



# Financial Management

## **SAMPLE TIME CONSTRAINED ASSESSMENT MARKING SCHEME**

This marking scheme has been prepared as a **guide only** to markers. This is not a set of model answers, or the exclusive answers to the questions, and there will frequently be alternative responses which will provide a valid answer. Markers are advised that, unless a question specifies that an answer be provided in a particular form, then an answer that is correct (factually or in practical terms) **must** be given the available marks.

If there is doubt as to the correctness of an answer, the relevant NCC Education materials should be the first authority.

**Throughout the marking, please credit any valid alternative point.**

**Where markers award half marks in any part of a question, they should ensure that the total mark recorded for the question is rounded up to a whole mark.**

## Discount factors table

Year	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%
1	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877
2	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769
3	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675
4	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592
5	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519
6	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456
7	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400
8	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351
9	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308
10	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270
11	0.650	0.585	0.527	0.475	0.429	0.388	0.350	0.317	0.287	0.261	0.237
12	0.625	0.557	0.497	0.444	0.397	0.356	0.319	0.286	0.257	0.231	0.208
13	0.601	0.530	0.469	0.415	0.368	0.326	0.290	0.258	0.229	0.204	0.182
14	0.577	0.505	0.442	0.388	0.340	0.299	0.263	0.232	0.205	0.181	0.160
15	0.555	0.481	0.417	0.362	0.315	0.275	0.239	0.209	0.183	0.160	0.140
16	0.534	0.458	0.394	0.339	0.292	0.252	0.218	0.188	0.163	0.141	0.123
17	0.513	0.436	0.371	0.317	0.270	0.231	0.198	0.170	0.146	0.125	0.108
18	0.494	0.416	0.350	0.296	0.250	0.212	0.180	0.153	0.130	0.111	0.095
19	0.475	0.396	0.331	0.277	0.232	0.194	0.164	0.138	0.116	0.098	0.083
20	0.456	0.377	0.312	0.258	0.215	0.178	0.149	0.124	0.104	0.087	0.073
21	0.439	0.359	0.294	0.242	0.199	0.164	0.135	0.112	0.093	0.077	0.064
22	0.422	0.342	0.278	0.226	0.184	0.150	0.123	0.101	0.083	0.068	0.056
23	0.406	0.326	0.262	0.211	0.170	0.138	0.112	0.091	0.074	0.060	0.049
24	0.390	0.310	0.247	0.197	0.158	0.126	0.102	0.082	0.066	0.053	0.043
25	0.375	0.295	0.233	0.184	0.146	0.116	0.092	0.074	0.059	0.047	0.038
26	0.361	0.281	0.220	0.172	0.135	0.106	0.084	0.066	0.053	0.042	0.033
27	0.347	0.268	0.207	0.161	0.125	0.098	0.076	0.060	0.047	0.037	0.029
28	0.333	0.255	0.196	0.150	0.116	0.090	0.069	0.054	0.042	0.033	0.026
29	0.321	0.243	0.185	0.141	0.107	0.082	0.063	0.048	0.037	0.029	0.022
30	0.308	0.231	0.174	0.131	0.099	0.075	0.057	0.044	0.033	0.026	0.020
31	0.296	0.220	0.164	0.123	0.092	0.069	0.052	0.039	0.030	0.023	0.017
32	0.285	0.210	0.155	0.115	0.085	0.063	0.047	0.035	0.027	0.020	0.015
33	0.274	0.200	0.146	0.107	0.079	0.058	0.043	0.032	0.024	0.018	0.013
34	0.264	0.190	0.138	0.100	0.073	0.053	0.039	0.029	0.021	0.016	0.012
35	0.253	0.181	0.130	0.094	0.068	0.049	0.036	0.026	0.019	0.014	0.010
36	0.244	0.173	0.123	0.088	0.063	0.045	0.032	0.023	0.017	0.012	0.009
37	0.234	0.164	0.116	0.082	0.058	0.041	0.029	0.021	0.015	0.011	0.008
38	0.225	0.157	0.109	0.076	0.054	0.038	0.027	0.019	0.013	0.010	0.007
39	0.217	0.149	0.103	0.071	0.050	0.035	0.024	0.017	0.012	0.009	0.006
40	0.208	0.142	0.097	0.067	0.046	0.032	0.022	0.015	0.011	0.008	0.005
41	0.200	0.135	0.092	0.062	0.043	0.029	0.020	0.014	0.010	0.007	0.005
42	0.193	0.129	0.087	0.058	0.039	0.027	0.018	0.012	0.009	0.006	0.004
43	0.185	0.123	0.082	0.055	0.037	0.025	0.017	0.011	0.008	0.005	0.004
44	0.178	0.117	0.077	0.051	0.034	0.023	0.015	0.010	0.007	0.005	0.003
45	0.171	0.111	0.073	0.048	0.031	0.021	0.014	0.009	0.006	0.004	0.003

**Question 1**

Shore Tours plc is completing its financial accounts for internal use for the year ending 28 February 2021. It has produced the following trial balance to summarise the ledger account balances.

Shore Tours plc  
Trial Balance as at 28 February 2021

	Dr £	Cr £
Sales revenue		965,000
Payments to hotels	141,300	
Fuel and maintenance	124,100	
Wages and salaries	323,000	
General expenses	162,600	
Vehicles - cost	230,000	
Accumulated depreciation – vehicles		46,000
Premises - cost	325,000	
Accumulated depreciation – premises		99,000
Share capital (£1 shares)		100,000
Retained losses	4,000	
6% loan repayable 2030		100,000
Cash at bank	2,000	
Accounts receivable	6,000	
Accounts payable		8,000
	<u>1,318,000</u>	<u>1,318,000</u>

The matters below should be addressed before completing the company's accounts:

- Premises – depreciation is charged over the 20-year life of the premises using the straight-line method. The premises were bought on 1 March 2009 at cost with an expected residual value of £145,000. The current market value of the premises is £250,000.
- The company does not have a policy of revaluing its non-current assets.
- Vehicles – depreciation is charged using the reducing balance method at 20% per annum.
- The 6% loan was taken out on 1 July 2020 and is guaranteed by the government. Interest is due to be paid on 31 May each year.

- a) Prepare the *Income Statement* of Shore Tours plc for the year ended 28 February 2021 and the *Statement of Financial Position* at the same date. Explain how the financial statements would differ if the premises had been revalued in the accounts rather than depreciated.

**15**

## Mark Scheme

0-3 Marks	4-5 Marks	6-8 Marks	9-10 Marks	11-15 Marks
<i>Basic financial statements showing some understanding of constituents of each.</i>	<i>Limited financial statements with an understanding of assets, liabilities, income and expenses in context.</i>	<i>Adequate financial statements with an appropriate format and most items correctly transferred from trial balance.</i>	<i>Good presentation of financial statements with largely correct transfers from trial balance and attempts at adjustments for depreciation.</i>	<i>Coherent financial statements with good standard of end of year accounting and accurate adjustments.</i>
<i>Vague to no understanding of revaluation without illustration.</i>	<i>Limited understanding of asset revaluation but uncertainty of accounting transactions.</i>	<i>Consistent understanding of revaluation of assets and of the revaluation reserve.</i>	<i>Critical understanding of revaluation of assets and of the revaluation reserve.</i>	<i>Consistently critical understanding of revaluation of assets and accounting for revaluation.</i>

**Shore Tours plc****Income Statement for the year ended 28 February 2021**

	£	£
<b>Sales revenue</b>		<b>965,000</b>
<b>Payments to hotels</b>	<b>141,300</b>	
<b>Fuel and maintenance</b>	<b>124,100</b>	
<b>Wages and salaries</b>	<b>323,000</b>	
<b>General expenses</b>	<b>162,600</b>	
<b>Depreciation – premises</b> <i>(5% x 325,000 – 145,000)</i>	<b>9,000</b>	
<b>Depreciation – vehicles</b> <i>(20% x 230,000 – 46,000)</i>	<b>36,800</b>	
<b>Interest on loan</b> <i>(6% 100,000) x 8/12</i>	<b><u>4,000</u></b>	<b><u>800,800</u></b>
<b>Profit for year</b>		<b>164,200</b>
<b>Retained losses b/f</b>		<b><u>(4,000)</u></b>
<b>Retained profits c/f</b>		<b><u>160,200</u></b>

**Statement of Financial Position as at 28 February 2021**

	Cost £	Accumulated Depreciation £	Net Book Value £
<b>Non-Current Assets</b>			
<b>Premises</b>	<b>325,000</b>	<b>108,000</b>	<b>217,000</b>
<b>Vehicles</b>	<b><u>230,000</u></b>	<b><u>82,800</u></b>	<b><u>147,200</u></b>
	<b><u>555,000</u></b>	<b><u>190,800</u></b>	<b>364,200</b>
<b>Current Assets</b>			
<b>Accounts receivable</b>		<b>6,000</b>	
<b>Cash at bank</b>		<b><u>2,000</u></b>	<b><u>8,000</u></b>
			<b><u>372,200</u></b>

<b>Share capital £1 shares</b>		<b>100,000</b>
<b>Retained profits</b>		<b><u>160,200</u></b>
		<b>260,200</b>
<b>Non-Current Liabilities</b>		
<b>6% Loan 2030</b>		<b>100,000</b>
<b>Current Liabilities</b>		
<b>Accounts payable</b>	<b>8,000</b>	
<b>Loan interest accrued</b>	<b><u>4,000</u></b>	<b><u>12,000</u></b>
		<b><u>372,200</u></b>

*If the premises had been revalued the asset would have been revalued to £250,000 in the Statement of Financial Position. Depreciation for the year for premises would not need to be included in the Income Statement, thus increasing the profit for the year to £173,200 and retained profits carried forward to £169,200. A revaluation reserve of £250,000 - £226,000 = £24,000 would have been created.*

*If the company revalued its premises, there would be a revaluation reserve within capital and equity and the asset would be included at market value.*

- b) Compare and contrast the roles of a *board of directors* and the *audit committee*, as required by corporate governance principles, in respect of *going concern, long-term viability, risk management* and *internal control*. Evaluate any concerns which might have arisen in the case of Shore Tours plc.

10

**Mark Scheme**

<b>0-2 Marks</b>	<b>3 Marks</b>	<b>4-5 Marks</b>	<b>6 Marks</b>	<b>7-10 Marks</b>
<i>Basic explanation of the role of the board and/or audit committee.</i>	<i>Some comparison or contrast of the roles of the board and audit committee.</i>	<i>Adequate comparison and contrast in basic terms between the board and audit committee.</i>	<i>Sound comparison and contrast of the board and audit committee focused on two of the categories in the question.</i>	<i>Thorough and coherent comparison and contrasting of the board roles across the categories in the question.</i>
<i>Provide basic interpretation and evaluation of relevant concerns which might have arisen in the case of Shore Tours plc.</i>	<i>Provide limited interpretation and evaluation of relevant concerns which might have arisen in the case of Shore Tours plc.</i>	<i>Provide consistent interpretation and evaluation of relevant concerns which might have arisen in the case of Shore Tours plc and recognition of why it is relevant to the board or audit committee.</i>	<i>Provide critical interpretation and evaluation of relevant concerns to the company, the board and audit committee. which might have arisen in the case of Shore Tours plc.</i>	<i>Provide consistently critical interpretation and evaluation of relevant concerns which might have arisen in the case of Shore Tours plc.</i>

**Indicative content:**

- ***The board of directors should establish the audit committee with an appropriate number of independent non-executive directors (three in the UK) with one member of the committee having recent and relevant financial experience.***
- ***The board has overall responsibility for the long-term success of the company, and set out remuneration policy. They are responsible for the governance of the company whereas the audit committee fulfil part of that responsibility.***
- ***In its overall role, the board should maintain sound risk management and internal control systems so it looks at the nature and extent of principal risks and determines the level of risk it is willing to take to take to achieve its strategic objectives. Risk management and internal controls should be monitored on an ongoing basis by the board. It needs to explain actions taken for remedying weaknesses.***
- ***In determining the level of risk, the long-term viability of the business and its status as a going concern is a key concern of the board. Indeed, in the annual report, directors include two statements – confirmation of the appropriateness of the going concern basis: and a broader assessment by the board of the company's ongoing viability.***
- ***Non-executive directors offer a constructive challenge to the board.***
- ***The audit committee also complements the role of the board. It monitors the integrity of the financial statements, reviews the internal financial control system and monitors and reviews the effectiveness on the internal audit function.***
- ***Hence, there are similarities in roles in respect of going concern, viability and internal controls. The audit committee offers a degree of independence and expertise to enhance governance.***
- ***There are differences in respect of risk management.***
- ***Audit committees are also concerned with external audit, including making recommendations to the board for the engagement of specific external auditors and monitoring the independence, objectivity and effectiveness of external audit.***
- ***There may have been some concern about going concern for Shore Tours Ltd as there were retained losses at the start of the year. Some concern may have been discussed in respect of the loan and its impact on the finances of the company although the government guarantee should have provided some assurance of long-term viability.***

Total 25 Marks

## Question 2

K, L and M are three public companies. K trades as a supermarket, L as an electrical engineering contractor and M is a fashion brand.

The following ratios have been calculated for the three companies for the year ended 31 December 2020 and are presented below with comparative industry average ratios for the retail industry:

Ratio	K	L	M	Industry Average (retail)
Return on capital employed	8%	12%	20%	10%
Gross profit margin	40%	60%	75%	50%
Operating profit margin	15%	12%	25%	11%
Interest cover	10 times	5 times	1 times	3 times

- a) Compare and contrast the performance of the three companies with each other and against the industry averages for the benefit of a potential investor. Explain limitations with the information provided for your analysis and the process of *ratio analysis*.

15

## Mark Scheme

<b>0-3 Marks</b>	<b>4-5 Marks</b>	<b>6-8 Marks</b>	<b>9-10 Marks</b>	<b>11-15 Marks</b>
<i>Provides basic interpretation and evaluation of the performance of each organisation .</i>	<i>Provides limited interpretation and evaluation of the performance of each organisation and limited comparison with others and the industry average.</i>	<i>Provide consistent interpretation and evaluation of organisational performance with some contrasts and comparison s with others and industry average.</i>	<i>Provides critical interpretation and evaluation of organisational performance with contrasts and comparisons with other companies and industry averages with recognition of different types of business.</i>	<i>Provides consistently critical interpretation and evaluation of the performance of the three organisations individually, against each other and against the industry averages with appreciation of the implications of differences between entities for investors.</i>
<i>Can basically identify more than one valid limitation in respect of the information, or more than one valid limitation in respect of the process of ratio analysis.</i>	<i>In a limited way can identify more than one valid limitation in respect of information and more than one in respect of the process of ratio analysis.</i>	<i>Can adequately explain several limitations of the information and/or the process of ratio analysis.</i>	<i>Can soundly explain various limitations of the information and/or the process of ratio analysis.</i>	<i>Can coherently explain a range of limitations with the information provided and the process of ratio analysis.</i>



**Indicative content:**

- *K, the supermarket, achieves a lower return on capital employed and gross profit margin than the other companies and the industry average. However, its operating profit margin is higher than all but the fashion brand.*
- *A supermarket deals primarily in food and other commodities which are usually easily saleable. Hence, it is likely to have greater competition and will need to keep margins relatively low. It may, indeed, trade as a low-cost outlet.*
- *Nevertheless, the likelihood of less chance of bad debts and ability to keep its costs low seems to have allowed it to achieve a good operating profit margin. It has a high rate of interest cover which perhaps indicates it does not have a significant need to borrow.*
  
- *L, the engineering contractor, has a lower interest cover than the supermarket so perhaps has some need to finance longer term contracts by loan. It is a riskier business than K because it is unlikely to have such strong day to day cash flows which is reflected in the higher return on capital employed (demanded by shareholders).*
- *The gross profit margin perhaps indicates some specialism in the contracts undertaken and the ability to charge high prices. Overheads seem to have impacted on the results so that a lower operating profit margin is seen as compared with K.*
- *As with K, it is difficult to properly compare with the industry average and the retail industry may not represent the electrical contractor in any case.*
  
- *M has outstanding results as compared with the other companies and the industry average. This again indicates that the industry average may not be representative of any of the industries involved.*
- *The fashion brand may be significantly subject to fluctuations in consumer taste and without a trend in the company results it is difficult to judge its ongoing success. It has a relatively high gross profit margin probably reflecting the impact of the brand on pricing.*
- *Both return on capital employed and operating profit margin indicate a successful year. The interest cover is a concern as it shows a high commitment to borrowing so means that the business could be high risk for investors.*
  
- *As the information only covers four ratios and no trend of individual companies over time, it is impossible to judge performance effectively and certainly not for investment purposes.*
- *Each of the companies is in a significantly different industry so comparison is meaningless other than for a potential investor looking for a particular level of return and risk. The industry average is linked to retail so is of limited use in comparisons. It may not be representative of K, L or M.*
- *The size of each company is not indicated. Nor are any relationship with any other companies in a group, for example. An investor would need that information to be able to assess the risks of an investment.*
- *Accounting policies, whether the businesses are subject to different GAAPs and so on would all impact on the underlying figures and the ratios so again limit the value of the information.*

- b) Explain what is meant by total quality management (TQM) and discuss how it may be used in each of the companies, K, L and M, to improve performance.

**Mark Scheme**

<b>0-2 Marks</b>	<b>3 Marks</b>	<b>4-5 Marks</b>	<b>6 Marks</b>	<b>7-10 Marks</b>
<i>Provides a basic explanation of TQM and how it is used.</i>	<i>Provides a limited explanation of TQM and how it is used.</i>	<i>Provides consistent explanation of TQM and how it is used.</i>	<i>Provides critical interpretation explanation of TQM and how it is used.</i>	<i>Provides consistently critical explanation of TQM and how it is used.</i>
<i>Demonstrates basic understanding of how TQM may be used in each of the companies, K, L and M, to improve performance.</i>	<i>Demonstrates limited understanding of how TQM may be used in each of the companies, K, L and M, to improve performance.</i>	<i>Demonstrates adequate understanding of how TQM may be used in each of the companies, K, L and M, to improve performance.</i>	<i>Demonstrates sound understanding of how TQM may be used in each of the companies, K, L and M, to improve performance.</i>	<i>Demonstrates comprehensive understanding of how TQM may be used in each of the companies, K, L and M, to improve performance.</i>

**Indicative content**

- **Total quality management (TQM) focuses on the continual improvement in quality throughout the organisation. Quality is considered to be the ability to fully satisfy customer needs at the lowest internal price as opposed to a subjective standard.**
- **TQM is also concerned with assessing costs associated with not meeting quality standards and reducing those costs to improve profitability.**
- **The costs of quality can be categorised under four headings:**
  - **Prevention costs: such as preventing the production of sub-quality products or service. K could monitor its products to ensure the food sold was fit for consumption, was kept at appropriate temperatures and met all hygiene requirements. It would be concerned with maintaining a high reputation and ensuring customers knew it was a safe place to shop. Likewise, L would be concerned with the safety of its customers in using its products and services and ensuring that all legislative requirements were fulfilled. M would also be concerned with its products to ensure that there was little risk of the products being flammable or causing skin irritation when worn. For each company, lawsuits and damage to reputation would be costs to avoid.**
  - **Appraisal costs: including inspection of products and detecting sub-quality outputs. Some of these would be within the organisation and others monitored by external inspectors appointed by governments and regulators.**
  - **Internal failure costs: those costs found before products leave the organisation typically intercepted on the production line or within a shop and by internal systems/inspectors. These seek to drastically reduce reputational damage and cost to the organisations.**
  - **External failure costs: represent the cost of complaints, warranties and repairs when mistakes, etc are found outside the organisation.**

- *The appraisal costs, internal and external failure costs could all be addressed by K, L and M with the idea of preventing sub-standard products. There will be a balance in costs of quality with the benefits of incurring those costs.*

Total 25 Marks

**Question 3**

- a) Provide a reasoned recommendation why a manufacturing company that produces a high volume of medicines in tablet form would find *standard costing* a useful technique. Contrast this with the suitability of standard costing for a manufacturer of medical aids made specifically for an individual person. 15

**Mark Scheme**

<b>0-3 Marks</b>	<b>4-5 Marks</b>	<b>6-8 Marks</b>	<b>9-10 Marks</b>	<b>11-15 Marks</b>
<i>Explanation of standard costing and variance analysis.</i>	<i>Discussion of standard costing as a useful technique to recommend for high volume manufacturing.</i>	<i>Recommendation of use of standard costing in high volume as compared with low volume bespoke manufacturing.</i>	<i>Clear recommendation of standard costing in manufacturing in the context of a high-volume production with contrasting argument for bespoke manufacturing.</i>	<i>Well-reasoned recommendation of the usefulness of standard costing in appropriate context providing suitable contrasts between low and high-volume manufacturing.</i>

- *As a standard cost is defined in the CIMA terminology as: the planned unit cost of the product, components or services produced in a period, it indicates that there is the need for the product to be predictable so that planning is possible. A high-volume product produced over a period of time, presumably in the same or a similar way is predictable and so planning is possible. A ‘one-off’ bespoke design is neither predictable nor capable of ongoing planning.*
- *In a high-volume business, material costs for each unit of product will be the same. Labour and machine costs will be uniform for the manufacture of each product and so on.*
- *Although there will be variations in costs over time, it is likely to be cost-effective to determine a standard cost for materials, labour and other costs, rather than look at each individual batch of materials, labour costs each week. This would not be the same with a single product prepared for an individual which would be better dealt with through a job costing system.*

- *Standard costs are useful for planning and producing budgets.*
- *Desired levels of performance can be decided upon and built into the standards so that a level of challenge is provided.*
- *The results can then be monitored by comparing actual outcomes with budgets to identify variances which can then be investigated.*
- *Standard costing information can conveniently be included in costing and pricing decisions.*
- *When producing a single bespoke product, costs are based on the actual time spent in production and materials used and although there is some planning, the actual results simply inform management of the outcome of that particular job although the results can and should be considered for future jobs.*
- *Hence, it is recommended that for the production of medicines in tablet form at high volume should be subject to standard costing as an efficient and cost-effective basis for planning, monitoring and control.*

- b)** Discuss how the introduction of standards in a system of standard costing, variances and other forms of performance evaluation can impact on human behaviour in the workplace. Illustrate your discussion with examples relevant to a manufacturing company.

10

## Mark Scheme

<b>0-2 Marks</b>	<b>3 Marks</b>	<b>4-5 Marks</b>	<b>6 Marks</b>	<b>7-10 Marks</b>
<i>Demonstrates basic understanding of the impact of performance evaluation on human behaviour in the workplace.</i>	<i>Demonstrates limited understanding of the impact of performance evaluation on human behaviour in the workplace.</i>	<i>Demonstrates consistent understanding of the impact of performance evaluation on human behaviour in the workplace.</i>	<i>Demonstrates a sound understanding of how the introduction of standard and variances as illustrations of performance evaluation impact on human behaviour in the workplace.</i>	<i>Demonstrates a comprehensive understanding of how the introduction of standard and variances as illustrations of performance evaluation impact on human behaviour in the workplace.</i>
<i>Can basically use appropriate examples of standards within a manufacturing context.</i>	<i>In a limited way can use appropriate examples of standards within a manufacturing context.</i>	<i>Can adequately use appropriate examples of standards within a manufacturing context.</i>	<i>Can soundly determine, adapt and use appropriate examples of standards within a manufacturing context.</i>	<i>Can coherently determine, adapt and use appropriate examples of standards within a manufacturing context.</i>

**Indicative content**

- *Any setting of standards through budgeting, standard costing, targets etc. are likely to impact on human behaviour (as they are designed to). Generally, this would challenge individuals to achieve greater efficiency and effectiveness.*
- *For instance, if higher volumes of tablet production were required to be manufactured to meet demand in an epidemic, targets would be raised and it would be expected that machinery would be maintained and run at peak performance to achieve the goals.*
- *However, human behaviour is influenced by a wide range of factors.*
- *If it is clear from management communication about standards that focus should be on a limited number of specific targets, emphasis on those targets may mean that other matters are ignored. Machines may be run at full power to achieve goals but maintenance ignored to meet a short-term goal, for example.*
- *If it is not possible to achieve the targets set, the data may be manipulated by workers so that it appears that success has been achieved. This may be particularly so if rewards flow from meeting targets. Some production may be held back one week if a target is easily met in case of problems with machines or flow or product in the next week for instance.*
- *If there are no tangible benefits in meeting targets, workers may be less incentivised to meet requirements.*
- *And attaining a standard may be considered sufficient. Workers may be able to exceed a level of production but if there is no incentive to do so or the standard is perceived as being sufficient no additional effort may be expended. Innovation may be stifled.*

Total 25 Marks

## Question 4

Camraphone plc, a manufacturer of mobile technology, needs to upgrade its production facilities and is considering the options of developing its existing labour-intensive facilities or to replace them with a computerised production line which will have a significant saving in labour costs. The following forecasts have been produced for each of two options:

Labour-intensive			Computerised production		
Cash outflows			Cash outflows		
Year		£m	Year	New production line cost	£m
Y0	Re-equipment cost	10	Y0		150
Y0	Retraining costs	1	Y1	Retraining costs	10
Y1	Retraining costs	1	Y1 and Y2	Materials, labour, overheads	20 each year
Y1, Y2 and Y3	Materials, labour, overheads	50 each year	Y3 and Y4	Materials, labour, overheads	45 each year
Y4, Y5 and Y6	Materials, labour, overheads	70 each year	Y5 and Y6	Materials, labour, overheads	60 each year
Cash inflows		£m	Cash inflows		£m
Y1, Y2 and Y3	Cash inflows	56 each year	Y1 and Y2	Cash inflows	45 each year
Y4, Y5 and Y6	Cash inflows	80 each year	Y3 and Y4	Cash inflows	85 each year
			Y5 and Y6	Cash inflows	120 each year

Both options are expected to need replacing in Year 7 because of technological advances planned in respect of the products and the production facilities at that time are not expected to have a residual value. The cost of capital is 8%.

- a) Calculate the *payback periods* and *net present values* of both the labour-intensive and computerised production options and evaluate the options considering both financial **and** potential non-financial concerns.

**Mark Scheme**

<b>0-3 Marks</b>	<b>4-5 Marks</b>	<b>6-8 Marks</b>	<b>9-10 Marks</b>	<b>11-15 Marks</b>
<i>Calculations demonstrate a basic understanding of a capital investment appraisal technique for each option.</i>	<i>Calculations demonstrate a limited understanding of payback and NPV for both options.</i>	<i>Calculations demonstrate an adequate understanding of payback and NPV for both options</i>	<i>Calculations are largely correct and demonstrate a sound understanding of payback and NPV for both options.</i>	<i>Calculations are clear and largely correct and demonstrate a coherent understanding of payback and NPV for both options.</i>
<i>Provides basic interpretation and evaluation of the options, considering both financial and potential non-financial concerns.</i>	<i>Provides a limited interpretation and evaluation of the options, considering both financial and potential non-financial concerns.</i>	<i>Provides a consistent interpretation and evaluation of the options, considering both financial and potential non-financial concerns.</i>	<i>Provides a critical interpretation and evaluation of the options, considering both financial and potential non-financial concerns.</i>	<i>Provides a consistently critical interpretation and evaluation of the options, considering both financial and potential non-financial concerns.</i>

**Payback**

• **Labour Intensive**

Year	Details	£m
Y0	Outflow	(11)
Y1	Net Inflow (56-51)	5
Y2	Net Inflow (56-50)	<u>6</u>
		<u>0</u>

• **Computerised production**

Year	Details	£m
Y0	Outflow	(150)
Y1	Net Inflow (45-10-20)	15
Y2	Net Inflow (45-20)	25
Y3	Net Inflow (85-45)	40
Y4	Net Inflow (85-45)	<u>40</u>
		<u>30</u>
Y5	Net Inflow (120-60)	<u>60</u>

**Payback – Year 2**

**Payback – 4 ½ years**

**Net Present Value**

• **Labour Intensive**

Yr	Cash flow	DCF	NPV £m
Y0	(11)	1.000	(11.00)
Y1	(56-51) = 5	0.926	4.63
Y2	(56-50) = 6	0.857	5.14
Y3	(56-50) = 6	0.794	4.76
Y4	(80-70) = 10	0.735	7.35
Y5	(80-70) = 10	0.681	6.81
Y6	(80-70) = 10	0.630	<u>6.30</u>
		NPV	<u>23.99</u>

• **Computerised production**

Yr	Cash flow	DCF	NPV £m
Y0	(150)	1.000	(150.00)
Y1	(45-10-20) = 15	0.926	13.89
Y2	(45-20) = 25	0.857	21.42
Y3	(85-45) = 40	0.794	31.76
Y4	(85-45) = 40	0.735	29.40
Y5	(120-60) = 60	0.681	40.86
Y6	(120-60) = 60	0.630	<u>37.80</u>
		NPV	<u>25.13</u>

- **Payback is quicker for the labour-intensive option which is preferred under that measure. This ignores cash flows after the payback as well as the time value of money.**
- **NPV which considers cash flows over the full six-year period indicates that computerised production is favoured.**
- **Generally, the NPV consideration would be taken as the better and more complete choice in financial terms.**
- **However, there is not a significant difference between the outcomes of the two options and a six-year period is difficult to forecast and expect the outcome to be precisely as planned. For instance, the costs, levels of income and volumes may differ over time.**
- **There is also a significant investment in computerised production facilities together with what appears to be an acceptance that the facilities only have a limited life. If technology moves on more quickly, will the computerised production facilities be able to match requirements as effectively as a more labour-intensive approach?**
- **It is not clear but if the computerised facilities replace the workforce or at least part of it, could this lead to difficulties with unions and the local community? Competition and its impact should also be considered.**
- **The labour-intensive option may prove to be the most appropriate for the next few years without involving the same degree of risk although, if the plans are completely fulfilled, will mean marginally lower cash flows.**

- b) The directors of Camraphone plc are considering including a *balanced scorecard* in future published financial statements to demonstrate the organisation's commitment to more aspects of the business than the purely financial one. Explain the purpose and contents of a *balanced scorecard* and evaluate the idea of including additional reporting of the business affairs in this way. **10**

### Mark Scheme

<b>0-2 Marks</b>	<b>3 Marks</b>	<b>4-5 Marks</b>	<b>6 Marks</b>	<b>7-10 Marks</b>
<i>Provide basic explanation of the purpose and contents of a balanced scorecard.</i>	<i>Provide limited explanation of the purpose and contents of a balanced scorecard.</i>	<i>Provide consistent explanation of the purpose and contents of a balanced scorecard.</i>	<i>Provide critical explanation of the purpose and contents of a balanced scorecard.</i>	<i>Provide consistently critical explanation of the purpose and contents of a balanced scorecard.</i>
<i>Provide basic evaluation of whether Camraphone plc should incorporate this into their formal reporting of the business' affairs.</i>	<i>Provide limited evaluation of whether Camraphone plc should incorporate this into their formal reporting of the business' affairs.</i>	<i>Provide consistent evaluation of whether Camraphone plc should incorporate this into their formal reporting of the business' affairs.</i>	<i>Provide critical evaluation of whether Camraphone plc should incorporate this into their formal reporting of the business' affairs.</i>	<i>Provide consistently critical evaluation of whether Camraphone plc should incorporate this into their formal reporting of the business' affairs.</i>

**Total 25 Marks**



## Question 5

15

- a) Explain how each of the financial statements and the additional information required by *IAS1 Presentation of Financial Statements* help to meet the needs of user groups who analyse financial statements. Illustrate your discussion with examples of how these address legal requirements and *generally accepted accounting principles (GAAP)* to provide a true and fair view.

**Mark Scheme**

<b>0-3 Marks</b>	<b>4-5 Marks</b>	<b>6-8 Marks</b>	<b>9-10 Marks</b>	<b>11-15 Marks</b>
<b><i>Demonstrates basic understanding of how each of the financial statements and the additional information required by IAS1 Presentation of Financial Statements.</i></b>	<b><i>Demonstrates limited understanding of how each of the financial statements and the additional information required by IAS1 Presentation of Financial Statements.</i></b>	<b><i>Demonstrates adequate understanding of the financial statements and the additional information required by IAS1 Presentation of Financial Statements help to meet the needs of user groups who analyse financial statements.</i></b>	<b><i>Demonstrates sound understanding of the financial statements and the additional information required by IAS1 Presentation of Financial Statements help to meet the needs of user groups who analyse financial statements.</i></b>	<b><i>Demonstrates comprehensive understanding of the financial statements and the additional information required by IAS1 Presentation of Financial Statements help to meet the needs of user groups who analyse financial statements.</i></b>
<b><i>Provide basic examples of how these address legal requirements and generally accepted accounting principles (GAAP)</i></b>	<b><i>Provide limited examples of how these address legal requirements and generally accepted accounting principles (GAAP)</i></b>	<b><i>Provide adequate examples of how these address legal requirements and generally accepted accounting principles (GAAP)</i></b>	<b><i>Provide sound examples of how these address legal requirements and generally accepted accounting principles (GAAP)</i></b>	<b><i>Provide comprehensive examples of how these address legal requirements and generally accepted accounting principles (GAAP)</i></b>

**Indicative content**

- ***IAS 1 Presentation of Financial Statements requires financial statements to comprise the following:***
  - ***Income statement***
  - ***Statement of financial position***
  - ***Statement of cash flows***
  - ***Statement of changes in equity***
  - ***Notes on accounting policies and other explanatory notes***
  - ***Comparative information over time***

- **Typical user groups who analyse financial information and their needs are:**
  - **Owners and those who are considering owning an organisation or shares in the organisation who are looking for a safe and profitable well-run organisation which will generate returns for them for some years to come.**
  - **Lenders and creditors who are concerned to generate a reasonable income from lending or providing credit. They are focused on payback of the funds extended within a given period and to protect themselves in case of the unexpected.**
  - **Employees who need a source of employment and income for the future in an organisation that offers prospects for improvement.**
  - **Customers who are looking for a reliable supplier for the future and the ability to fulfil warranties in case of problems with products and services.**
  - **Tax authorities and government who generate income from profitable organisations.**
  - **The public, campaigning groups and others who have a general interest on how organisations impact on their concerns, such as the environment.**
  
- **Owners and potential owners will need information from most of the financial statements and will certainly need to see that the financial statements have fulfilled all legislative and GAAP requirements of the countries in which the accounts are published. This is generally shown in an auditor's report which is in addition to the IAS 1 statements. And, if the shares are quoted on stock exchanges, confirmation that all stock exchange requirements are fulfilled will also be needed.**
- **The income statement provides an idea of the profitability of the company and this, as well as other statements is supplemented by the notes to the accounts which explain line by line entries in the main financial statements. The notes also provide information about trends over time. Together, these will give some assurance of profitability through past years and an indication of a well-run company.**
- **The statement of financial position provides an indication of strength from a comparison of assets and liabilities and the comparison of finance by loan and equity. Again, this information is expanded upon in the notes. The statement of cash flows and comparison information showing trends over time indicates how the business managed the flow of funds through the organisation and its cash position. The statement of changes in equity is particularly pertinent to shareholders as it indicates how the company manages its equity as a whole including shares, retained profits, earnings and so on and indicates, to some extent, the policy between distributing dividends and retaining profits. Some shareholders are concerned with capital growth and others with regular dividend income so this is an important area.**
- **Other users have general concerns about profitability and strength because of the need for company survival to meet their needs over time so the income statement, statement of financial position, statement of cash flows and the notes are all important.**
- **Specifically, lenders and creditors need to see that cash is likely to be available to repay borrowing and to meet interest charges on time. The income statement provides some background to indicate profitability to generate cash. And the statement of cash flows indicates cash availability in the past to meet needs with the implication that this will be similar in the future. The statement of financial position indicates assets which may be available as collateral for lenders.**

- *Employee focus is more likely to be on the income statement and statement of cash flows and the notes to the accounts as an indicator of a profitable and ongoing organisation able to provide employment and remuneration.*
- *Customers are also looking for an ongoing organisation to meet their needs and the income statement to indicate profits and a strong organisation as indicated by the statement of financial position are likely to be key, together with the notes to the accounts.*
- *The income statement will provide much of the information needed for tax authorities although the ability to pay tax when due would also be relevant and the statement of cash flows should provide some historical evidence to this ability.*
- *The needs of the public and others is more nebulous, and the specific detail required is most likely to be contained in the notes to the accounts and additional statements such as the directors' report and environmental statements not required by IAS 1.*
- *All users would welcome a clear view of the future, but this is not offered by IAS 1 statement and these could not be produced with a true and fair view in any case.*

- b) Evaluate the usefulness of ethical rules and conventions in enhancing the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework. 10

### Mark Scheme

<b>0-2 Marks</b>	<b>3 Marks</b>	<b>4-5 Marks</b>	<b>6 Marks</b>	<b>7-10 Marks</b>
<i>Demonstrates basic understanding of ethical rules and conventions.</i>	<i>Demonstrates limited understanding of ethical rules and conventions.</i>	<i>Demonstrates adequate understanding of ethical rules and conventions.</i>	<i>Demonstrates sound understanding of ethical rules and conventions.</i>	<i>Demonstrates comprehensive understanding of ethical rules and conventions.</i>
<i>Provides a basic evaluation of how ethical rules and conventions enhance the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework.</i>	<i>Provides a limited evaluation of how ethical rules and conventions enhance the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework.</i>	<i>Provides an adequate evaluation of how ethical rules and conventions enhance the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework.</i>	<i>Provides a sound evaluation of how ethical rules and conventions enhance the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework.</i>	<i>Provides a comprehensive evaluation of how ethical rules and conventions enhance the value of financial information provided in accordance with IAS1 and the IFRS conceptual framework.</i>

**Indicative content**

- ***History has shown that lapses in ethics have led to the collapse of companies in the past and significant losses to investors, lenders, suppliers and others. This has proved to be so serious that it has led to the need for corporate governance as well as ethical requirements on accountants and others.***
- ***Ethical rules and conventions such as objectivity set out to prevent personal bias and prejudice in applying accounting rules and relevance to ensure that the information provided is what is needed and not used to cloud the financial affairs of the organisation. Such principles underlie the concept of true and fair applied in the IAS 1 financial statements.***
- ***In addition to objectivity and relevance, there are long-standing rules in accounting. Prudence is applied to prevent an overoptimistic view of performance being shown which could mislead shareholders, lenders and others. Care is taken not to overinflate the value of assets or overstate profits by ignoring potential bad debts. This impacts particularly on the income statement and statement of financial position on which most analysts rely.***
- ***Consistency in the use of accounting bases, etc. is applied to again prevent the accounts misleading users. Once an approach has been decided upon, such as straight-line depreciation, it should be applied year after year in the same way. This enables trends to be more clearly seen and understood. Changes may take place, such as when a new accounting standard is introduced, but the notes to the accounts must clearly show the changes and the impact of those changes. Again, this is an effort to be clear and as truthful as possible to prevent misleading the readers of accounts.***
- ***The philosophy behind the accounting standards, the true and fair view and application of ethical standards is embodied in the conceptual framework produced by IFRS. It sets out generally accepted guidance for the development of new reporting practices and for challenging and evaluating the existing practices. It seeks to help in understanding and interpreting accounting standards and to assist those aiming to develop accounting standards in emerging areas of concern.***

Total 25 Marks

**End of paper**

## Learning Outcomes matrix

Question	Learning Outcomes assessed	Marker can differentiate between varying levels of achievement
1	1	Yes
2	2, 3	Yes
3	2	Yes
4	2, 3	Yes
5	1, 3	Yes

## Grade descriptors

Learning Outcome	Fail	Referral	Pass	Merit	Distinction
Analyse and prepare financial statements using International Financial Reporting Standards (IFRS)	Can basically determine, adapt and use appropriate methods to reach basic solutions.	In a limited way can determine, adapt and use appropriate methods to reach limited solutions.	Can adequately determine, adapt and use appropriate methods to reach appropriate solutions.	Can soundly determine, adapt and use appropriate methods to reach established and appropriate solutions.	Can coherently determine, adapt and use appropriate methods to reach well established and highly appropriate solutions.
Assess the financial performance of companies	Provide basic interpretation and evaluation of relevant information, concepts and ideas to address problems that are broadly defined yet complex.	Provide limited interpretation and evaluation of relevant information, concepts and ideas to address problems that are broadly defined yet complex.	Provide consistent interpretation and evaluation of relevant information, concepts and ideas to address problems that are broadly defined yet complex.	Provide critical interpretation and evaluation of relevant information, concepts and ideas to address problems that are broadly defined yet complex.	Provide consistently critical interpretation and evaluation of relevant information, concepts and ideas to address problems that are broadly defined yet complex.
Assess the use of managerial accounting in business strategy	Demonstrates basic understanding of different perspectives, approaches or school of thought and the reasoning behind them.	Demonstrates limited understanding of different perspectives, approaches or school of thought and the reasoning behind them.	Demonstrates adequate understanding of different perspectives, approaches or school of thought and the reasoning behind them.	Demonstrates sound understanding of different perspectives, approaches or school of thought and the reasoning behind them.	Demonstrates comprehensive understanding of different perspectives, approaches or school of thought and the reasoning behind them.