

AS ACCOUNTING

AS (7126)

Marked responses

See responses to a 20-mark question to show how different levels are achieved and understand how to interpret the mark scheme.

Version 1.0 October 2017

EXAMPLE RESPONSES



Please note that these responses have been reproduced exactly as they were written and have not been subject to the usual standardisation process.

Specimen paper, question 18

Question

HP DAK Ltd is a small company which manufactures a single niche product for the UK catering market. The company is looking for opportunities to grow the business but due to a lack of consumer confidence the existing market for its product is relatively static. The current forecast is to sell 7 000 units this year at an average selling price of £150 per unit.

The variable costs of a unit of output is as follows:

	£
Material X – 2 kilos at £6.00 per kilo	12.00
Material Y – 0.5 litres at £10.00 per litre	5.00
Labour: Skilled – 3 hours at £15.00 per hour	45.00
Labour: Semi-skilled – 4 hours at £8.00 per hour	32.00
Total variable cost	94.00

The company has just received an approach from a potential overseas customer who is prepared to place an order for 1 500 units if a total sales price of £187 500 is agreed and delivery takes place within 3 months. The overseas customer is prepared to pay in full before the order is shipped but HP DAK Ltd will have to pay the shipping and insurance costs of £16 500. If the delivery terms and quality standards are met then the overseas customer will look to place future orders totalling in the region of 5 000 units per annum.

(1) Budgeted fixed overheads for the current year are £280 600 and it is anticipated the profit for the year will be £111 400.

(2) It is forecast for the current year skilled labour will be under-utilised by 2 040 hours but the decision has been taken to retain the existing 12 skilled employees and pay them for a 40 hour week even though they may not be producing any output. All non-productive wages are included within fixed overheads.

(3) Any shortfall in skilled labour hours would be worked as overtime at a premium of £5.00 hour.

(4) Obtaining extra supplies of materials and semi-skilled employees at the current rates is not considered to be a problem.

Evaluate the financial and non-financial implications of the proposed order from the overseas customer. Your answer should include a justified recommendation as to whether to accept or reject the order.

[20 marks]

Mark scheme

AO2 – 5 marks, AO3 – 15 marks

Level	Marks	Description
4	16–20	<p>A balanced response that presents a coherent and logically reasoned judgement and conclusion/solution that is supported by an astute consideration of relevant evidence drawn from both the stimulus and other sources.</p> <p>There is a clear assessment of the significance and limitations of the evidence used to support the judgement.</p>
3	11–15	<p>A reasoned, but in places unbalanced, judgement and conclusion/solution is presented that considers relevant evidence that can be drawn from the stimulus and/or other sources.</p> <p>The judgements of relative significance may be indistinct. There is an awareness of the impact of any limitations or qualifying factors, but assessment is partial or equivocal.</p> <p>A comprehensive and relevant selection of information is analysed, showing a developed logical chain of reasoning. The results of any appropriate calculation/s are integrated into the analysis and evaluations offered on most.</p>
2	6–10	<p>An underdeveloped judgement and conclusion/solution is presented, supported by a limited evaluation of evidence provided in the stimulus material. There may be inconsistencies and the reasoning may contain inaccuracies.</p> <p>A limited but relevant selection of information is analysed, starting to develop a logical chain of reasoning. The results of the calculation/s are integrated into the analysis but with weak evaluations.</p> <p>Relevant knowledge and understanding of principles/concepts/techniques is drawn together and applied successfully to the context. Where appropriate, relevant calculations are attempted; these may include minor errors.</p>
1	1–5	<p>A basic judgement and conclusion/solution may be asserted, but it is unsupported by any evidence.</p> <p>Responses present a limited selection of information that is not wholly relevant with an attempt at analysis. A chain of reasoning ranges from being barely present to undeveloped.</p> <p>Fragmented items of knowledge and understanding of principles/concepts/techniques relevant to the contexts are present. These are likely to be descriptive, with limited application to the context. Where appropriate, some calculations are attempted; these are likely to contain errors and may not be relevant to the context. Results of the calculations are stated with little or no evaluation.</p>
0	0	Nothing written worthy of credit.

Answers may include:

<p>AO2 – Application</p> <ul style="list-style-type: none"> • The incremental revenue is £187 500 • Incremental costs are calculated as $1500 \times (12+5+32) = £73 500$ • Skilled labour cost is calculated as $1500 \times 3\text{hrs}, 4500 - 2040 = 2460 \text{ hrs} \times (£15 + £5) = £49 200$ • Shipping and insurance cost £16 500 • Profit on the order is found by deducting costs from revenue. $£187 500 - (£73 500 + £49 200 + £16 500) = £48 300$ • Financially the order would produce a significant increase in profit ($£48 300 \times 100 / 111 400 = 43.4\%$)
<p>AO3 – Analysis and evaluation</p> <p>Financial implications of order:</p> <ul style="list-style-type: none"> • Financially the order would produce a significant increase in profit and as growth is wanted this would meet this objective. • If order is accepted then a large discount is being given, how will existing customers react if they discover this? • Potential future orders would also give growth, but much will depend upon what unit selling price is agreed for such large quantities, will further discounts be required? • Need to consider exchange rate issues ie what currency will be used to pay for current and future orders? • Will future orders be paid for in advance and if not will credit control checks prove satisfactory? • If future large orders taken will there be sufficient production capacity to handle this? If not what are the cost implications of adding more capacity, eg how will fixed overheads change? • What are the working capital implications of order under consideration and future orders? <p>Non-financial matters to consider:</p> <ul style="list-style-type: none"> • Would skilled employees be prepared to work overtime at £5 premium? • What about stress caused by working large amounts of overtime in a short period of time? • Can delivery be guaranteed in 3 months and what would happen to current customer orders? Extra 1500 units is close to 3 months current output • Will the output match the quality requirements of the overseas customer and what happens if it does not? • How likely is it that future orders of the size indicated will materialise? • If subsequent orders of 5000 units p.a. materialise will extra skilled staff needed be recruited? • Would material and semi-skilled resources be available if large future orders materialise and at current cost levels? • What alternative overseas markets are there that HP DAK Ltd. should investigate?

Note: Not all content needs to be covered to gain full marks.

The indicative content is not exhaustive; other creditworthy material should be awarded marks as appropriate.

Student responses

Student response 1

If HP DAK Ltd take the order, then they can make an additional £187,500 revenue in the first year and £750,000 (5000 x £150) in future years. This is a significant increase in their revenue, especially in such a niche, static market where they are unlikely to gain additional consumers in the short-run. Also, the customer is willing to pay in advance, meaning there is little effect on the liquidity of the firm if they take the order.

However, there are several additional costs that would be incurred by taking this order. HP DAK Ltd will need to pay an additional £12,300 in overtime wages to reach the demand and will incur an additional £16,500 in shipping costs. This will increase the costs of this order, thus decreasing its profitability. The contribution per unit of this order would be £22.80 which is significantly lower than the usual contribution per unit of £56. This implies that the selling price of the order could be too low. It would be more beneficial for HP DAK Ltd to expand their usual consumer base but this is unlikely to happen. Also, if existing customers find out about this deal then they may feel that they are being charged too high a price and demand a lower price for future purchases. If HP DAK Ltd do not grant this, then they may look elsewhere. This would be very bad for HP DAK Ltd as whilst they gain 5000 unit sales from the order, they might lose 7000 units of demand from their usual customers.

By taking the order, HP DAK Ltd will be using up all the labour hours available to them, so they will have to pay their skilled workers overtime rates. This would shift the non-productive wage costs from fixed overheads to variable overheads, which would be more appealing to shareholders as it shows the firm working more efficiently with its resources. However, the number of required extra skilled hours is questionable. 2460 hours are required in 3 months, with 12 skilled workers working 40 hours per week. That is 17 hours extra work per week per worker. It is uncertain whether all or any of the workers would be willing to do this, so HP DAK Ltd may need to consider hiring more skilled workers. This would come with additional costs for recruitment and training, and it is unknown whether HP DAK Ltd will be able to hire more workers in time to complete the order. As the new workers would be inexperienced they may not be able to produce output to an adequate level of quality. This would be particularly bad as subsequent orders from this customer are dependent on high quality. It is also questionable whether HP DAK Ltd can consistently obtain extra supplies of materials and semi-skilled employees in the long-run.

I would advise HP DAK Ltd to go ahead with the order if they are certain they can reach the total output level needed. This is because it grants a stable customer base in an uncertain market, an opportunity that is unlikely to occur again. However, if the skilled workers are unwilling to work overtime and HP DAK Ltd cannot find sufficient material or labour to meet the total output needed, then they should not go ahead with the order as they are unlikely to meet the criteria for future orders and they may be distracted from meeting the needs of their current customer base.

This is a level 3 response.

The judgement contained is reasoned but unbalanced in places. There is partial assessment of the significance and limitations of the evidence, and a logical chain of reasoning is present. Relevant knowledge and understanding is applied to the context, and some calculations have been attempted but contain errors.

Student response 2

The first factor to consider with this order is the drop in selling price from £150 per unit to £125 per unit. As a result, contribution also drops, from £56 to £31 which in turn will lower profits. For a bulk order of 1500 units, HP DAX Ltd would usually expect revenue of £225,000 minus costs of £141,000 leaving a profit of £84,000, however, with this order profit is only £46,500 and then shipping costs reduce it to £30,000. The difference of £54,000 is a significant amount of profit to lose, however, this order guarantees that they will sell units.

If the order is successful, the new customer will order 5000 units per annum going forward. This will almost double the expected sales of this year which will help the company to expand.

The time given for the delivery is 3 months and for some niche products it may take a lengthy period of time to produce. We are unsure on the product HP DAK Ltd produces, however the time allowed needs to be considered.

To reduce costs the company may start to pay staff on an output level. This means they only get paid for the work they produce. This will stop the workers from being paid when they are not doing anything. This may worsen relations with employees, however it will reduce costs meaning profits will increase.

Also, to meet the quality standards expected by the customer, HP DAK Ltd may need to improve the quality of the materials it uses in order to meet the standards expected. However, this will likely mean that their material costs will increase so again profits will be lower.

Overall, I would recommend not taking the order as despite it guaranteeing sales, as they may create another competitor. The overseas company could sell the products on for £150 as they can buy them for £125 and so make a quick profit of £25 each. Other customers may also ask for a price of £125 if this deal is publicly announced and the new customer could be selling the products overseas for a significantly higher price.

This is a level 1 response.

There is a basic level of judgement but overall only a limited use of evidence. There is a weak chain of reasoning, and fragmented knowledge and understanding has been applied.

Student response 3

One non-financial factor to consider is the time frame. The overseas customer is only prepared to place an order if the delivery takes place within 3 months. The customer wants 1500 units which means that a total of 10500 hours will be worked – 4500 skilled and 6000 semi-skilled. It raises the issue of whether the firm will be able to cope with the order in that time frame. Skilled labour is currently underutilised but the workers are still being paid even if they are not producing output. This will increase costs and lower production efficiency. The firm will pay skilled labour £600 per week even though they may not be producing output. If the firm doesn't meet the requirements of the customer due to the time frame being too short, then they may have to lower their selling price or lose the customer totally. So, they may end up paying a large amount of overtime at £5.00 per hour premium which will increase costs significantly.

A financial factor to consider is that the selling price is much lower for the overseas customer. Currently, the firm charges £150 per unit but for the overseas customer it will only be £125 per unit. This may reduce profitability as the firm will charge a lower price and in addition will have to pay for insurance. Total contribution will be £31 per unit compared to the current contribution of £56 per unit. However, the fixed overheads and net profit are only budgeted so the accuracy and reliability of the figures can be questioned.

Although, the overseas customer could bring about a great deal of potential for the firm. They are operating in a niche market and consumer confidence is low. If they sell to this customer it can help them expand its customer base beyond the UK which may help the firm grow. If the firm can meet their requirements to a suitable standard then there is potential for further orders of 5000 units per annum. Even though the selling price will be lower, the firm will make a profit and it will allow the firm to expand. The potential order of 5000 units at £125 per unit will bring an additional revenue of £625,000. Although the firm will still have to pay shipping costs which may be higher due to the increased volume. It will have to be cautious as to whether the overseas company might try to demand a selling price even lower than £125 per unit if and when it places the order for the additional 5,000 units.

Another consideration is just how might the existing market react. If the firm allows a lower price to be charged to the overseas customer then its existing customers may demand an equivalent price reduction and as a result profitability will be lowered. If prices are not reduced then customers might go elsewhere and this would mean a loss of sales revenue which could be very damaging in this niche market. Also, there is the issue of whether the firm can cope with the potential demand of this overseas customer in addition to what it is currently producing. If it cannot cope then one possibility is that its current quality standards might fall. This again would have negative implications for future orders. In short, there is a clear risk of losing or damaging its current reputation.

Overall, I think the firm should accept the order because it will help the firm expand its customer base overseas which in turn will help the firm to grow. However, they still need to be aware of the risks involved with having a large overseas customer due to the challenging time frames and the potential impact on its current customer base. In the long run the rewards outweigh the risks in my opinion.

Workings:

$7000 \times £150 = £1,050,000$ revenue

$£12 + 5 + 45 + 32 = £94$ variable cost per unit

$£150 - 94 = £56$ contribution per unit

Produced for overseas:

$£125 - 94 = £31$ contribution per unit

$1500 \times £31 = £46,500$ total contribution

$£46,500 - 16,500 = £30,000$ profit

$40 \text{ hours} \times £15 = £600$ wages

This is a level 3 response.

Judgement is becoming reasoned, and a partial assessment of the significance and limitations of the evidence is provided. There is some logical chain of reasoning present. Relevant knowledge and understanding applied to the context. Calculations have been attempted but do contain some errors.

Get help and support

Visit our website for information, guidance, support and resources at [aqa.org.uk/7127](https://www.aqa.org.uk/7127)

You can talk directly to the accounting subject team

E: business-studies@aca.org.uk

T: 01483 477 863