

Accounting

Answers and commentaries A-level (7127)

Paper 1: Financial accounting

Marked answers from students for questions from the June 2022 exams. Supporting commentary is provided to help you understand how marks are awarded and how students can improve performance.

Contents

The below content table is interactive. You can click on the title of the question to go directly to that page.

Section A

6 mark (question 11)	3
5 mark (question 12)	6
5 mark (question 13.1)	10
4 mark (question 13.2)	13

Section B

14 mark (question 14.1)	16
6 mark (question 14.2)	23
14 mark (question 15.1)	27
6 mark (question 15.2)	33

Section C

25 mark essay (question 16)	36
25 marks essay (question 17)	48

Answers and commentaries

This resource is to be used alongside the A-level Accounting June 2022 Question Paper 1 Financial accounting and inserts.

6 mark question

Question 11

Explain **two** advantages of using a bank overdraft as a source of finance for a business.

[6 marks]

Mark scheme

AO1 – 6 marks

Apply the levels of response mark scheme to each advantage – maximum 3 marks for each advantage.

Level	Marks	Description
3	3	A clear and thorough explanation showing understanding of an advantage of using a bank overdraft as a source of finance.
2	2	A partial explanation showing understanding, but lacking detail and/or minor inaccuracies.
1	1	Fragmented points made.
0	0	Nothing worthy of credit.

Answers may include:

- Flexibility – can change the amount borrowed at any time as long as the business are within the overdraft limit set by the bank.
- Cost – interest is only paid on amounts borrowed so it is cost effective in that if the business pay it off quickly it will reduce the overall cost and there is not normally a charge for early payment.
- Speed – overdrafts can usually be arranged/amended quickly so that the business can access the money when needed to meet short-term obligations eg wages, trade payables.
- Risk – overdrafts are not usually secured against non- current assets so the business should not be at risk of losing their non-current assets.

Marker note:

- Do not reward disadvantages.
- Not all content needs to be covered to gain full marks.
- The indicative content is not exhaustive other credit worthy material should be awarded marks as appropriate.

Student responses

Response A

Advantage 1 *A bank overdraft will provide a short-term finance source for the business. This means that they will be able to meet smaller short-term debts successfully with a relatively low interest charge over a short time period.*

Advantage 2 *A bank overdraft can usually be negotiated to allow a business a larger credit limit, which will be helpful for them as they ~~will~~^{may} not require another finance source, which could be time consuming to request and receive - if they are eligible.*

This is a Level 3 response

This is a clear and thorough explanation showing understanding of two advantages of using a bank overdraft as a source of finance. The student's response has a focus on flexibility, time and cost.

Overall the answer meets the requirements of Level 3 for both points.

6 marks

Response B

Advantage 1 it allows the business to borrow money from the bank to continue operating, therefore, helping with payments to trade payables by allowing the business to make payments on time.

Advantage 2 it allows the business to grow and solve their monetary issues temporarily, which means that they can still operate instead of potentially going into liquidation.

This is a Level 3 response

This is only a partial explanation showing an understanding of one benefit of using an overdraft, however the student focuses only on meeting short-term obligations so only one advantage has been demonstrated. A clear and separate point needs to be made for the other advantage to be awarded.

Overall the answer meets the requirements of Level 3 for only one advantage being demonstrated.

3 marks

5 mark question

This is a stand-alone question which requires the students to prepare a rent received account, this is assessing the student's ability to effectively utilise their understanding.

The book-keeper of Halpine is preparing the accounts for the year ended 31 March 2022. The rent receivable account for a flat rented out is still to be completed.

The following information was provided.

	£
Rent receivable owed to Halpine on 1 April 2021	860
Rent receivable paid into the bank during the year ended 31 March 2022	13 900
Rent receivable refunded by Halpine	500

Additional information

Included in the rent receivable paid into the bank was £2 730 which covered the three months ending 31 May 2022.

Question 12

Prepare the rent receivable account for the year ended 31 March 2022. Show clearly the amount to be transferred to the income statement and the balance brought down 1 April 2022.

[5 marks]

Mark scheme

AO1 – 5 marks

Dr	Rent receivable		Cr
Details	Amount £	Details	Amount £
Balance b/d	860 (1)	Bank	13 900 *
Bank	500 (1)* both		
Income Statement	10 720 (1)** OF		
Balance c/d	1 820 ***		
	<u>13 900</u>		<u>13 900</u>
		Balance b/d	1 820 (2) W1 ***

W1

$$£2\,730 / 3 \times 2 = £1\,820 \text{ (1)}$$

Marker note:

*Award 1 mark for both entries. Do not award where the student has netted the figures off ie £13 400

**Award 1 mark for the income statement figure being used to balance the account – this could be on the debit or the credit side. This must be arithmetically correct.

***Award 1 mark for the calculation of £1 820. Award 1 further mark for the balance brought down. This must be on the credit side of the account and must use one of the following figures (£1 820, £910 or £2 730) to be awarded.

To award the marks amounts must be supported by an appropriate label (recognisable abbreviations are acceptable for Balance, eg Bal c/d, b/d, Bal c/fwd., b/fwd. For the income statement label accept profit and loss account, I+S and P+L. For the bank label accept refund.

Student responses

Response A

Dr		Rent receivable		Cr	
Details	Amount £	Details	Amount £		
Prepayment	1,820	Bal b/d	800		
Rent refunded	500	Bank	13,400		
Income Statement	10,080				
Prepayment		Bal c/d Prepayment	1,820		
	10,580		10,580		
Prepayment	1,820	Prepayment			

3 marks awarded in total for this response, no mark awarded for the incorrect treatment of the opening balance. 1 mark awarded for both the bank entries. 1 mark awarded for the calculation of £1,820, however a further mark hasn't been awarded for the balance brought down as this must be on the credit side of the account. 1 own figure mark awarded for the income statement figure being used to balance the account which is arithmetically correct.

3 marks

Response B

Dr		Rent receivable		↑ Cr
Details	Amount £	Details	Amount £	
bal b/d	860	BANK	13900	
Refund	500			
Refund	1820			
Trf to Income Statement	10720			
bal c/d	1820			
	13900			13900
		bal b/d		1820

5 marks awarded in total for this question. 1 mark awarded for the correct treatment of the opening balance. 2 marks awarded for the correct calculation and treatment of the closing balances. 1 mark issued for the correct treatment of the two bank figures and 1 mark awarded for the income statement figure being used to balance the account which is arithmetically correct.

5 marks

5 mark question

Correction of errors question which requires students to prepare a suspense account and discover the trial balance shortfall.

Ross is completing his draft trial balance, which does not balance. A suspense account is opened and the following errors are discovered:

1. Rent payable of £7 600 had been correctly entered in the bank account but credited to the rent payable account.
2. Discount received of £2 400 had been correctly entered in the payables ledger account but omitted from the discount received account.
3. Drawings of £3 500 had been correctly entered in the bank account but credited to the wages account.

Question 13.1

Prepare Ross's suspense account to correct the errors, clearly showing the opening balance.

[5 marks]

Mark scheme

AO1 – 5 marks

Dr	Suspense		Cr
Details	Amount £	Details	Amount £
Balance b/d	19 800 (1) OF *	Rent payable	15 200 (1)
Discount received	2 400 (1)	Wages	3 500 (1)
		Drawings	3 500 (1)
	<u>22 200</u>		<u>22 200</u>

Marker note:

* The balance brought down could be on either side but must be numerically correct to be awarded.

To award the marks amounts must be supported by an appropriate label (recognisable abbreviations are acceptable for Balance, eg Bal b/d, Bal b/fwd. For Balance b/d accept trial balance shortfall however do not accept balance c/d as this implies it is carried forward for the next financial period.

Accept a £7 000 credit entry for drawings/wages combined if supported with an appropriate label (ie wages and drawings (it needs to say both) or journal).

Where a learner makes an entry with the label trade receivables and/or trade payables for £2 400 or £4 800 this should be ignored and not treated as an alien item. This could be on either side (or both sides) of the account.

For the OF Balance b/d to be awarded the account must be balanced and arithmetically correct.

Student responses

Response A

Dr		Suspense		Cr	
Details	Amount £	Details	Amount £		
Balance b/d	19,800	Rent Payable	15,200		
Discount Received	2,400	Wages	3,500		
		Drawings	3,500		
	22,200			22,200	

This response fulfils all the demands of this question and therefore has been awarded full marks. The answer demonstrates the student's ability to correctly deal with the errors that have occurred, effectively utilising the suspense account and calculating the trial balance shortfall.

5 marks

Response B

Dr		Suspense		Cr	
Details	Amount £	Details	Amount £		
Discount Received	2,400	Rent Payable	7,600		
Trail balance	12,800	Rent Payable	7,600		
		Wages			
	15,200		15,200		

This response has been awarded 3/5. The student has been awarded 1 mark each for the correct treatment of discount received and rent payable. 1 own figure mark has been awarded for the calculation of the trail balance shortfall, however the student has failed to deal with the wages and drawings error.

3 marks

4 mark question

This is a continuation from question 13.1 where students are expected to revise the level of profit post the correction of errors.

Question 13.2

Ross had calculated his draft profit to be £86 454 before noticing the errors.

Calculate the revised profit figure, taking into account any adjustments required for correcting the above errors.

	£
Draft profit	86 454
Error 1	
Error 2	
Error 3	
Revised profit	

[4 marks]

Mark scheme

AO1 – 4 marks

	£
Draft profit	86 454
Error 1	(15 200) (1)
Error 2	2 400 (1)
Error 3	(3 500) (1)
Revised profit	70 154 (1) OF *

Marker note:

Both amount and direction must be correct for each mark to be awarded for items 1 to 3.

* The revised profit figure can be awarded as long as the total is arithmetically correct. Any reference to trade payables or trade receivables should be ignored and not treated as an alien item.

Student responses

Response A

	£
Draft profit	86 454
Error 1	(15,200)
Error 2	2,400
Error 3	(7,000)
Revised profit	66,654

The response achieves 3 out of the 4 marks available. 1 mark for correction of error 1 and 2 is awarded, however no mark has been awarded for error 3 as the profit only falls by £3,500 not the £7,000 used in the answer. 1 own figure mark has been awarded for the revised profit as it is arithmetically correct to the student's response.

3 marks

Response B

	£
Draft profit	86 454
Error 1	(7600)
Error 2	2400
Error 3	0
Revised profit	81254

2 marks have been awarded in total for this response. 1 mark for the correct treatment of error 2 and 1 mark for the revised profit as it is arithmetically correct to the student's response. No marks have been awarded for errors 1 and 3 as these are incorrect treatments.

2 marks

14 mark question

Students are required to calculate net cash flow from operating activities by producing a reconciliation statement displaying how to convert operating profit to net cash flow from operating activities.

Additional information

1. Taxation for the year was £6 534.
2. Dividends paid during the year were £24 000.
3. A second debenture was taken out on 1 November 2021.
4. A non-current asset which originally cost £62 000 with a net book value of £35 000 was sold for £39 500.

Question 14.1

Prepare a reconciliation of operating profit to net cash flow from operating activities for the year ended 31 March 2022 to comply with IAS 7.

A full statement of cash flows is **not** required.

[14 marks]

Mark scheme

AO2 – 14 marks

	£
Profit from operations	45 667 (5) W1
Profit on disposal	(4 500) (1) W2
Depreciation	95 555 (2) OF W3
Decrease in inventory	2 222 *
Increase in trade receivables	(1 888) *(1) both
Decrease in trade payables	(3 422) (1)
Cash from operations	133 634
Interest paid	(4 700) ** (1) OF
Tax paid	(5 834) (2) W4
Net cash flow from operating activities	123 100 (1) OF

W1 Profit from operations:

	£
Retained earnings c/fwd.	122 030
Retained earnings b/fwd.	(111 597)
	10 433 (1)
Taxation	6 534 (1)
Dividends	24 000 (1)
Interest	4 700 (2)
Profit from operations	45 667 OF

Workings for interest

$$£70\,000 \times 6\% = £4\,200 * 7/12 = £2\,450 \text{ (1)}$$

$$£90\,000 \times 6\% = £5\,400 * 5/12 = £2\,250 \text{ (1)}$$

$$£2\,450 + £2\,250 = £4\,700$$

Alternative method for calculating the interest

$$£70,000 \times 6\% = £4,200 \text{ (1)}$$

$$£20,000 \times 6\% \times 5/12 = £500 \text{ (1)}$$

$$£4,200 + £500 = £4,700$$

W2 Profit on disposal:

$$£39\,500 - £35\,000 = £4\,500 \text{ (1)}$$

W3 Depreciation:

Provision For Depreciation

Disposal	27 000 (1)	Balance b/d	339 930* (1)
Balance c/d	<u>408 485*</u>	Depreciation charge	95 555 OF
	<u>435 485</u>		<u>435 485</u>

Marker note:

*Mark is for both items

A-LEVEL ACCOUNTING – 7127 – PAPER 1 - ANSWERS AND COMMENTARIES

Alternative:

$$£408\,485 - £339\,930 = £68\,555 \text{ (1)} + £27\,000 \text{ \# (1)} = £95\,555 \text{ OF}$$

Student may show add £62 000 and deduct £35 000 so please reward this instead if direction is correct.

Award **one** mark for the following depreciation figures shown in the reconciliation statement (with or without workings).

£68 555

£27 000

£41 555

All other figures must be checked via the workings

W4 Tax paid:

Tax			
Bank	5 834 OF	Balance b/d	1 800* (1)
Balance c/d	<u>2 500 (1)</u>	Income statement	<u>6 534*</u>
	8 334		8 334

Marker note:

*Mark is for both items

Alternative:

$$£6\,534 + £1\,800 = £8\,334 \text{ (1)} - £2\,500 \text{ (1)} = £5\,834 \text{ OF}$$

Marker notes:

Calculations where the workings are not transferred or are transferred but in the wrong direction into the reconciliation will not be fully rewarded. For example a depreciation charge of £95 555 would be awarded 1 mark if it is not transferred into the reconciliation or if £95 555 is shown as a negative figure in the reconciliation. A profit on disposal figure of £4 500 would be awarded zero marks if it is not transferred into the reconciliation or if shown as an addition in the reconciliation.

Each entry must have a reasonable narrative (does not have to say increase or decrease as long as the direction is clear).

** Interest paid must agree with their original figure in their profit from operations figure.

Student responses

Response A

<u>Operating Activities</u>	
Operating Profit from Operations	50 967
Depreciation	41 555
(profit) / loss on disposal	(4 500)
Inventory inc or dec	2 222
Trade Receivable inc / Dec	(1 888)
Trade Payable inc / Dec	(3 422)
Cash from Operating Activities	84 934
(Finance cost)	(40 000) → 20 000
(Tax)	(6 534)
Net Cash from Operating Activities	58 400

ii) Profit from Operations

Difference in Retained Earnings			
112 030	-	111 597	= Increase £433
<small>Diff in Ret Earnings</small>	<small>Dividends</small>	<small>Finance Cost</small>	<small>Tax</small>
433	+ 24 000	+ 20 000	+ 65 34
= 50 967			

Depreciation

408 485	-	339 930	= 68 555 this year
		<u>- 27 000</u>	
		41 555	
Asset sold	cost	62 000	-
		<small>Dep 27 000</small>	= 35 000
			Dep on NCA sold

This answer achieves 8/14. 2/5 marks have been awarded for the calculation of profit from operations, the student has miscalculated the difference in retained earnings and the finance cost (interest) on the debenture. 1 own figure mark has been awarded for the calculation of depreciation, the student has correctly calculated and treated profit on disposal, change in inventory, receivables and payables. 1 own figure has been issued for debenture interest as this agrees with the profit from operations calculation but no marks awarded for taxation. 1 own figure has been issued for net cash flow from operating activities as the student's answer is arithmetically correct to the figures that have been awarded.

8 marks

Response B

	£
Profit from operations	
Profit from operations	45667
Depreciation	41555
Profit on disposal	(4500)
Decrease in inventory	2222
Increase in trade ^{Receivables} payables	(1888)
Decrease in trade payables	(3422)
Cash from operating activities	79634
Less interest	(4700)
Less Tax	(5834)
Net cash used in operating activities	69100

W1) profit from operations.

111597

122030 RE 2022

(111597) RE 2021

6534 Tax

4700 Interest

24000

75667

W2) Interest

20,000 1st Nov 2021

$20,000 \times 0.06 \times \frac{5}{12} = 500$

$70,000 \times 0.06 = 4200$

4700

W3) Dividends Depreciation

$708485 - 339,930 = 68,555$

(27,000)

41,555

Disposed Asset: Dep = $62,000 - 35,000 = 27,000$

This response has been awarded 13/14. Full marks have been awarded for the correct calculation of operating profit, the correct calculation and treatment of profit on disposal, inventory, trade receivables and trade payables. 1 own figure has been awarded for the calculation of depreciation, this is for the workings of £68,555. Further marks have been issued for interest payments, taxation and net cash flow from operating activities.

13 marks

6 mark question

This question follows on from question 14.1 where students had to prepare a reconciliation of operating profit to net cash flow from operating activities for the year ended 31 March 2022 to comply with IAS 7, the answers of which provide context for question 14.2

Question 14.2

The Managing Director of Grussell plc has asked the Finance Director about why the company needs to prepare the statement of cash flows. The Managing Director feels that preparing this statement is a waste of resources and that the information produced is confusing.

Assess the Managing Director's opinion.

[6 marks]

Mark scheme

AO2 – 2 marks, AO3 – 4 marks

Level	Marks	Description
3	5-6	Judgements are fully supported by a wide range of evidence. A clear and balanced analysis of data/information/issues is provided, showing a logical chain of reasoning.
2	3-4	Judgements are partially supported by evidence. A reasoned, but unbalanced analysis of data/information/issues is provided; starts to develop a chain of reasoning. Comprehensive and relevant knowledge and understanding of principles/concepts/techniques has been applied in context.
1	1-2	Judgements may be asserted but are unsupported by evidence. An analysis of discrete points of data/information/issues provided; no chain of reasoning is attempted. Limited but relevant knowledge and understanding of principles/concepts/techniques has been applied to the context.
0	0	Nothing written worthy of credit.

Answers may include:

Case for preparation of a statement of cashflows

- Highlights the differences between cash and profit since they are treated differently in the financial statements so that it is known where cash is generated and spent. In this instance the business has generated £123 100 OF from its operating activities, spent £277 500 on non-current assets and received £127 000 from its financing activities. This means cash has reduced by £27 400 overall.
- Knowledge of the cash position is important as a business can fail despite being profitable if it does not have enough cash to meet its obligations.
- Being a public limited company, they should already comply with accounting standards They have to produce a Statement of Cash Flows to comply with these standards and have their accounts signed off by the auditors. If the company's accounts are not prepared to meet these standards the auditors will have made comments in the accounts or possibly refused to sign them off.
- Stakeholders can see lots of information which is not shown in the Income Statement and Statement of Financial Position such as the amount of the dividends paid and changes to the amount of borrowing more clearly. This will help stakeholders to make more informed decisions.
- Being on the stock exchange will also involve attracting potential shareholders who may want to see all of the financial statements. Potential investors want to make an informed decision based on reliable information that shows a true and fair view. They would be nervous about investing in the business if the accounts do not appear to be reliable. This could result in future shareholders not investing in Grussell plc and existing shareholders selling their shares which would mean the share price falls and damages the company's reputation.

Case against preparation of a statement of cashflows

- For someone with limited accounting knowledge the Statement of Cash Flows can seem confusing and hard to understand compared to an Income Statement and Statement of Financial Position.
- The cost of preparing the accounts and having them audited reduces profitability.
- A lack of understanding of the content of a statement could actually put some investors off investing in shares which might stop the share price rising as much as it could potentially have done.
- The amount of time and/or money spent on the accounts could have been better spent on improving the business in other ways.
- Accounts can be window dressed to some degree to make the business look better/worse than it actually is.

Marker notes:

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

The indicative content is not exhaustive other credit worthy material should be awarded marks as appropriate.

Student responses

Response A

Grussel plc should prepare a statement of cash flows as it clearly highlights the financial welfare of the business, and is useful for current and/or potential shareholders who can use this to evaluate whether they want to invest in the business. However, it is time consuming and so the managing director is rightfully cautious of the time and ~~see~~ resources it will use. Although the room to influence potential new investors is too big to not produce a cash flow statement. Furthermore, the business can own see where any problems/improvements can be made such as assessing dividend prices and debenture repayments etc.

This is a Level 1 response

The total for this response is 2/6. Some balance has been provided here with the student building an argument for and against the managing director's opinion. However a limited range of knowledge has been displayed, the points made are generic with no context and there are limited chains of reasoning. 1 mark has been awarded for each argument.

2 marks

Response B

A statement of cash flows can allow a firm to identify the difference between profit and cash flow in their business, which will highlight any noticeable cash outflows. These can be examined and improved on by Grussell Plc, which is likely to improve cash flow in the future, this is a strong argument against the director's opinion.

However, it could be agreed that the statement of cash flows could be difficult to understand to a stakeholder e.g. shareholders, owners, making the advantages of the data more difficult to access. On the other hand, the statement could be simplified, to appear less confusing, which makes it more worthwhile to Grussell Plc.

This is a Level 2 response

The total for this response is 3/6. Here the student has provided a Level 2 response where the student has built a case for and a case against the director's opinion. There is balance in this response and the student has displayed relevant knowledge and understanding of principles, concepts and techniques. However the student has failed to apply this in context, and therefore cannot move up to the next level of response.

3 marks

14 mark question

Paulo is a sole trader, trading as Cluedo Coffee. A trial balance has been extracted from his books of account and is shown below.

Trial balance of Cluedo Coffee at 31 March 2022

	Dr	Cr
	£	£
Bank balance	22 456	
Drawings	17 345	
Capital at 1 April 2021		103 907
General expenses	15 043	
Inventory at 1 April 2021	16 276	
8% loan		50 000
Loan interest paid	2 000	
Premises at cost	120 000	
Premises – provision for depreciation at 1 April 2021		16 800
Purchases and revenue	43 451	102 564
Rent payable and rent receivable	9 600	3 100
Trade receivables and payables	1 500	8 300
Vehicles at cost	83 000	
Vehicles – provision for depreciation at 1 April 2021		46 000
	330 671	330 671

Additional information

- Inventory at 31 March 2022 was valued at £12 304.
- Goods returned to a supplier had been included in the purchases and trade payables at the purchase price of £4 200.
- The proceeds from the sale of a vehicle were recorded incorrectly as revenue rather than as a disposal of a non-current asset. No other entries for the disposal of the vehicle had been recorded in the accounts. The vehicle was sold for £6 000 more than the net book value of £22 000. The vehicle cost £49 500 when it was originally purchased.
- Depreciation of vehicles is to be charged using the reducing balance method at a rate of 33 1/3% per annum. A full year's depreciation is charged in the year of purchase and none in the year of disposal.
- Depreciation of premises is to be charged using the straight-line method at a rate of 2% per annum.
- The loan was taken out on 1 April 2021.

Question 15.1

Prepare an income statement for Cluedo Coffee for the year ended 31 March 2022.

[14 marks]

Mark scheme

AO2 – 14 marks

Cluedo Coffee

Income statement for the year ended 31 March 2022

	£	£
Revenue		<u>74 564</u> (1) CF W1
Cost of sales		
Opening inventory	16 276 *	
Purchases	43 451 **	
Less returns outwards	4 200 **(1) both	
Less closing inventory	<u>12 304</u> *(1) both	
		<u>43 223</u>
Gross profit		31 341 (1) OF
Add other income		
Profit on disposal of vehicle		6 000 (1)
Rent receivable		<u>3 100</u> ***
		40 441

A-LEVEL ACCOUNTING – 7127 – PAPER 1 - ANSWERS AND COMMENTARIES

Less expenses		
General expenses	15 043	
Rent paid	9 600 ***(1) both	
Depreciation of vehicles	5 000 (5) W2	
Depreciation of premises	2 400 (1) W3	
Loan interest	<u>4 000</u> (1) W4	
		<u>36 043</u>
Profit for the year		<u>4 398</u> (1) OF

Marker notes:

- Gross profit must be labelled and mathematically correct based on the student's own revenue and cost of sales figures.
- Profit for the year must include general expenses, be mathematically correct and contain no extraneous items eg drawings in the expenses.
- Accept a net purchases figure of £39 251 **(1)** where a student has not shown purchases and returns outwards separately
- Accept net profit for the label. Do not accept abbreviations eg PFTY or just 'profit'.

W1 Revenue

	£
Original revenue	102 564
less sale of vehicle	<u>28 000</u>
Revised revenue figure	<u>74 564</u>

W2 Depreciation of motor vehicles

Cost	£
Vehicles at cost	83 000
Less disposal at cost	49 500
New vehicles at cost	33 500

Depreciation

	£
Provision at 1 April 2021	46 000
Disposal depreciation (49 500 – 22 000)	27 500 (1)
Provision prior to depreciation charge for the year	18 500

A-LEVEL ACCOUNTING – 7127 – PAPER 1 - ANSWERS AND COMMENTARIES

New cost	£33 500 (1)
less new dep	£18 500 (1)
Net book value at 31 March	£15 000 (1) OF
Depreciation rate	33 1/3%
Depreciation charge for the year	£5 000 (1) OF

Alternative

Cost	£83 000
less provision for depn at 1 April 2021	£46 000
less disposal	<u>£22 000</u>
Net book value at 31 March	£15 000 (4)
Depreciation rate	33 1/3%
Depreciation charge for the year	£5 000 (1) OF

If the working is shown but the answer is not used in the income statement award up to 4 marks.

W3 Depreciation of property

Property at cost	£120 000
Depreciation rate	2%
Depreciation charge for the year	£2 400

If an answer of £7 400 (ie combining both depreciation of £5 000 and £2 400) and is shown with a reasonable label (eg depreciation of non-current assets, depreciation) this can be awarded all **6** marks.

W4 Loan interest

Loan	£50 000
Annual interest rate	8%
Loan interest	£4 000

Student responses

Response A

Cluedo Coffee		
Income statement for the year ended 31 March 2022		
	£	£
Revenue (102,564 - 28,000)		74,564
Cost of Sales:		
Opening inventory	16,276	
Purchases (48,451 - 4,200)	43,451 39,251	
Returns outwards	(4,200)	
Closing inventory	(2,804)	39,023 43,223
Gross Profit		35,541 31,341
Rent received		3,800 5,100
		38,641 34,441
Less expenses:		
General expenses	15,043	
Loan interest	2,000	
Rent payable	9,600	
Premises depreciation (20,000 × 0.02)	2,400	
Vehicle depreciation (83,000 - 46,000 × 33 1/3% 83,000 - 46,000 × 33 1/3%)	5,000	34,043
Profit for the year		4,598

W1

$$\begin{aligned} \text{Vehicle depreciation} &= 83,000 - 46,000 - 22,000 \\ &= 15,000 \times 33 \frac{1}{3}\% \\ &= \boxed{\text{£ } 5,000} \end{aligned}$$

1 mark issued for the correct figure for revenue. The purchases figure has been miscalculated as this has been adjusted for the purchase returns. 1 mark issued for closing inventory. 1 own figure for the calculation of gross profit (this is arithmetically correct to the student's response). 1 mark awarded for the correct treatment of rent receivable and payable. 1 mark for the depreciation of premises. 5 marks awarded for the calculation of vehicle depreciation. 1 own figure for profit for the year. The student hasn't included profit on disposal or the loan interest as an expense.

11 marks

Response B

Cluedo Coffee		
Income statement for the year ended 31 March 2022		
	£	£
Revenue		74,564
<u>Cost of sales</u>		
Opening inventory	16,276	
Purchases	39,251	
Less: Returns out	(4,200)	
Less: Closing inventory	<u>(12,304)</u>	
	39,023	
Gross Profit		35,541
Add: Rent received		3,100
	44,641	44,641
<u>Less: expenses</u>		
General expenses	15,043	
Rent paid	9,600	
Interest paid	4,000	
Depreciation: Vehicles	5,000	
Premises	<u>2,000</u>	
	36,043	
Profit for year	8,598	8,598
Add: Profit on disposal		6,000

13/14 marks awarded. All marks awarded. However, no mark issued for purchases or purchase returns as the mark is only issued if a net purchases figure of £39,251 is reached (1 mark) where a student has not shown purchases and returns outwards separately.

13 marks

6 mark question

See [introduction table](#) on page 27 for context.

Question 15.2

Assess whether Paulo is correct in his assumption about the profitability of Cluedo Coffee.

[6 marks]

Mark scheme

AO2 – 2 marks, AO3 4 marks

Level	Marks	Description
3	5-6	Judgements are fully supported by a wide range of evidence. A clear and balanced analysis of data/information/issues is provided, showing a logical chain of reasoning.
2	3-4	Judgements are partially supported by evidence. A reasoned, but unbalanced analysis of data/information/issues is provided; starts to develop a chain of reasoning. Comprehensive and relevant knowledge and understanding of principles/concepts/techniques has been applied in context.
1	1-2	Judgements may be asserted but are unsupported by evidence. An analysis of discrete points of data/information/issues provided; no chain of reasoning is attempted. Limited but relevant knowledge and understanding of principles/concepts/techniques has been applied to the context.
0	0	Nothing written worthy of credit.

Answers may include:

- Gross profit margin is 42% (OF) and the profit in relation to revenue is 5.9% (OF). Better control of expenses is needed based on this information.
- A loss (OF) would have been made were it not for the profit of £6 000 on the disposal of a non-current asset.
- A significant proportion of the profit came from rental income (rent receivable) of £3 100. If this were to fall in the future it could cause losses to occur.
- Drawings are significantly higher than the profit made (OF). This will not help Cluedo Coffee in the future as there is less money available to use for any expansion.
- Although revenue has grown by 10% profitability is very low and we do not know if profit grew by a similar amount.

- Loan interest of £4 000 will significantly reduce profit until it is repaid.
- It would be helpful to have ratios from similar business and/or last year's figures to make a more informed decision on its profitability trend.

Student responses

Response A

Although the general revenue of the business may be rising this doesn't always mean that the business is therefore going to become more profitable, as shown in the income statement the business has far greater levels of expenses compared to sources of income. As a result of this the revenue figure becomes less valuable as with an increased level of output this may only lead to further expenses needing to be paid by the company, for example they may need to buy larger premises to produce their products.

Therefore Paulo's assumption may not be correct as he needs to view all the other incomes and expenses of the business rather than just the revenue to be able to make a valid assumption about its profitability.

This is a Level 1 response

The total mark for this answer is 2/6. This student has provided an unbalanced response which shows a low-level of knowledge and understanding and isn't in the context of the question.

2 marks

Response B

The revenue of Cluedo's Coffee has been steadily increasing by around 10% year on year. However, this does not show Paulo that his business has a good level of profitability. From his income statement, we can see that his expenses are greater than his gross profit and so, without the additional income that he received, his business would have made a loss. The profit on the disposal of a non-current asset is a one-off income and is unlikely to occur every year and so, without the controlling of his expenses, Paulo is likely to see a further reduction in his profit.

This is a Level 2 response

The total marks awarded for this answer is 4/6. The case against is quite well-written which displays a good level of knowledge/understanding and is supported by evidence (one-off disposal) which has some development. It identifies that a growth in revenue does not always link to a change in profitability hence the response lacks focus and cannot achieve a Level 3 response.

4 marks

25 mark question

Essay question

Otmar is a sole trader and owns a small manufacturing business which makes designer leather shoes. The business has grown quickly and has recently been unable to keep up with customer demand due to a shortage of skilled labour. Otmar thinks it is time to purchase some new machinery to help speed up production and enable the business to complete more orders. This could boost profitability by at least 25%. The cost of the machinery is significant at £25 000 and the company is unlikely to secure further external funding as the business regularly uses an overdraft.

Otmar provides the following financial information.

	£
Capital at 31 May 2022	35 000
Average monthly profit	3 500
Monthly drawings	2 500

Otmar believes he needs to bring a partner into the business ownership in order to inject funds into the business. He is considering the following two options.

1. Kimmi

Otmar employs Kimmi as the production manager. Kimmi has suggested on a number of occasions that she should become a partner. Kimmi has good ideas, knows every part of the production process and trains all the staff to a high standard. The staff have a strong working relationship with Kimmi. Otmar worries about their loyalty if Kimmi ever left.

Otmar and Kimmi would have a formal partnership agreement and share profits on a 2:1 ratio respectively. Kimmi's current salary of £31 000 would reduce to £25 000 and Otmar would have a salary of £28 500 per annum. Kimmi would invest all her savings of £20 000 into the business. Otmar would put a further £5 000 into the business from his own funds.

2. Priya

Priya, an old friend of Otmar, contacted him to suggest she is willing to invest in the business. Priya has recently sold her own very successful footwear business. She has no interest in getting involved in the day-to-day running of another business at the moment. Priya wishes simply to receive her share of any profits. This should leave Otmar to run the business without interference. Priya could access funds of up to £100 000 to invest in the business.

There would be no formal partnership agreement. Priya would invest £90 000 into the business.

Question 16

Evaluate which of the two options Otmar should choose. Justify your answer.

Consider **both** financial and non-financial factors.

[25 marks]

Mark scheme

A02 – 5 marks, A03 – 20 marks

Level	Marks	Description
5	21–25	<p>A clear and balanced response that presents a coherent and logically reasoned judgement and conclusion/solution that is supported by an astute consideration of a wide range of evidence including other factors relevant to the wider context.</p> <p>There is an insightful assessment of the significance and limitations of the evidence used to support the judgement.</p>
4	16–20	<p>A reasoned, but in places unbalanced, judgement and conclusion/solution is presented that is supported by an evaluation of a wide range of evidence, including a narrow consideration of other factors relevant to the wider context.</p> <p>There is a partial assessment of the significance and limitations of the evidence used to support the judgement.</p>
3	11–15	<p>An underdeveloped judgement and conclusion/solution is presented that is supported by an evaluation of a range of evidence provided in the question; however there may be inconsistencies and the reasoning may contain inaccuracies.</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> <p>Comprehensive and relevant knowledge and understanding of principles/concepts/techniques is drawn together and applied successfully to the context. Where appropriate, a thorough selection of relevant calculations is attempted; these may include minor errors.</p>

A-LEVEL ACCOUNTING – 7127 – PAPER 1 - ANSWERS AND COMMENTARIES

2	6-10	<p>A basic judgement and conclusion/solution is presented, it is supported by a limited evaluation of evidence provided in the question, containing significant 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>Limited but relevant knowledge and understanding of principles/concepts/techniques is drawn together and applied successfully to the context. Where appropriate, a limited selection of relevant calculations is attempted; these may include minor errors.</p>
1	1-5	<p>A 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.

Indicative content may include:

General comments

Application AO2

Purchasing the machinery is needed to ensure further orders can be completed – potential for an increase of 25% in output which could improve profit by £875 per month (£10 500 per annum) to £4 375 per month (£52 500 per annum).

Making Kimmi a partner

Application AO2

- Slight reduction in Kimmi's salary by £6 000 which reduces the risk to Otmar and gives him a higher profit figure before distribution.
- Current annual profits are £42 000 which all belong to Otmar. If he takes up the partnership it will be £42 000 + £10 500 + £31 000 (no salary to pay Kimmi) = £83 500. After deducting the salaries of £53 500 there could be £30 000 available which would be split 2:1.

Case for choosing Kimmi

Analysis and evaluation AO3

- Otmar could receive £48 500 which is an improvement on the £42 000 by £6 500.
- Kimmi will receive £35 000 (£25 000 salary + £10 000 profit share) which means Kimmi is better off by £4 000.
- Risk of losses are now shared which spreads risk for Otmar.
- Making Kimmi a partner could help avoid Kimmi leaving and any potential loss of staff that could follow. This helps keep the skills and experience in the business.
- Ideas could increase if Kimmi is now more motivated to try and boost profitability.
- Add in monthly figures

Case against choosing Kimmi

Analysis and Evaluation AO3

- Profits will now need to be shared.
- Decisions will need to be discussed with Kimmi.
- Kimmi is not putting as much money in so Otmar needs to make a further injection of his own capital.
- Otmar is receiving less investment than with Priya although Kimmi will only own 1/3 of the business.
- Conflict could escalate further now that Kimmi has more power and influence as an owner and her strong influence over the staff.
- Does Kimmi have enough management experience to successfully part own a business?

Making Priya a partner

General comments

Application A02

- No formal partnership agreement means Otmar will not receive a salary for working there
- Partners will share profit equally despite Priya not being involved in the running of the business
- Current annual profits are £42 000 (3500×12) which all belong to Otmar. If he takes up the partnership it will be £42 000 + £10 500 = £52 500. Profits are shared equally so Otmar would only receive £26 250 as his share of the profits.

Case for choosing Priya

Analysis and Evaluation A03

- No change to the way the business runs if Priya stays as a silent partner so the business could still be run the way Otmar wishes.
- Priya is taking a 50% stake but is putting in proportionally much more than this. The amount could be enough to repay any non-current liabilities/bank overdrafts and/or buy the machinery. It could also be used to boost profits from interest saved and reduce the issues they have with cash flow which might be beneficial if the additional orders are on the usual credit terms.
- Priya has experience in the industry and could provide knowledge and industry contracts which could further boost profitability.

Case against choosing Priya

- Could upset Kimmi as she does not achieve her partner ambition and could leave to set up her own business (possibly taking staff and customer contracts with her potentially).
- Priya may not remain a silent partner.
- Otmar will be £15 750 worse off (£42 000 – £26 250).

Limitations of the data

- Sales increase of 25% – how has this been estimated and is it realistic? Will they be able to sell the additional units they produce?
- Very limited financial data is provided such as sales revenue/profits in recent times which could have helped with a decision.
- How would the changing role of Kimmi affect their working relationship?
- Could Otmar work with Priya? Would it affect their friendship?
- Are there other staff who might wish to become owners in other areas of the business?

Marker note:

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

Student responses

Response A

In order to expand his business, Omar is considering a partnership, both options have both their advantages and disadvantages. A partnership will mean that the company has unlimited liability for any debts, the same as Omar will currently have as a sole trader. This means that personal assets of both partners can be seized should the business face any liquidity problems, which we can see is a possible risk due to the company already regularly using an overdraft, however this is a source of finance commonly used by companies as a 'safety net' to aid cash flow. We here have a limitation of evidence as we do not know the partners attitudes towards risk with regards to the investment. This has a chance of making both partners sceptical in investing large sums of money.

Should Omar choose Kimmi, they would share profits in a 2:1 ratio. Based on an estimated 25% increase in profit, Omar would receive £2917^{monthly} and Kimmi £1458^{monthly}. Immediately we can see this safely covers Omar's current drawings of £2500. However, this is only an estimate and the profitability may not increase by this much, this means that there is no guarantee that drawings will be covered as we only have an estimate and historic data to use in our calculations.

Further, Kimmi has good ideas, knows every part of the process and currently trains staff to a high standard. This means Otmar is partnering with a knowledgeable partner who may have ideas on how to expand the business further increasing profitability in the future. We also can see from this that Kimmi is reliable and Otmar is pleased with her current high standard of work. However, Kimmi will be employed as a production manager, therefore having an input on the decisions of the business, this means that there is the possibility of conflict between the pair and we do not know Otmar's attitudes towards control. (A limitation of evidence). However, Priya does not wish for an input of control, acting as a 'silent' partner meaning that Otmar would be able to run the business as he pleases. This means that the possibility of conflict is reduced. Referring back to Kimmi, we are able to see she has a strong working relationship with staff and that Otmar is worried in regards to their loyalty should she leave. With high possibilities of conflict, the likelihood of her leaving will be furthered should Otmar choose this option. This could potentially lead to Otmar losing staff, this has the potential to be detrimental for the business as we can already see that the business suffers from a shortage of skilled labour.

if Otmar selects Priya, she is willing to invest £90,000

Extra space, increasing the capital of the business to £125000, more than enough to cover the machinery. Whereas with Kimmi she will invest £20000 and Otmar will have to invest a further £5000. It is important to consider here whether Otmar has this cash to spare. A large injection of funding from Priya would be extremely beneficial to the company as it would decrease their gearing ratio, meaning the company would be lower risk, therefore making them more likely to be able to source external funding in the future which they currently are not able to do. This also would drastically increase the cash flow of the business meaning their options are open to invest in the future. However with the partners having no partnership agreement, they would share profits and losses equally according to the partnership act. This means each would receive £2187.5 monthly, this is £312.5 less than Otmar's current drawings. This means he could not finance this. Our evidence is limited here as we do not know if Otmar is willing to ^{take} ~~invest~~ less drawings for the benefit of the business.

To conclude, despite the obvious issue in regards to drawings, I believe Otmar should partner with Priya as it poses less risk such as threat to control and conflict as well as hugely benefiting the businesses cash position, enabling them to be lower risk via her huge

capital injection. However, it is important to consider the limitations of evidence and answer these before making a final judgement. It is always beneficial to see if there is any current financial data, as we currently are operating on historic data and estimates, which can fluctuate and are not guaranteed. Further we must note Otmar's attitudes to control and whether he feels there will be issues relating to either partnership. Finally, if Otmar does choose Kimmi we must also consider her attitudes and whether she is willing to take a £6000 salary cut, as Kimmi may not want to do this, making this a potential issue. Furthermore, Otmar may wish to take into account other sources of finance such as becoming a private limited company and issuing ordinary shares to raise the funds.

This is a Level 5 response

The total awarded for this response is 21/2. It has shown analysis throughout the answer with clear signposts to application in context with the student building on their ideas with effective chains of reasoning. This student makes astute judgement/recommendation which takes limitations of evidence into account. The conclusion/recommendation is slightly less convincing as the decision is a little unclear. However the main body of the response is clear and balanced and shows a consideration of a wide range of evidence including other factors relevant to the wider context.

21 marks

Response B

At one moment ~~time~~ Omar withdraws £30,000 from his business per year in drawings, however if he partners with Kimmi this will reduce to a £28,500 salary. Having said this, together with Kimmi's £20,000 investment and Omar's £5000 from his own funds, they would be able to buy the new machinery. This means that the business's profitability is going to increase by at least 25% which would take his current average yearly profit of £42,000 to a minimum of £52,500. As the pair will have a formal partnership agreement the profits are split 2:1 which means Omar would have access to ~~£~~ at least £35,000 of the profits which means at the end of it Omar will have access to £63,500 (salary + Profits.). Furthermore, Kimmi is an existing employee who has 'good ideas' and 'knows every part of the production process', this means that she will be a good person to have on board and help with the decision making choices for the business. To add to this

Kimmi also has a 'strong' relationship with her employees and workers and therefore staff may be more likely to listen and respect her decisions. This could also improve motivation and productivity within the business resulting in higher profits. However, there is always the risk that there could be an argument/fall out between them and disrupt the business.

If Omar was to go with Priya, there would be no formal partnership agreement. This means that profits would be shared 1:1 rather than 2:1 with Kimmi, although with Priya's huge £90,000 investment Omar could buy 2 machines and effectively increase his profitability by at least 50%, meaning that the business would go from £42,000 average yearly profit to £52,500 - £63,000 depending on how many machines were purchased. If Omar could potentially have £31,500 in split profits + £30,000 in his drawings equalling £61,500 which is £2,000 less than if he was with Kimmi. Having said this Omar will have 100% say in all decision making as Priya doesn't

want anything to do with the business in terms of day to day running, which although she has lots of successful, valuable experience you have to question whether it's worth it or if her experience is relevant considering her reluctance to get involved.

larger
 Despite Priya offering a substantially ~~to~~ larger amount of money, Kimmi is the better option due to her pre-existing knowledge and relationship with the business. Plus they can still afford the new machinery with combined investments. and on ~~an~~ a personal note Omar is better off by £2000 if he goes with Kimmi.

This is a Level 3 response

This response was awarded 14/25, as it includes an error in the calculation (the drawings are used rather than current profits). Throughout the response there is evidence of good chains of analysis which are reasoned and by large supported by application. The student has demonstrated an idea of the scale of the investment which adds to their response. The judgement here is very limited and incomplete in places, this needs to be clearer and fully justified. The student has made no links to the limitations of the data discussed.

14 marks

25 mark question

Donna has retired and received a lump sum of £50 000 which she wishes to invest in shares. She needs a return from this investment to help fund her retirement.

She has researched companies of which she already had knowledge as a customer. She has two companies as her preferred choice. Donna has provided you with the following information based on the last three years' trading for each company.

Extract of financial information:

	Pik plc			Barnard plc		
	2022	2021	2020	2022	2021	2020
Earnings per share	12p	16p	14p	16p	9p	5p
Dividend cover	2.4 times	2.4 times	6.7 times	7.3 times	5.3 times	5.6 times
Market price per share at year end	200p	220p	140p	140p	125p	60p
Dividend yield	2.5%	3.0%	1.5%	1.6%	1.4%	1.5%

Pik plc is a social media company which owns a number of popular websites and apps. It has been trading for nine years and has very little debt. The company has a small head office since most of its staff work from home, which keeps costs to a minimum. Pik plc sells adverts on its websites and apps. There have been rumours that it tracks the data of its users and sells this to advertisers, which would breach data protection laws. This has created some concerns about its ethical stance as a company, particularly as many teenagers use the sites. The government has the ability to issue multi-million-pound fines for companies found guilty of breaching these rules.

Barnard plc is a supermarket chain. It is an established company which has been trading for around 50 years. Barnard plc has supermarkets in most major UK cities. It owns a large amount of land in key locations around the country. Most of its stores are owned by Barnard plc although there are a large number of mortgages secured on these properties. It sources as many Fairtrade products as possible and has a policy of dealing with suppliers and other stakeholders who behave ethically.

Question 17

Evaluate **both** businesses from Donna's perspective as a potential investor. Make a recommendation on how she should invest her savings.

Consider **both** financial and non-financial factors.

[25 marks]

Mark scheme

AO2 – 5 marks, AO3 – 20 marks

Use [level of response table on page 37 and 38](#).

Answers may include:

Case for purchasing shares in Pik plc

AO2 Application

- Can purchase 25 000 shares (£50 000 / £2.00).
- Dividend could be (based on 2022) $(50\ 000 \times 2.5\%) = £1\ 250$ per annum.
- Earnings per share is fluctuating.
- Dividend cover appears to be declining.
- Market price appears to fluctuate although the overall trend is an improvement of 60p.
- Pik plc has very little debt so more available for shareholders. Barnard plc has mortgages on a number of properties so has an increased risk for investors and the mortgage interest must be paid before dividends.
- Pik plc has an online business model which may keep costs lower.
- Ethically, Pik plc might face consumer backlash if the users are aware of the rumours whether they are true or not.
- Donna could be left with expensive shares if consumers switch to a new social media app/site as many app's tend to have a short product life.

AO3 Analysis and evaluation

- A yearly total dividend of £1 250 is significantly higher than Barnard plc (£800) by £450 so regular dividend earnings could be possible each year if this is what Donna is looking for. However an increase in share price might be equally desirable.
- Pik plc is predominantly an online only company so it may be able to keep costs lower which boost profitability and thus dividends in the longer term.
- Arguably greater risk overall than Barnard plc although the dividend yield also provides a greater reward.
- If found guilty of breaching GDPR/data protection fines could wipe out/reduce their profits considerably.
- Earnings per share is very high but fluctuates so hard to ascertain the true performance trend – what direction will it go in next?
- Dividend cover is falling and is lower than Barnard plc. This could suggest a greater return to shareholders which may be good for shareholders in the very short-term but could result in a lack of investment in the longer term.

- The recent (2022) fall in earning per share suggests profitability is falling unless a share issue has occurred.
- Dividend yield has fluctuated as a result of the fluctuation in share price and dividends. It is unclear to see which direction this is likely to go next.

Case for Barnard plc

AO2 Application

- Can purchase 35 714 shares ($50\,000 / £1.40$) which is a bigger quantity of shares than could be purchased in Pik plc.
- Dividends could be (based on 2022) $50\,000 \times 1.6\% = £800$ per annum which is less than Pik plc despite Donna owning more shares.
- Earnings per share is high and growing.
- Dividend cover is growing – suggesting lots of profit is being retained.
- Market price has more than doubled suggesting lots of investor confidence in the company's future.
- Established name in an established market for investors wishing for more security.
- Land ownership provides security for the business in the future.
- Good ethical stance which might be appreciated by its shareholders, potential shareholders and customers. The company might be less likely to suffer negative publicity which could harm its share price.

AO3 Analysis and evaluation

- Dividends could be (based on 2022) $50\,000 \times 1.6\% = £800$ per annum which is less than Pik plc despite Donna owning more shares.
- Dividend cover is high and growing each year. This would indicate investment through retained earnings which may be good for investors in the longer term although possibly less so in the short-term.
- Earnings per share is very high but fluctuates – what direction will it go in next?
- Dividend yield has stayed broadly the same so the increase in share price must mean an increase in the dividend per share.
- Rising market price suggests stock market confidence in the company which may make it a more attractive deal in the longer term. However she will own fewer shares than if she had bought the shares before the share price increases.
- Barnard plc has lots of land of significant value which could be sold to generate cash to pay future dividends.
- Barnard plc has a strong ethical stance in the way it runs its business. The company might be less likely to suffer negative publicity impacting on its share price as a result. This could mean Donna's investment is safer.

Limitations could include

- Ratios are all historic data – what is their current trading position? This data is at least 2 months out of date.
- Current market price of shares is unknown so the decision to buy shares could be affected by some more recent share price changes. Depending where the current price is this could have a significant impact on the attractiveness of buying the shares as the figures might need recalculating.
- More data could help the decision. For example we are not told the interest cover. Pik plc has low debt so has less risk attached to repayment of debt.
- Ratios do not provide the actual figures so could be masking a bigger problem that could be seen by looking at the accounts as a whole. The financial statements could have been window dressed. For example the data implies that Pik plc is lowly geared but this ratio is not given.
- Ratios do not take into consideration other non-financial factors such as the company changing its strategic direction, management experience, investment plans, sources of their finance.
- Market conditions of the two companies may be very different since they are in different sectors of business. It is difficult to make a true comparison between them as a result.
- The year 2020 could just be an anomaly in terms of the share price for both companies. What was the share price of each company before? Would be better to have a five-year history.

Evaluation

- There could be other better opportunities to invest elsewhere. With such a large amount Donna is likely to want to spread the risk by investing money into both Pik plc and Barnard plc and/or other companies.
- Non-financial factors could be important to decision making – what is Donna’s ethical stance on investment. Would she be prepared to invest in a business who may be using customer data inappropriately?
- Short-term gain vs potential long-term prospects should be considered. Barnard plc appears to be more consistent and less risky. What is Donna’s investment style – is she prepared to take risks for greater gain?

Marker note:

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

Student responses

Response A

Donna has received a large sum of money and is looking to invest this into the stock market for a return on her investment. She has researched into two companies, which she is already a customer of. The calculations of investor ratios of a business enables potential investors to gain an insight into the investment potential of it financially. They will allow predictions to be made of profits, dividend payments they may receive and other factors based on data from previous years. However, this means that, due to the retrospective nature of them, it is unsuitable to make investment decisions solely based on these.

Pike plc have recorded a fall in their earnings per share and the market price of their shares. This shows that the profit they are making is decreasing at a greater rate than the market price. This is a significant drawback to the investment potential as a rapid decline in their profits could result in an inability to pay dividends to their shareholders without using previous retained earnings. This could reduce the return that Donna would receive - we do not know the scale of the return that she requires as she ~~the~~ only states that "she needs a return." This is subjective, however we can assume that a greater return on her investment is desirable.

Pike plc managed to maintain their dividend cover at 2.4 times for the previous two years after seeing a drop of ~~to~~ 4.3 times from 2020 - almost ~~to~~ a third of what it was. This shows to Donna that, although they are still able to comfortably cover their dividend commitments, they are now less profitable than they have been, which could encourage investors away from them, on the assumption that it could

continue to decrease. For her investment, Donna would receive 25,000 shares in ~~the~~ Pik plc compared to the 35,714 shares she would get from Bernard plc at their 2022 market prices. This ~~and~~ means that she can expect to receive around £800 dividend payments from ~~the~~ Bernard and ~~an~~ £1,250 from Pik. Whilst it is seen that she would get a greater return from Pik, we do not know if they will continue to be able to cover this with their profits whereas the dividend cover of Blanchard has improved by 2 times over the last year. This suggests that there will be less risk involved with Blanchard in respect to the return that she requires.

Along with the financial factors, Donna should also consider the qualitative data she has before coming to a decision. Pik plc have recently begun being rumoured to practice unethical behaviour in their business. The bad press they are receiving from these rumours, whether true or not, can lead to detrimental impacts on their customer loyalty and reputations. As customers become more aware of this behaviour, it is likely that they will not want to continue trading with a business that is potentially breaking the law. This would impact their market share and the potential profits that they could make, meaning that, in the long term, it is not going to be a strong investment opportunity.

Bernard is an established company with ~~the~~ around 50 years of experience and is present in many major cities in the UK, making their stores accessible to a vast majority of customers. Although they still have secured debts on those stores, they ensure their behaviour in business is ethical - something becoming more attractive to customers.

Overall, I would suggest that Donna invests her retirement investment into Barnard plc. They are more likely to continue trading into the future, allowing her to continue receiving the return that she needs and are ethical in doing so. The negative media that Pike plc are facing is a sole reason to not invest into them. This is likely to cause a further fall in profitability and, therefore, dividends as more and more people hear of the rumours they ~~now~~ have against them.

$$£50,000 \times \frac{1}{2} = 25,000 \text{ shares} \quad \times 5p = £1,250 \text{ dividends} \quad \text{P}$$

$$£50,000 \sqrt{1.4} = 35,714 \text{ shares} \quad \times 2.24p \approx £800 \text{ dividends} \quad \text{B}$$

This is a Level 5 response

This student demonstrates a clear and balanced response that presents a coherent and logically reasoned judgement which is convincing. Conclusions have been supported by an astute consideration of a wide range of evidence including other factors relevant to the wider context. There is an insightful assessment of the significance and limitations of the evidence used to support the judgement. Calculations have effectively been utilised to enhance their arguments and deeper chains of reasoning.

23 marks

Response B

If Donna was to invest £50,000 into PIK PLC then she'll be able to afford 25,000 shares at the market price at the end of 2022. On the other hand if she invested £50,000 into Barnard PLC she'll be able to afford 35,714 shares.

The earnings per share (EPS) of PIK PLC has fluctuated between 2020 and 2022. This suggests that the profit of the company is unstable and can be hard to predict what will happen in the future. However, a reason why it might fluctuate is because in 2020 and 2021 more people were using social media and staying at home due to ~~the~~ Covid-19 pandemic so their profit would've increased. Furthermore, as of 2022 more people are going out and going to work so they don't need to use it as much. On the other hand, the EPS of Barnard PLC has increased by 11p between 2020 and 2022. This suggests that profit of the company is stable and despite external shocks like the pandemic they still seem to thrive. However, super markets are a necessity to live so despite

external issues they will always survive.

Donna also needs to take into account how ethical the companies are because if they're unethical then they are unlikely to survive in modern society. Barnard PLC sources as many fairtrade products as possible which shows that they care about the well being of the farmers that produces their products. This ~~was~~ gives Barnard PLC a good brand image and a good reputation. This can lead to an increase in sales which would lead to an increase in profit which will benefit Donna as she will get more EPS. On the other hand, Pk PLC is unethical as they track the data of their users and sell it to advertisers. This is unethical for 2 main reasons; one reason is that many teenagers use their sites which could cause a lot of safety issues. The second reason is that it breaches data protection laws which can lead to a multi-million pound fine from the government. This doesn't benefit Donna as it can result in a large sum of ~~peep~~ money withdrawn from the business which could lead to the company going bankrupt. This would result in Donna losing all the money she invested into the company.

Extra space Dividend Cover is how many times a company can cover ~~their~~ their dividends. Barnard PLC can cover ~~there~~ their dividends a total of 7.3 times in 2022 (an increase of 1.7 from 2020). This shows that they have a lot of profit in the business which suggests that they're quite successful. However, you can also view this as the company may not ^{be} ~~being~~ giving their shareholders a lot of their profit. On the other hand, Pit PLC can cover their dividends a total of 2.4 times in 2022 (a decrease of 4.3 from 2020). This suggests that they don't make a lot of ~~enough~~ profit so therefore they cannot cover as much. However, it can also be viewed as they give their shareholders a fair chunk of the profit.

Overall, I believe that Donna should invest her retirement money into Barnard PLC because it's a mandatory company so they^{es} should always make a profit even if it's small. Furthermore, Barnard PLC has a lot of experience under their belt that if there was going to be another recession they'll have the correct information and know what to do as they have survived the 2008 recession. In addition they're a very ethical company and

people are becoming more aware of ethics and environmental sustainability which could lead to growth in the future. However, ~~the~~ their dividend cover is questionable as they may not be giving their shareholders as much as they should be which could result in Donna having ~~to~~ less money to fund her retirement.

This is a Level 3 response

This response shows clear application throughout along with reasoned, and on occasion, developed chains of analysis. Calculations have been utilised, however more calculations need to be present in this response for it to move to a higher level. The student fails to discuss the limitations of the data, and although a conclusion has been presented, this is underdeveloped and not fully justified.

13 marks

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: 01483477863

Copyright © 2024 AQA and its licensors. All rights reserved.

AQA Education (AQA) is a registered charity (registered charity number 1073334) and a company limited by guarantee registered in England and Wales (company number 3644723).

Registered address: AQA, Devas Street, Manchester M15 6EX.

