
A-LEVEL
APPLIED BUSINESS

BS15 Financial Accounting for Managers
Mark scheme

8610
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Version 1.0 Final

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all associates participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for standardisation each examiner analyses a number of students' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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ADDITIONAL GUIDANCE FOR MARKING SCHEME

	Assessment Objectives
	The Assessment Objectives represent those qualities which can be demonstrated in students' work and which can be measured for the purposes of assessment.
AO1 Knowledge, skills and understanding	Students demonstrate knowledge and understanding of the specified content and relevant business skills.
AO2 Application of knowledge, skills and understanding	Students apply knowledge and understanding of the specified content and relevant business skills.
AO3 Research and analysis	Students use appropriate methods in order to obtain and select information from a range of sources to analyse business problems.
AO4 Evaluation	Students evaluate evidence to reach reasoned judgements.
Quality of Written Communication	<p>The quality of written communication is assessed in all assessment units where students are required to produce extended written material. Students will be assessed according to their ability to:</p> <ul style="list-style-type: none"> • select and use a form and style of writing appropriate to purpose and complex subject matter • organise relevant information clearly and coherently, using specialist vocabulary when appropriate • ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear. <p>The assessment of the quality of written communication is included in Assessment Objective 4.</p>

1

Total for this question: 28 marks

1 (a) Using **Item A**, explain why BM Ltd might be concerned by a fall in the value of purchase orders received for equipment.

[4 marks]

Level	Descriptor	Marks	Assessment Objective
2	Uses Item A when explaining an implication to BM Ltd of a decline in the value of purchase orders received.	4–3	AO2
1	Demonstrates an understanding of a purchase order.	2–1	AO1

Knowledge and Application:

- *purchase order – official order from a buyer to a seller detailing type, quantity and price of products the buyer requests the seller to provide*
- *establishes a contract between the buyer and seller, ie a ‘firm order’*
- decline was in relation to previous year’s first quarter and is significant at 20% - would indicate that sales might be lower for the entire year, resulting in a possible decline in total profits
- fall in sales of equipment might result in a fall in sales of maintenance contracts
- market might be saturated – 80% of airports using the equipment already – and this decline might be evidence of this
- BM Ltd has suffered a decline in profitability recently
- Gross profit margin on equipment sales is higher (41.8% rather than 26.5%)
- The cost of sales of maintenance contracts is rising more quickly.

1 (b) Using **Item A**, analyse why Duncan Read was worried about BM Ltd's profitability in 2013. Use calculations to support your answer.

[9 marks]

Level	Descriptor	Marks	Assessment Objective
3	Uses Item A to analyse factors affecting BM Ltd's profitability.	9–8	AO3
2	Uses Item A when describing BM Ltd's profit / profitability.	7–4	AO2
1	Demonstrates a generic understanding of profit / profitability.	3–1	AO1

Knowledge and Application:

- *profitability can be measured by the gross profit margin (GPM) and net profit margin (NPM)*
- *improving if gaining a greater return on activities/investments*
- cost of sales increased by £5.8 million, with much of that being an increase in maintenance costs (up by £3.8 million)
- equipment sales increased by £3.1 million whilst maintenance contract sales have increased by £4.9 million
- profit on equipment sales gone from £3.2 million to £4.3 million; profit from maintenance contract sales gone from £0.7 million to £1.8 million
- total gross profit has increased by £2.2 million and net profit by £0.5 million
- GPM fallen from 42.9% to 35.7% and NPM fallen from 7.7% to 7.0%

Analysis:

- the fall in GPM would seem to be largely due to increasing maintenance contract costs – return on equipment has gone from 44.4% to 41.7% whilst return on maintenance sales has gone from 36.8% to 26.5%
- over-reliance on maintenance contracts will inevitably reduce GPM and only through controlling overheads has the NPM not been reduced by as much as the GPM
- with equipment sales likely to slow down, 2014 returns are likely to be worse.

Markers' notes:

1. Award L2 (4 to 5 marks) for describing figures and L2 (6 to 7 marks) for calculating margins/costs with no analysis of results
2. Simple calculation on revenue /cost data = minimum L2 (4 marks)

1(c) To what extent do you agree with Li Yang that BM Ltd should **not** enter the European market? Use **Item A** to justify your answer.

[15 marks]

Level	Descriptor	Marks	Assessment Objective
3	Uses Item A to analyse the financial effect(s) of entering/not entering the market.	8–6	AO3
2	Uses Item A when explaining a financial advantage(s)/disadvantage(s) of entering the market.	5–3	AO2
1	Demonstrates a generic understanding of relevant financial accounting issues.	2–1	AO1

Knowledge and Application

Disadvantages of entering the market:

- *it would be risky and require definite cash outflows before receiving uncertain inflows*
- the business would have to borrow a very large amount of money (£9.6m) which would increase risk for a business of this size
- interest on the loan would increase the cost of building the factory to £17 million
- established competitor in the market may well make it either difficult to achieve the sales Duncan is forecasting or result in lower profits by BM Ltd having to match or exceed a possible price cut by the competitor.

Advantages of entering the market:

- *it might increase sales and increase profits; a new factory might be more efficient*
- the UK market is slowing down (falling purchase orders), so new sales have to be found from somewhere
- even if BM Ltd's costs could be controlled, profits would not increase by that much
- the new market might also result in extra maintenance contract sales.

Analysis:

- the uncertainty associated with the plan could result in BM Ltd facing an increase in annual overheads of at least £0.25 million (interest) plus the new overheads associated with operating the factory in France (administration as well as depreciation), whilst sales may well be significantly less than Duncan predicts and, even if they are achieved, could be £1.03 million lower due to matching the price cut
- at best, net profits could increase by £4.05 million (£4.3 million increase in gross profits - £0.25 million annual interest) plus any additional profits on maintenance contracts (eg £1.8 million) so that an annual return of up to £6 million might be achieved on an investment of £12 million
- at worst, BM Ltd could be left with extra annual interest costs, minimal additional sales and the prospect of selling, possibly at a loss, a £12 million asset they no longer need
- the presence of a major and popular competitor, and the fact that BM Ltd does not know the mainland market, would indicate that this is a particularly risky proposal.

For **AO4**, you should award marks using the scheme below.

Note that AO4 also assesses students' quality of written communication. When deciding on the AO4 level to be awarded, consider the degree to which the student orders and communicates his/her ideas.

Judgement is being made on whether BM Ltd should focus on developing the European market.

To access E3, judgement must be made on the relative importance of the financial effects of entering or not entering the European market.

Level	Descriptor	Marks	Assessment Objective
E3	Offers judgement with weighted justification. Ideas are communicated in a coherent structure with consistent and appropriate use of technical terms. There are few errors in accepted conventions of written communication.	7–5	AO4 and Quality of written communication
E2	Offers judgement with supported justification. Ideas are communicated using a logical structure, with some appropriate technical terms. There are occasional errors in accepted conventions of written communication.	4–3	
E1	Offers limited judgement. Ideas are communicated with some structure evident with occasional use of appropriate technical terms. There are some errors in accepted conventions of written communication.	2–1	

Evaluation

- there is a danger that the work involved in opening the new market will reduce UK profits as so much time would be focused on the new market
- if the new market does not work, BM Ltd will have made a very large investment in a new factory which is hard to recoup, and with UK profits of £1.2 million, interest and capital repayments might represent a significant drain on resources
- however, the trend in UK sales and the over-reliance on maintenance contracts would support entry into the European market – the potential return from the investment is high (almost 50% a year) and this level of return is not likely to be achieved by just controlling costs
- on balance, BM Ltd might benefit from further research into the European market, resale value of the new factory, any potential growth of UK market and the extent to which costs could be controlled
- Look at other markets.

2**Total for this question: 28 marks**

2 (a) Calculate the profit that BM Ltd could expect to make in the **first year** (January 2015 to January 2016) if it invested in the faststack system and sold 5 units.

[5 marks]

	£	£
Sales revenue		2 000 000
Cost of sales:		
- parts and materials	750 000	
- production and installation	825 000	
Gross profit		425 000 (1)
Depreciation of new production line	75 000 (2 - see below)	
Share of company overheads	305 000	
Total expenses		380 000 (1 OFR)
Net profit		45 000 (1 OFR)

Markers' note:

Under depreciation award ONE mark for a figure of £80 000.

2 (b)	<i>Analyse the possible impact on BM Ltd's cash flow of investing in the faststack system.</i>	[8 marks]
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Level	Descriptor	Marks	Assessment Objective
3	Analyses the impact on BM Ltd's cash flow if it invests in faststack.	8–7	AO3
2	Itemises BM Ltd's cash flow if it invests in faststack.	6–4	AO2
1	Demonstrates an understanding of factors affecting cash flow.	3–1	AO1

Knowledge and Application

- *any activity which results in bank transactions in or out of a business's account will have an impact on cash flow*
- *trading activities will result in inflows and outflows which could be net inflows or net outflows, but finance activities (for capital transactions) can also impact on cash flow, eg funding a major investment*
- *credit and debit transactions are not recorded until payments are made/received and this can have an effect on cash flows/liquidity*
- *BM Ltd will have to fund the design, manufacturing and installation of the five systems before it will be paid for them in full, this is very expensive and will affect its cash flow adversely*
- *the five new systems will cost £750 000 in parts and materials and £825 000 in production and installation costs, a total of £1 575 000 and the supermarket is only intending to pay a deposit of £400 000.*

Analysis:

- overall, will incur a negative cash flow of £1 175 000 / £1 975 000 by December 2015 with the exact amount depending on when the installation work and manufacturing is carried out
- BM Ltd will have to fund the new production line with borrowing and it may need to pay interest and/or repayments.
- The cash flow position may be problematic in the short-term but should resolve itself in the long-run.

2 (c) Do you think that BM Ltd should invest in the faststack system? Use **Item B** and your answers to **Questions 2(a)** and **2(b)** to justify your decision.

[15 marks]

Level	Descriptor	Marks	Assessment Objective
3	Analyses the factors affecting the success of the faststack investment.	8–6	AO3
2	Explains how investing in faststack will affect the business.	5–3	AO2
1	Demonstrates a generic understanding of return on investment (assets).	2–1	AO1

Knowledge and Application

- profits may rise and sales in the UK may increase with the new market
- needs to make a reasonable profit compared with the cost of investment measured as $\text{profit/asset cost} \times 100$
- faststack has the potential to increase profits by £45 000 (OFR) in year 1 on a £800 000 investment
- a £2m increase in UK sales in year 1 is significant against existing sales of £17.1m
- BM Ltd will need to borrow a large amount to develop the new system and will have quite a negative impact on cash flow during the first year
- first customer has potential to buy up to 50 faststack systems.

Analysis:

- whilst first year profits are modest, if the supermarket likes the system and buys more this would increase profits and turnover
- the new market would also diversify the business and reduce its reliance on airports
- less risk than the European market as the supermarket has confirmed orders
- a 5.6% return on the £800 000 investment in year 1. NPM in 2013 was 7.0%.
- NPM for faststack is only 2.25%, much lower than the company's overall NPM in 2013, which was 7.0%.

For **AO4**, you should award marks using the scheme below.

Note that AO4 also assesses students' quality of written communication. When deciding on the AO4 level to be awarded, consider the degree to which the student orders and communicates his/her ideas.

Judgement is being made on whether BM Ltd should invest in the faststack system.

To access E3, judgement must be made on the relative merits of the investment.

Level	Descriptor	Marks	Assessment Objective
E3	Offers judgement with weighted justification. Ideas are communicated in a coherent structure with consistent and appropriate use of technical terms. There are few errors in accepted conventions of written communication.	7–5	AO4 and Quality of written communication
E2	Offers judgement with supported justification. Ideas are communicated using a logical structure, with some appropriate technical terms. There are occasional errors in accepted conventions of written communication.	4–3	
E1	Offers limited judgement. Ideas are communicated with some structure evident with occasional use of appropriate technical terms. There are some errors in accepted conventions of written communication.	2–1	

Evaluation:

- initial contract would seem to be profitable, but perhaps providing a low rate of return
- this might be expected as BM Ltd are entering a new market, ie they could have charged a lower price to attract the supermarket and increase price later if the system proves successful
- obvious issue in relation to liquidity and the potential cash flow problem – any difficulties in its existing airport market could make this additional cash flow issue quite crucial for the survival of the business
- however, this market would seem to be more reliable/less risky than the alternative of entering the European market and doing nothing would not seem to be an option.

3

Total for this question: 24 marks

3 (a) Using **Item C**, analyse why Brian Palma might be concerned about the accuracy of CAT Ltd's 2014 forecasted accounts.

[9 marks]

Level	Descriptor	Marks	Assessment Objective
3	Uses Item C to analyse <u>the implications</u> for CAT Ltd of Brian's concerns.	9–7	AO3
2	Uses Item C when explaining Brian's concerns.	6–3	AO2
1	Demonstrates an understanding of relevant accounting concept(s) / relevant accounting issues.	2–1	AO1

Knowledge and Application:

- consistency – continued adoption of policies for dealing with financial records, unless there is a sound reason for change
- realisation – revenue regarded as received only when transaction carried out
- reasons for depreciating assets – to provide as accurate an account as reasonable of the value of a business; to recognise the deteriorating value of fixed assets; to prepare plan for capital investment
- the figures are only a forecast and Brian might be concerned that the sisters are treating them as guaranteed
- the change in accounting policy for depreciating the newer bikes – should have been at 20% which would have meant total depreciation should have been forecasted as £8 400 and not £6 200
- funds for replacing older bikes perhaps insufficient – older bikes 5 years old and, depreciated at 20%, would seem that 5 years is the maximum.

Analysis:

- consistent use of depreciation would be changing the forecast from a profit of £800 to a loss of £1 400 and the slightly less favourable figures might imply that this loss could be even higher
- the inability to fund the replacement of the business's key fixed asset, bikes, threatens its viability: how safe/functional would the bikes be and might this result in lower sales, for example? Replacing 20 bikes would cost at least £22 000 and possibly more given inflation. They only have an overdraft facility of £15 000, so would have to fund this through additional finance. Is the business viable?
- The accountant may be worried about the implications of too optimistic forecasts of future revenue

Markers' note:

- Level 2 -1 area covered (3 to 4 marks)
2 areas covered (5 to 6 marks).

3 (b) Do you think that the sisters should sell CAT Ltd to the competitor for £50 000?
Use **Item C** to justify your answer.

[15 marks]

Level	Descriptor	Marks	Assessment Objective
3	Uses Item C to analyse financial factors affecting the decision to sell.	8–6	AO3
2	Uses Item C when explaining CAT Ltd's financial position.	5–3	AO2
1	Demonstrates understanding of financial statements/values.	2–1	AO1

Knowledge and Application:

- *fixed assets (from balance sheet) provide some indication of the value of a business*
- *profits (from P&L account) provides some indication of the returns generated by a business*
- *going concern concept – assumption that the business will trade in the foreseeable future*
- Brian calculates that the business can generate cash – £12 600 by the end of 2016 – but it is not making a profit if 20% depreciation is used
- the bikes have a book value of approximately £30 000 so an offer of £50 000 might be seen as being acceptable considering that shareholders' funds could be falling in the future
- the sisters invested £25 000 in the business two and a half years' ago – they would double their money which would seem a good return
- the business is just about providing them with £25 000 each a year - £50 000 does not seem very generous considering this.

Analysis:

- the business is on the edge of being viable if they pay themselves £25 000 a year: consistent accounting policy would indicate an annual loss of £1 400 (or more if forecasts do not materialise) but this could be covered by an increase in prices so that it breaks even; cash position would seem to be less favourable given the possible inflationary increase in the finance required to fund the replacement of 20 bikes which require at least £17 600, ie £5 000 overdraft
- the sisters had different earnings before setting up the business – Sara is receiving more income whilst Rachel is receiving less – and they would seem to have a slightly different commitment to the business: Sara produced the forecast and seems to have thought about the future of the business; Rachel is less optimistic and is just looking at the book value of the business.

For **AO4**, you should award marks using the scheme below.

Note that AO4 also assesses students' quality of written communication. When deciding on the AO4 level to be awarded, consider the degree to which the student orders and communicates his/her ideas.

Judgement is being made on whether the sisters should sell CAT to the competitor.

To access E3, judgement must be made on the relative merits of the sale.

Level	Descriptor	Marks	Assessment Objective
E3	Offers judgement with weighted justification. Ideas are communicated in a coherent structure with consistent and appropriate use of technical terms. There are few errors in accepted conventions of written communication.	7–5	AO4 and Quality of written communication
E2	Offers judgement with supported justification. Ideas are communicated using a logical structure, with some appropriate technical terms. There are occasional errors in accepted conventions of written communication.	4–3	
E1	Offers limited judgement. Ideas are communicated with some structure evident with occasional use of appropriate technical terms. There are some errors in accepted conventions of written communication.	2–1	

Evaluation:

- returns are certainly acceptable for Sara given the fact that she is earning more than she did working in the leisure centre
- however, returns are less acceptable for Rachel who seems more risk averse and is taking a pay cut
- if the business can continue to provide £25 000 for each of the sisters, then this is an on-going stream of income – concept of going concern would indicate that £50 000 is a very poor offer – and so the key factor would remain, ie how reliable is Sara's forecast, her contention that increasing prices charged for its holidays would improve finances and Rachel's willingness to receive a return which is less than she gained in teaching two and half years' ago
- overall, perhaps too early to accept the offer – continue to run the business, reflect on the 2014 actual figures, try increasing prices and review situation in 2015
- always the danger that the offer will not be made again, but all returns are risky and the current business model, whilst a little suspect, would seem to be with continuing if both sisters are gaining satisfaction from running it.