

Examiners' Report

June 2016

IAL Accounting WAC02 01

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Introduction

The level of responses by candidates for this paper was good. There was a wide range of marks but overall the standard was very pleasing. Some areas of the specification have been well learnt by candidates who were able to respond to questions on these topics. In common with past series', some topics were found to be more challenging and the marks for these questions were mixed.

Question 1

This was a fairly popular question (Q). Marks for (a) were generally good, with the calculations being more accurate than the labels for the parts of the capital budget. Many candidates found (b) quite challenging, although the balancing off was generally accurate. Candidates need to be aware that every row on the cash budget requires a label, otherwise it is just a number, with an unsure meaning. Answers for (c) were varied, with a range of marks. Candidates need to develop points given in the question. For example, rather than quoting only the question and stating "Option 1 is in the town centre", candidates needed to develop this, to say "therefore there will be passing trade/the possibility of more business/easier access for potential customers."

Common errors included:

- in (a), incorrect or vague labelling of items, which often did not indicate the type of capital (eg shares or loan) or the source (eg bank or Chong and Mei)
- failure, in (b), to calculate the correct figure for sales in (i) and/or (ii), although these were the most difficult parts
- treating the initial cost of £30 000 as the opening balance of (£30 000)
- confusion concerning the calculation of the Sales Commission in (b)(ii)
- not labelling every row, especially for items such as Total Payments (Outflow), and Net Monthly Cash Flow
- labelling the Net Monthly Cash Flow as Profit and Loss
- in (c), often only quoting figures from the question or the answer, eg "the lease will cost £10 000", which did not show any indication of evaluation or comparison.

Case for option 1

Advantages:

- Option 1 is in the town centre, which is a very ^{convenient} good location and has ~~to~~ chances to become successful in the future.
- Staffs are not needed to pay commission which reduces expense.

Disadvantage:

- As it is ~~a very good location~~ in the town centre, costs are very high which gives a monthly loss in the first for three months so far.
- Sales are not enough to cover costs.

Case for option 2

Advantages:

- Option 2 is located at the edge town, ~~res~~ where costs are comparatively low.
- There are more customers and also more staff available at a cheaper rate. Commissions are paid by the customers.

Disadvantage:

- Costs are still higher and profit is not made.

- Commission of 25% of premium is high which would be needed to pay be paid by the company after six months.

Conclusion Option 2 is better as it has lower costs and high sales. Very few customers would ~~even~~ visit the office as works are ~~usually~~ mostly done by staff at ~~the~~ customer's preferred place or over the phone. So location would not be a big factor.



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Option 1 Advantages:

Vague, not enough to achieve any marks.

Option 1 Disadvantages:

Makes the point that costs are high for 1 mark (even though it is called a loss)

Sales do not cover costs (1 mark) which is a way of stating "negative cash flow".

Option 2 Advantages:

"costs are comparatively low" achieves 1 mark. The rest is vague.

Option 2 Disadvantages:

No marks – unclear and contradictory. Comment about commission is wrong regarding when the payment is made.

Conclusion

2 marks for choice of Option 2 and the fact that costs are lower and sales are higher.

The conclusion contains a further 2 marks as an advantage for Option 2. The candidate argues that customers do not visit the office etc and argues location would not be important.

Total of 7 marks awarded for (c).

Question 2

This was the most popular question on Section A, and the question that accrued the highest marks in this section. Answers to (a) were generally strong, with the correct method used to calculate purchase price and the number of shares issued. Part (b) probably exemplified the weakest answers, with difficulties encountered with entries, labels, and figures. Many candidates entered assets at the revalued amount, and had difficulty with the labels and amounts for Profit on Realisation and Purchase Consideration. In (b)(ii), many candidates did not know which entries to make at all for this account. The evaluation in (c) was often very good, with some candidates obtaining the maximum 12 marks. Similarly, the merged Statement of Financial Position in (d) was answered very well, with most candidates gaining the majority of the marks available.

Common errors were:

- in (a) omitting bank and cash from the assets, despite the question stating all assets were to be taken over
- entering assets at the revalued amount, in (b)(i) and problems with the labels and amounts for Profit on Realisation and Purchase Consideration in (b)(i) and (b)(ii)
- failing to give a conclusion for (c), therefore losing two marks
- in (d), candidates often added only the figures for Bangla Homes and Red Sun, instead of using the number and value of shares issued to take over each company. To help candidates, this was the same for each company
- including the total of each company's retained earnings in (d)– as a new company, Style plc will have no retained earnings.

You have been asked to speak at an Extraordinary General Meeting of the shareholders of Bangla Homes Furnishings plc, who are considering the merger with Red Sun Department Stores plc.

(c) Evaluate the merger on behalf of the shareholders of Bangla Homes Furnishings plc. (12)

In favor of the merger:

- * The shareholders of Bangla Homes plc will receive $\pounds 1.40$, that is $\pounds 0.40$ more than the previous $\pounds 1$.
- * Larger & fees for firms will achieve larger benefits.
- * New company will be benefited from economies of scale and the shareholders will be benefited too.
- * More profits as more goodwill. Profit on realization.

Against the merger:

- * Larger company may mean greater problems.
- * Dilution of ownership and voting power.
- * No company & for the shareholders in new company.

Overall, it can be said that the

merger should take place as
the company will expand and get
bigger resulting into more profits.
Shareholders will be safe.



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Examiner Comments

In favour of merger:

*1- The shareholder probably paid £1.60 for the Bangla share, from the information in the Statement of Financial Position for Bangla

*2- Very vague- 0 marks

*3- Economies of scale- 1 mark

*4- Profit on realisation- 1 mark.

Against merger:

*1- Not specific, too vague

*2- One for each point- 2 marks

*3- Answer is confused- 0 marks.

Conclusion:

Good conclusion- 2 marks.

Total of 6 marks awarded for (c).

Question 3

This was the least popular question in Section A.

The ledger entries in part (a) were found to be the most difficult part of the whole question. The question stated that dates should be shown, but many candidates omitted dates, or entered the wrong dates. Some candidates did not, or have forgotten how to, balance off accounts, despite the question asking for accounts to be balanced off or closed.

Part (b) was answered much better, with a clear indication that the final figure was a loss, not a profit. The Journal entry in (c) was usually able to obtain three marks, but not all parts were included. Most candidates achieved at least half marks for (d), with all being able to give a correct formula. The evaluation in (e) was generally good, with most offering a sensible discussion of the merits and drawbacks of shares and debentures.

Common errors:

- in (a), omitting dates, getting the wrong dates, or balancing off at 31 December instead of 31 March
- incorrect treatment of the monies returned on June 20 in (a)
- omitting the date and the narrative in the Journal entry for (c)
- incorrect substitution into the formula for (d), especially forgetting to add the £50million loss from (b) to make (£170million) on Retained earnings, not (£120million).

(e) Evaluate the decision to convert the 8% Debenture into £1 Ordinary Shares from the viewpoint of the directors of Mashariki Railways plc.

(12)

In Favour :

- * Gearing ratio will be improved as there will be no interest to pay.
- * Shares will increase resulting in more profit.
- * Liquidity position of the company will be improved.

Against :

- * Share price may fall as there will be more shares available.
- * Dilution of ownership and voting power.
- * Capital will be decreased as debenture will be converted into ordinary shares.

Conclusion : Overall, the decision of converting 8% debenture into ordinary shares is very effective as the gearing ratio will be improved. The company will not have to pay interest thus resulting into more profit.



In favour:

- *1 Two separate points here, each gaining one mark- 2 marks
- *2 This is incorrect- 0 marks
- *3 No detail or reason given as to why. It may have been covered in *1- 0 marks.

Against:

- *1 Correct- 1 mark
- *2 Correct- 1 mark
- *3 There is no change in capital, it does not decrease- 0 marks.

Conclusion:

Good conclusion, repeating an important point- 2 marks

Also makes a point about not having to pay interest etc, which gains 1 more mark under "In favour".

Total of 7 marks awarded for (e).

Question 4

This was the least popular question on Section B. Attempts at section (a) were reasonably good. As expected, valuing the closing inventory proved to be the most difficult part of the question. There were some good answers to (b) from those candidates who used marginal costing. Part (c) was found more difficult, especially by those who did not follow the instruction to answer using marginal costing. The evaluation section saw quite low marks, mainly because candidates did not answer the question, which was "the use of marginal costing in decision-making". Many gave their argument for marginal costing versus absorption costing, much of which was irrelevant.

Common errors:

- in (a), trying to work out a value for inventory using a marginal costing approach, rather than the absorption costing stated in the question
- comparing the selling price of £4.75 on offer in (b), to the usual £5.95 selling price from (a), and concluding that this meant a "loss" and the sale should not go ahead
- using type of total cost approach in (c), which usually resulted in erroneous figures that led nowhere. Some candidates used figures for the total of 30 000 units, which gave £7 500 and £4 500 as answers, but wrongly referred to this as "profit" rather than contribution
- the evaluation in (d) often did not answer the question, comparing marginal costing to absorption costing.

On 1 April 2016, Konichiwa plc, a large smartphone producer, requested Silverseal plc to supply 50 000 batteries during April at a price of £4.75 per battery.

(b) Advise management whether they should sell the 20 000 batteries in the inventory to Konichiwa plc at a price of £4.75 per battery, to meet part of the order.

(6)

Silverseal plc should not sell the 20,000 batteries in the inventory to Konichiwa plc at a price of £4.75 per battery as they would be making a loss of £24,000. Silverseal plc's selling price is £5.95; if it somehow manages to sell the batteries at a later date at this price, then the amount received would be $(20,000 \times £5.95) = £119,000$. On the contrary, selling at £4.75 per battery would result in an amount of $(20,000 \times £4.75) = £95,000$. Hence, ^{supposed} loss of £24,000. However, since Silverseal plc only has to supply only 500,000 batteries to Voyager plc, it may consider selling the 20,000 batteries to Konichiwa. But it is wiser to wait for a client who will pay a higher price, close to the original selling ^{price} of Silverseal of £5.95 per unit.

(d) Evaluate the use of marginal costing in decision making.

(8)

Marginal costing is useful as it helps ~~(and)~~ in decision making in the ~~(ess)~~ short ~~(term)~~ run. This method allocates costs to time and uses the prudence concept by showing a lower figure of closing stock. Hence, the profit figure is lower. Prudence concept is maintained as a lower profit figure stops a business from being bankrupt. The business is not unrealistically optimistic, hence may improve the decision making process by controlling costs.

On the contrary, marginal costing is useful only in the short run, not long run. Compared to marginal costing, absorption costing shows a more realistic profit figure. Marginal costing also violates the accrual concept by not matching the total revenue with the total cost incurred to generate the revenue.

In conclusion, marginal costing is useful in decision making, but other method such as absorption costing may be more useful.



Examiner Comments

Section (b)– refers to a possible sale as "supposed loss" and fails to use marginal costing.

Total of 0 marks awarded for (b).

Section (d) 3 marks for:

- Mention of use in short run allocation of costs to time period prudence.
- Detailed discussion regarding prudence gains no further marks.
- Candidate then discusses absorption costing and deviates from the point.

Conclusion is sufficient– 2 marks.

Total of 5 marks awarded for (d).

Question 5

This was the second most popular question in Section B. It was disappointing to see how many candidates were unable to work out a simple percentage increase in the share price for (a). Calculating a percentage should be part of any accounting student's 'tool kit'.

Answers to part (b) were mixed, with candidates often falling into one of two categories: they were able to calculate almost all ratios correctly, and give appropriate units, or they found ratios difficult. Those candidates who found it difficult, evidently had not learnt the ratios required for this part of the specification.

Answers to (c) were also varied. Some candidates were able to make a valid comparison between the shares chosen by Yasmin, and the All Share Index, interpreting the meaning of the figures calculated. Others decided to ignore figures and calculations, and answered highlighting points such as fees charged by stockbrokers, and comments about their knowledge etc. This approach was rewarded marks, but overall marks were no more than average due a limited number of observations that could be made.

Common errors:

- using £1.32 as the denominator, at the bottom of the formula for (a)
- applying an incorrect formula in (b) which resulted in only 0 or 1 mark per part
- stating for example "Yasmin's choice gave a return on capital employed (Roce) of 3%, and the All Share Index gave a Roce of 5%". This type of statement would not gain credit. Marks were awarded in (b) for the calculation of Roce of 3%, and the All share index was stated in the question. A better answer would have been "Yasmin's choice gave a higher Roce (1 mark) than the All share index, giving a better return by two percentage points" (1 mark). A relative comparison has been made and the difference determined.

(c) Evaluate whether Yasmin should select her own shares, or invest in the shares recommended by a stockbroker.

(8)

- ~~For~~ For Dubarab Shipping plc:
- Higher percentage of profit in the rise of share price (10% / 7%)
 - This ~~may~~ leads in higher profit for Yasmin, since she will receive more dividends.

For All share Index of the stock exchange:

- Higher return on capital employed (5% / 3%)
- Higher dividend cover (2 times / 1.3 times)
- Higher dividend yield (5.6% / 2.27%)
- The profit percentage may be lower, but ~~this~~ this company may be more profitable and Yasmin ~~can~~ make more money investing in All share Index of the stock Exchange.
- A stockbroker knows more about investing.

Conclusion: Yasmin should ~~invest~~ invest in the shares recommended by ~~the~~ ^{the} stockbroker.



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Examiner Comments

For Dubarab:

- 1st bullet point candidate states rise in share price is higher (1)
- 2nd bullet point this does not necessarily mean more dividends. Use of "may" would be required.

For All Share Index:

- 1st three bullet points all use "higher" and gain 1 mark each
- 4th bullet point is vague and rather meaningless
- 5th bullet point gains 1 mark, to take candidate up to the maximum of 4 marks for one side of the argument.

Conclusion: clear decision – 2 marks.

Total of 7 marks awarded for (c).

Question 6

This was the third most popular question of the four questions on Section B. Generally, marks achieved in (a) were good.

Most candidates overlooked the closing inventory of steel when calculating B, which required working to find the cost of sales. However, the 'own figure' rule applied, and most candidates gained a large percentage of the other marks available. However, it was disappointing to see how many candidates made the wrong choice when stating that the variance was adverse or favourable. Section (b) proved quite difficult, with many candidates again overlooking the raw material that had been purchased, but not used in production. Most were able to gain some marks by adding (b)(i) and (b)(ii), to arrive at an answer for (b)(iii) and rely on the 'own figure' rule again. Answers to (c) rarely achieved more than average marks, with candidates finding it difficult to come up with valid points that were relevant.

Common errors:

- overlooking the 70 kilograms of steel unused in (a) when calculating material costs
- confusion over what was an adverse variance and what was a favourable variance. Often, the thinking was, if the actual figure is bigger, it must be better, so 'favourable'. This is not true, of course, with cost figures
- not learning the formulas correctly in (b)
- incorrect substitution into the formula, especially in (b)(i), where the actual quantity was (14 550– 70). Actual quantity usage in (b)(ii) was also rarely correct, again due to the unused inventory. The actual quantity should have been £9.05 per radiator
- including a number of statements in (c) that referred to labour or material variances that were irrelevant, given that the question concerned sales variances.

At a meeting, the Sales Director stated "There is an adverse variance, comparing budgeted sales to actual sales, but this is not necessarily bad for the company".

(c) Evaluate the statement made by the Sales Director from the point of view of Sliema Domestic Limited.

(8)

Adverse variances are good for the business. This is because predetermined standards can sometimes be unrealistic and the ~~best~~ Sliema might be actually performing well. Moreover, they might have better sales than other competing firms and actual sales can be better than anticipated. Sliema might charge low selling prices and may have an adverse variance in sales figures but customers would actually be more happy about cheaper price and be loyal to Sliema.

On the other hand, adverse variances could be because sales are not to the expected level. This may be because demand is falling due to higher price, or lower quality or competitors might be offering better products. Management needs to take action to improve Sliema's performance. They can compare with standards set.

To conclude, adverse variances means that management by exception can take place and hence is not ~~ne~~ bad for companies to some extent.



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Examiner Comments

After a poor first sentence, the second sentence gains a mark – 1 mark.

The first paragraph gains two further marks for identifying that selling prices are low (1), but this may result in customer loyalty (1) – 2 marks.

The second paragraph discusses situations that do not exist. Sales volume is at the expected level, and prices are not "higher" – 0 marks.

Conclusion – 2 marks.

Total of 5 marks awarded for (c).

Question 7

This was the most popular question in Section B. Candidates often managed successfully to work through the calculations required for part (a) resulting in the correct answer. This was a considerable achievement. Answers to (b) were usually very good as well. Some candidates even took the time to calculate the payback period and the average rate of return.

Common errors:

- failing to deduct the depreciation from the running costs to arrive at the figure for cash outflow in (a)
- in (b), giving a generic commentary on how net cash flows changed over the years, which earned no marks.

(b) Evaluate the project for Suntours plc, using calculations made in (a) and considering any other relevant factors.

(8)

Net present value is, net cash flow multiplied by disc. factor minus investment. Net present value is a discounted method of. It takes into account the time value of money ~~and~~ ^{As Suntours plc is having a positive NPV value of 205929.12} ~~and~~ ^{it would be very beneficial to accept it.}

However, there are ^{is} ~~no~~ specific formula or way of calculating it. And figures can be estimates, therefore it might not show the real values. Moreover, calculations of cash inflows, outflow and net cash flow etc may consume time which might be more beneficial if spent on other things. ~~There are other~~ Only net present value ^{should not} ~~cannot~~ be considered, ~~with~~ there are other relevant methods such as internal rate of return and non-discounted factors such as Average rate of return and payback period. Payback period can help to know ~~with~~ ~~with~~ ^{to know} ~~through~~ the time period it will take to recover the amount of investment. And average rate of

return will help to know ~~the return amount~~
of the % of return Suntuours plc can gain
by accepting ~~a part~~ the project.
In my opinion ^{Suntuours plc ~~can~~ might gain benefits} even though the net present value is
by accepting this projects, However other methods
should also be considered

(Total for Question 7 = 32 marks)



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This candidate is confused between evaluating the project and evaluating the net present value method of project appraisal. However, they do gain a number of marks.

The first paragraph mentions the positive net present value, so the project should be accepted – 1 mark.

The second paragraph states figures are estimates – 1 mark.

It also discusses the use of other project appraisal methods – 1 mark.

Names two other methods required – 1 mark.

The conclusion to invest – 2 marks.

Total of 6 marks awarded for (b).

Paper Summary

Based on their performance on this paper, candidates are offered the following advice.

- At this level, it is to be expected that candidates are aware of the difference between 'profit' and 'net cash flow'. The term 'net cash flow' would have been the appropriate term to use in Q1, rather than profit. Also, in Q7, the term 'discounted net cash flow', or 'net present value', would be the correct term, not profit.
- It is also important to realise the meaning of the term 'contribution', and to be aware of how this differs from profit. This would have been important when answering Q4.
- Candidates 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. This would apply to the variances in Q6, and the ratios in Q5.
- Although not used as frequently as in the AS Paper 1 (WAC01), double entry book-keeping in t-shaped accounts is still part of the A2 Paper (WAC02). Candidates should not forget the basics of double entry, including dates, balances brought down, and how to balance off a ledger account. This knowledge would have resulted in more marks in Q2 and Q3.

Grade Boundaries

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