate the project for the company, using the calculations made, and considering any other relevant factors.

(12)

For

- ① The NPV is positive, which is £ 64.505 m.
- ② The ARR is 8.95%, which is positive.
- ③ <sup>Since</sup> The figures are estimates, the NPV and ARR could be greater.
- ④ Can build up brand awareness through this project, thus leads to more profits and dividends.
- ⑤ Helping business development in the future.

Against:

- ① Figures are only estimates, NPV and ARR may be lower.
- ② Other appraisal techniques are available eg. payback period.
- ③ The ARR does not meet the target of 10%.
- ④ ~~Other~~ Better projects may be available.
- ⑤ This project may not suit for business strategy.

Conclusion:

The company should accept the project.



This student manages to score a very good 11 out of 12 marks available. This is done by including a number of points, although only one is developed to earn two marks. The scoring is:

For

- 1) 1 mark
- 2) no marks
- 3) 1 mark
- 4) +
- 5) together 1 mark

Against

- 1) 1 mark
- 2) 1 mark
- 3) 2 marks
- 4) 1 mark
- 5) 1 mark

Conclusion 2 marks

## **Question 4**

This was the least popular question from Section B, with marks obtained around average. A surprisingly large number of students included depreciation in the expenses section of the cash budget. A really basic error. Many calculated drawings to be £720 a month, instead of £1 440, overlooking the word "each". However, the monthly totals and the balancing off were usually done very well. In section (b), it was disappointing how many students wrongly used the words profit or loss, instead of positive or negative cash flow. Many must have had question one still in their minds as they felt the bank loan would increase gearing.

Common errors were:

- Failure to use a columnar format for the cash budget in (a).
- Including Farm shop expenses of £280 as an expense for each of the 6 months, instead of just 2 months.
- Labelling the monthly balance as "profit" or "loss".
- Not including the opening balance as an overdraft of £4 000 ie (4 000).
- Missing the point of the question in (b) by arguing George and Mary should issue shares instead.

## SECTION B

Answer **THREE** questions from this section.

If you answer Question 4 put a cross in the box  .

Source material for question 4 is on pages 8 and 9 of the source booklet.

- 4 (a) Prepare a monthly cash budget for the farm, for **each** month of the 6 month period 1 July 2015 to 31 December 2015.

(24)

	July	Aug	Spt	Oct	Nov	Dec
<u>Receipts.</u>						
Sales	2240	2240				
sale of wheat.			8775			
sale of fruits				2500	2500	
sale of vegetable.				900	900	900
sale of animal					650	650
	2240	2240	8775	3400	4050	1550
<u>payments</u>						
wages to farm worker.	700	700	700			
feed and fertiliser.	235	235	235	235	235	235
power and fuel	175	175	175	175	175	175
depreciation.	150	150	150	150	150	150
other fixed costs	100	100	100	100	100	100
Drawings.	720	720	720	720	720	720
expenses of farm shop.	280	280				
	2360	2360	2080	1380	1380	1380
opening balance.	-	2260	2260	2060	1360	1380

opening balance	-	-120	-240	6455	8475	11145
monthly balance	-120	-120	6695	2020	2670	170
closing balance	-120	-240	6455	8475	11145	11315

(b) Evaluate the Bank Manager's recommendation.

(8)

Bank managers recommendation is good. because with £600 they can do lot of things. their business is seasonal so they have very less amount of capital within the business. with help of £6000 bank loan they can spend for day to day running expenses, because they get income after one or two months later. also they can use that money for business expansion. if they choose overdraft interest rate will be very high so they have to pay much money. as a result their profit will decrease decrease. but if they took a bank loan interest rate will be lower than overdraft. So they have to pay less amount.



**ResultsPlus**

**Examiner Comments**

This student has included depreciation of £150 each month in error. Drawings are recorded at only £720 a month instead of £1440. The opening overdraft of £4 000 has been omitted. Other balancing off is correct, and a total of 20 marks was achieved for (a). A very good score.

In (b) 2 marks are awarded for what the loan can be used for, and 2 more for the interest lower than an overdraft. The case against gets one mark, saying the interest will reduce profit. Finally, only one mark is given for what may be a vague conclusion, given at the start. The student scored 6 marks for section (b).

## **Question 5**

This was a below average question in popularity and scoring. Many students in (a), tried to calculate the purchase price by subtracting the value of the liabilities from the value of the assets. However, the question clearly stated the purchase price was calculated as a cash payment to shareholders. The mark scheme for (b) shows the Acquisition account in the form of a control account, which many students showed. However, a "mirror reversal" was acceptable, as the company could skip the "control account" step. The company would merely credit assets in the Acquisition account, and debit the assets account with the assets acquired. Whichever method was used, goodwill was often omitted. Section (c) saw reasonable answers, with marks usually obtained when the figures were straightforward additions. However, more difficult figures, such as Cash or Ordinary shares presented problems. Most students managed to include enough in the evaluation to obtain reasonably good scores for (d).

Common errors:

- Using the wrong method to calculate the purchase price in (a).
- Failing to include goodwill, and the cash purchase price in (b), or balance off the account.
- Omitting goodwill paid from the statement of financial position after the purchase.
- Not deducting the cash paid out to buy Lifejoy plc from the cash figure for Middle East Medical plc.
- Adding items from the equity section of Lifejoy plc Statement of Financial Position to the equity section of Middle East Medical plc.

If you answer Question 5 put a cross in the box .

Source material for question 5 is on pages 10 and 11 of the source booklet.

5 (a) Calculate the purchase price of Lifejoy plc.

(4)

The purchase price of Lifejoy plc is calculated on the basis of net payments method as follows:-

As agreed as a cash payment of £1.03 per share in Lifejoy plc.

$$\text{Ordinary Share Capital} = 24,000,000$$

$$\text{Ordinary Share Value} = £0.25 \text{ each.}$$

$$\begin{aligned} \therefore \text{Number of Shares} &= \frac{24,000,000}{0.25} \\ &= \del{96,000,000} \\ &= 96,000,000 \text{ Shares} \end{aligned}$$

$$\begin{aligned} \text{Purchase price of Lifejoy plc} &= 96,000,000 \times 1.03 \\ &= £98,880,000 \end{aligned}$$

(b) Prepare the Acquisition Account in the books of Middle East Medical plc to show the purchase of Lifejoy plc.

(6)

Acquisition A/c.

	Amt-		Amt.
		Plant	4800000
Bank loan —	20000000	Property	17750000
Trade & other payable	5240000	Other property &	
Short term Provision	1250000	Equipment —	60382000
Purchase Consideration	93880000		
		Intangible Assets	14000000
		Goodwill (Bal fig)	1815000
		Inventories —	3120000
		Trade and other receivable	561600
	<u>119529000</u>		<u>119529000</u>

(d) Evaluate the use of cash to finance the purchase of a company.

(8)

Whenever using the cash balance of the existing ~~business~~ business to purchase a new firm, there are some benefits and there. At the same time some drawbacks also. The main drawback is affecting the working capital for the future running of the business. If there is excess funds available (as in the given example excess funds are used to pay the purchase price), then no problem facing to meet the working capital. A good rule of thumb is to aim for adding an additional 90 days of working capital i.e. current assets - current liabilities.



**ResultsPlus**

**Examiner Comments**

Correct method used in (a) for 4 marks.

Full 6 marks obtained for a "mirror reversal" of mark scheme in (b).

A weak section (d) scores only 2 marks, one for each side of the argument.

(c) Prepare the Statement of Financial Position of Middle East Medical plc at 1 April 2015 after the purchase of Lifejoy plc.

(14)

Balance Sheet as at 1 April 2015

Non - current Assets	Cost	Dep	NBV
property, plant and equipment ( 355 000 000 + 75 432 000 )			430 432 000
intangible Assets ( 98 000 000 + 14 000 000 )			112 000 000
			542 432 000
Current Asset			
Inventories		30 920 000	
Trade receivables ( 14 660 000 + 56 160 )		15 221 600	
Cash and cash equivalents (258 117 000 + 78 000)		25 819 500	304 336 600
Total Assets			846 768 600
Equity and liabilities			
Ordinary share £1 each		250 000 000	
ordinary share £0.25 each		24 000 000	
Share premium		124 000 000	
<del>Non-current liabilities</del> retained earnings		286 595 000	
Non-current liabilities			
Mortgage		100 000 000	
Bank loan		20 000 000	
Current liabilities			
Trade payables		12 787 000	
Current tax payable		5 514 000	
Short term provision		127 000	82 302 1000



**ResultsPlus**  
**Examiner Comments**

This student has scored 8 out of the 14 marks available.

The 6 errors where marks are not achieved are:

Property, plant and equipment calculations

Goodwill omitted

Cash - added on Lifejoy plc cash by mistake. Question states this asset is not taken over.

Ordinary shares of £0.25 - included £24 000 000 of Lifejoy in error.

Share premium - added in Lifejoy plc in error.

Current tax payable - included Lifejoy, although question states this is a liability that Middle East Medical plc will not settle.

## Question 6

This was quite a popular question, and the scores achieved were reasonably good. Most students managed to complete the variances in (a) without too much difficulty. Calculating the variances in (b) however, was found much more difficult. Responses to (c)(i) were disappointing as many students really gave answers that were for semi-fixed costs or even variable costs ie a rise in output. However, (c)(ii) was better, with good examples and some sensible reasons given. Answers to (d) were generally good, as students were able to address the question with confidence.

Common errors were:

- Confusion between, or failure to show, adverse and favourable variances in (a).
- Failure to calculate correctly the net profit variance in (a), as an addition was required, not a subtraction.
- Inability to substitute the correct figures into what was often the correct formulae in (b).
- In (c)(i), explanations that were vague and did not really get it right.
- Explanations in (c)(ii) that were better suited to variable costs.

If you answer Question 6 put a cross in the box .

Source material for question 6 is on pages 12 and 13 of the source booklet.

- 6 (a) Complete the Variance column for the month of April 2015.

(7)

	BUDGET £	ACTUAL £	VARIANCE £
Revenue	165 000	162 500	(2 500) A
Less			
Material Costs	(47 890)	(49 910)	(2 020) A
Labour Costs	(24 640)	(24 057)	583 F
Variable Overheads	<u>(36 620)</u>	<u>(38 880)</u>	(2 260) A
= Cost of Sales	(109 150)	(112 847)	(3 697) A
Gross Profit	55 850	49 653	6 197 A
Less Fixed Overheads	<u>(54 750)</u>	<u>(54 750)</u>	0
Net Profit	1 100	(5 097)	(3 997) A

(c) (i) Briefly explain why a fixed overhead figure may change.

(1)

fixed overhead might change due to expansion of the business in the long run

(ii) Give **three** examples of fixed overheads that may rise, and explain briefly why they may increase.

(6)

Rent → rent may change due to expansion of the area that the factory needs to operate.

Business may buy a new area for production

Depreciation → Depreciation may increase due to high depletion in the value of machinery and or non current assets.

Insurance → Insurance may increase due to changes in the insurance policy and legislation

(d) Evaluate the usefulness of a standard costing system to Tangapur Paper Limited.

(8)

• For standard costing.

• - It shows the actual and budgeted figures.

• This could be used to make decisions and to

• calculate the variance. By comparing budget

• and actual, business will know why actual

• is greater than budgeted or why it is lower. So

• it helps to make decisions. Also, standard costing

• is easy to calculate

- May not need the knowledge of an expert.
- Against standard costing:
  - It is time consuming to make and time is money. So it may lead to waste of money.
  - Budgeted figures are only estimates so it may lead to a wrong decision.
  - Tangapur Paper Limited could use other methods which is much easier and less time consuming.
  - May need expert knowledge.
  - Decisions made may be inaccurate as budgets are only estimates.



### ResultsPlus Examiner Comments

In (a), to calculate Net profit variance the student needed to add figures not subtract. 6 marks scored here.

In c(i), answer makes no mention of time, but refers to business expansion instead. Score 0.

For c(ii), the 3 examples given are fine. The argument for rent is acceptable, as it mentions buying a new area for production. The depreciation reason fails to score, as it would not make sense using the reducing balance method, and depletion is associated with taking resources from a mine. The reasons given for insurance are good. 5 marks were scored.

The answer for (d) managed to score 5 marks without going into any real depth, or giving a conclusion. The case For scored 2 marks, mentioning variances and decision-making. The case Against scored 3 marks, mentioning time/money, expertise, and estimates.

## **Question 7**

This was the most popular question in Section B, and the marks attained were fairly good. It was pleasing to see that most students were able to handle the ratio calculations. The ratio that gave the most problem was (a)(i) where many had the wrong capital employed figure. As usual, a number of students failed to give units to their answers. Scores for (b) were also pleasing, especially since this question had not been asked before. However, answers for (c) were very muddled, with a very basic analysis of "a bigger number is better than a smaller number". It required some calculations to conclude that actually dividends received would be larger with Kowloon, despite China Capital having a greater figure.

- Common errors were:
- Not showing units with answers for (a).
- Mixing up the figures of both companies when putting forward an argument in (c).
- Giving meaningless comments about comparative share prices, as the face value of China Capital plc shares was not given.
- Making superficial comments about dividends per share, without thinking through the relative share prices.

(c) Evaluate whether Jiao Suen should keep her shares in China Capital plc, or sell her shares and buy shares in Kowloon Investments plc.

(8)

### KEEP SHARES

→ If <sup>Jiao</sup> she sells and buy share kowloon investment plc, Jiao will receive much less income as the dividend per share paid is lower in kowloon plc ( $\$0.048$ ) than in China plc ( $\$0.063$ ).

→ Kowloon plc ~~earn~~ is covering their dividend <sup>[1.5 times]</sup> less in times than China plc [~~2.38 times~~]. So in long run Jiao may affect negatively.

→ China Capital plc <sup>is</sup> has much better earning per share ( $\$0.15$ ) than Kowloon Investment plc ( $\$0.072$ ).

### SELL SHARES:-

→ ~~She~~ Jiao could get  $\$15$  gain if she Jiao ~~sell~~ sells the shares ~~she~~ Jiao holds.

→ Kowloon Investment plc ~~is~~ provides high dividend yield ~~that~~ (4%) than China Capital plc.

→ ~~Kowloon Investment plc also has higher Price/Earning ratio (~~14 times~~) than Chi~~

→ Kowloon Investment plc gives higher return to their capital employed than China Capital plc by [ $9.6\% - 8.1\% = 1.5\%$ ].  
extra.

Conclusion; keep share as Jiao could receive higher dividend (income) in <sup>China</sup> Capital plc than in Kowloon Investment plc.



This answer achieved a below average mark of 3. Scoring:

For

- 1) theory is wrong
- 2) dividend cover can be argued both ways (generosity versus safety) but this answer argues neither
- 3) this means nothing without mentioning the price of the share. We know ROCE in Kowloon is better.

Against

- 1) true, but marks have already been awarded for this calculation in (b)
- 2) correct - 1 mark
- 3) correct, and further calculation to work out the difference, giving 2 marks

Conclusion

Wrong conclusion given figures and the students' own argument for keeping is not appropriate  
- 0 marks

## Paper Summary

Based on their performance on this paper, students are offered the following advice:

- At this level it is to be expected that students are aware of the difference between profit and net cash flow. In questions 1 and 4, the correct labels would have been eg "Net Cash from Operating Activities" or "Net monthly cash flow". To include the word "profit" would have been wrong.
- Students would be advised to try to learn all formulas required for the examination. Although no marks were given for stating the correct formulas in this examination, knowledge of the exact formulas was needed in order to calculate the correct answer.
- There is a clear benefit from showing all workings. If a student makes a mistake early in the question, they may not achieve any marks for the figure calculated. However, if this figure is taken forward and treated correctly, the students will benefit from the "own figure rule" and score marks.

## **Grade Boundaries**

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>

Ofqual  
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