

# Mark Scheme (Results)

## Summer 2015

Pearson Edexcel IAL Accounting (WAC02/01)

Unit 2 Corporate and Management Accounting

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#### **General Marking Guidance**

All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.

☐ Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.

Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.

There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.

All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.

□ Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.

☐ When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.

Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

#### Question 1a Mark Scheme

#### Ticks in first column shows workings

Statement of Cash Flows for Maltese Construction for y/e 31 March 2015		$\checkmark$	1
Cash Flows from operating activities			
Profit from operations			
(481 600√ + 55 000 /2√ + 90 000/2√)	554 100	$\sqrt{\sqrt{\sqrt{1}}}$	
Add Depreciation	689.000	(5) below	
Add Loss on Sale of Non-current Asset	009 000	DEIOW	
(900 000-360 000) √ - 420 000√	120 000	$\sqrt{}$	
Operating cash flow before working capital changes	1 363 100	√ o/f	
Decrease in inventories	88 000	$\checkmark$	
Decrease in trade receivables	84 000	$\checkmark$	19
Decrease in trade payables	(31 000)	$\checkmark$	
Cash generated from operations	1 504 100	√ o/f	
Less Interest Paid: Debenture	(27 500)	$\checkmark$	
: Bank Loan	(45 000)		
Less Tax Paid	(208 000)		
Net Cash from Operating Activities	1 223 600	√ o/f	
		V 0/1	
Cash Flow from Investing Activities			
Payments to acquire tangible non-current assets	(1,200,000)		
Proceeds from sale of tangible non-current assets	420,000	v v	4
Paymonts to acquire shares in other companies	(175,000)	v 	
Net Cash Used in Investing Activities	(173 000)	v v/o/f	
Net cash used in mivesting Activities	(455 000)		
Cash Flow from Financing Activities			
Redemption of Ordinary shares (500 $000\sqrt{+50000}$	(550 000)	$\sqrt{}$	
Redemption of debenture	(1 000 000)	$\checkmark$	
Receipt of bank loan	1 500 000	$\checkmark$	
Dividends Paid : Final 2014 (3 500 $000\sqrt{x} 2p$ )	(70,000)	$\sqrt{}$	11
Interim 2015 (3 000 $000\sqrt{x}$ 1p $\sqrt{)}$	(30,000)	$\sqrt{}$	
$\frac{1}{2} = \frac{1}{2} \left( \frac{1}{2} \frac{1}{2}$	(9,600)	$\sqrt{\sqrt{1}}$	
Net Cash Used in Financing Activities	(159 600)	√ o/f	
		V 0/1	
Net increase in cash and cash equivalents $$	109.000	$\sqrt{0/f_{1}/C}$	3
		10/11/0	
Cash and cash equivalents at the beginning of the year	326 000		
		v	
Cash and cash equivalents at the end of the year	435 000	$\checkmark$	2
			40
	TOTAL	√ x 40	Marks

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Depreciation calculation		
Depreciation at 31March 2015	1 979 000	$\checkmark$
Less depreciation at 31 March 2014	(1 650 000)	$\checkmark$
=	329 000	$\checkmark$
Plus depreciation on assets sold	360 000	$\checkmark$
Total depreciation for year	689 000	$\checkmark$

1(b)

\_x 100 Using the formula Gearing Ratio = Debt\_ Debt + equity Gearing ratio at 31 March 2014 =  $(320\ 000\ +\ 1\ 000\ 000)\sqrt{\times100} = 22.1\%\sqrt{$  $(4973000 + 1000000) \sqrt{}$ Gearing ratio at 31 March 2015 =  $(320\ 000\ +\ 1\ 500\ 000)$   $\sqrt{x\ 100}$  = 29.2%  $\sqrt{x\ 100}$ (4 727 000 + 1 500 000) √ Other formulas were accepted. Strong points Gearing ratio still below 30% o/f  $\sqrt{}$  and therefore low.  $\sqrt{}$ Interest payments are easily covered  $\sqrt{}$  by profits for the period.  $\sqrt{}$ Perhaps the bank loan does not have assets offered as security  $\sqrt{}$  (ie no charge on assets) which the debenture may have had.  $\sqrt{}$ Share price may rise if shares redeemed  $\sqrt{}$ Weak points Ratio has increased  $\sqrt{}$  by 7.1% o/f points.  $\sqrt{}$  which is a worsening/increased risk  $\sqrt{}$  and increased interest payments  $\sqrt{}$ Borrowing at 5.5% has been replaced  $\sqrt{}$  by higher borrowing at 6%.  $\sqrt{}$  Maybe the bank loan was the best interest rate available.  $\sqrt{}$ Shares that were being given a nominal return of 3%,  $\sqrt{}$  seem to be replaced by borrowing at 6%.  $\sqrt{}$  What is the reason for this/ is there a reason?  $\sqrt{}$ Shareholders equity holdings have been reduced  $\sqrt{}$ 

Maximum of 8 marks for arguing one side.

Conclusion (2 marks)

Overall the gearing/financing position has worsened over the 12 months.

12 marks

Total 52 Marks

#### Q2 Mark Scheme

(a)						
	minutes per day	one unit time	days	weeks	staff	Total
Calctn of production	(500√	/25√)	x 5√	x 50√	x 25√	=125 000√

(b)				
Statement of Compre	hensive Incor	ne		
Calcltn of revenue	(2 400	x 50) √	x £6.5 √	=780 000 🗸
	Marginal	<u>Absorption</u>		
Revenue	780 000	780 000		
Less				
Direct Materials	(118 750)	(118 750)	$\checkmark$	
Direct Labour	(312 500)	(312 500)	$\sqrt[]{}\sqrt[]{}$ (below)	
Semi-variable costs	(70 000)	(70 000)	$\sqrt{}$	
Fixed Overheads	<u>(122 500)</u>	<u>(122 500)</u>	$\checkmark$	
	(623 750)	(623 750)		
Opening Inventory	(16 800)	(16 800)	$\checkmark$	
Closing Inventory	33 764	45 908	$\sqrt{x7}$ (below)	
Profit	173 214	185 358	$\sqrt{0/f} + \sqrt{0/f}$	

Calculation of Labour Cost breakdown

(25/60)  $\checkmark$  x (£6.00 x 125 000)  $\checkmark$  = £312 500  $\checkmark$ 

Calculation of Closing inventory

Calculation of inventory quantity =  $(4\ 200\ +\ 125\ 000\ -\ 120\ 000)\ \sqrt{}$  = £9 200  $\sqrt{}$ 

Marginal Costing =  $(2.50+0.95+0.22)\sqrt{x9200} = £33764\sqrt{}$ 

Absorption Costing =  $\frac{623\ 750}{125\ 000}\ \sqrt{0}$  o/f = £4.99 x 9 200 = £45 908  $\sqrt{125\ 000}\ \sqrt{0}$ 

20 marks

(6 marks)

#### (c) Answers could include:

#### Shop owner: (Maximum 5)

The order could be accepted  $\checkmark$  on the grounds that £4.00 is greater  $\checkmark$  than the marginal cost of £3.67 $\checkmark$  o/f ie a positive contribution  $\checkmark$  of £0.33 OR total contribution of £990 $\checkmark$ However in the long term,  $\checkmark$  selling at £4.00 would result in a Net Loss/ not all costs are covered.  $\checkmark$ 

#### Market trader: (Maximum 5)

The order should be accepted  $\sqrt{}$  on the grounds that £5.50 is greater  $\sqrt{}$  than the marginal cost of £3.67 $\sqrt{}$  o/f ie a positive contribution  $\sqrt{}$  of £1.83 OR a total contribution of £3 660  $\sqrt{}$  Marginal costs and fixed costs are covered Or a profit is made  $\sqrt{}$ 

#### Wholesaler (Maximum 5)

The order should not be accepted  $\sqrt{}$  on the grounds that £3.50 is less  $\sqrt{}$  than the marginal cost of £3.67  $\sqrt{}$  o/f ie a negative contribution  $\sqrt{}$  of £0.17 OR a total negative contribution of £680  $\sqrt{}$  A loss would be made in the short term or the long term.  $\sqrt{}$ 

#### Other points (to be scored only once) (Maximum 5)

New customer may result in more orders in the future,  $\sqrt{}$  perhaps at a higher price.  $\sqrt{}$  May be an incentive to offload t-shirts quickly  $\sqrt{}$  before they go out of fashion.  $\sqrt{}$  Existing customer/overseas retailer would be unhappy  $\sqrt{}$  to hear of this low price on offer.  $\sqrt{}$ 

Possible damage to image  $\sqrt{}$  if t-shirts appear on market stall.  $\sqrt{}$  Marginal costing should be used to make these decisions.  $\sqrt{}$ 

#### 14 marks

#### (d) Answers could include:

Statement is correct, as a greater profit is shown.  $\checkmark$  However, this is only due to a larger figure for closing inventory,  $\checkmark$  and does not result in higher sales or cash inflow.  $\checkmark$  ie a higher "paper" profit  $\checkmark$  Also, this year closing inventory is next years opening inventory,  $\checkmark$  so next year's profit will be reduced.  $\checkmark$ 

Maximum of 8 marks for argument of one side.

#### Case for Absorption Costing

Sees costs allocated to products.  $\checkmark$  Could be useful for management  $\checkmark$  when fixing prices  $\checkmark$  or reviewing if a product/project has been profitable $\checkmark$  in the long term  $\checkmark$  Recommended $\checkmark$  by IAS 2  $\checkmark$ 

Follows the matching concept  $\checkmark$  ie matches costs with revenues earned for a particular product  $\checkmark$ 

#### Case for Marginal Costing

Could be said to help decision making  $\sqrt{}$  in the short term  $\sqrt{}$  when deciding whether to accept an offer price  $\sqrt{}$  or make or buy  $\sqrt{}$  or discontinue a product/profit centre.  $\sqrt{}$  Sees costs allocated to a time period,  $\sqrt{}$  so it may be argued that profit for that time period is more accurate.  $\sqrt{}$  External accounts  $\sqrt{}$  are drawn up on the basis of a time period.  $\sqrt{}$ 

Follows the prudence concept  $\sqrt{}$  as lower figures for profit and closing inventory.  $\sqrt{}$  Business owners may like this method as it shows a lower profit  $\sqrt{}$  so less tax is paid  $\sqrt{}$  which is probably one of the reasons why final accounts should not use the method.  $\sqrt{}$ 

#### **Conclusion**

Max 2 marks available. Should draw up accounts according to absorption costing method.  $\sqrt{\sqrt{}}$ 

(12 marks)

Total 52 marks

#### Q3 Mark scheme ~

<u>a)</u>				
			Interest	
<u>Package A</u>	£ million	Interest Rate	£m	
Debenture	100	9.00	9	
Bank Loan	50	8.00	4 √	both
Preference Share	50	6.00	3	
Ordinary Shares	<u>200</u>	4.00	<u>    8 </u> √	both
Total	400		24 √ o/f	

WACC =  $24 \sqrt{0/f} \times 100 = 6\% \sqrt{0/f}$ 

Package B	£ million	Interest Rate	Interest £m	
Debenture	50	8.00	4	
Bank Loan	200	9.00	18 √	both
Preference Shares	40	4.00	1.6	
Ordinary Shares	<u>110</u>	4.00	<u>4.4</u>	both
Total	400		28 √ o/f	

WACC =  $\frac{28}{400} \sqrt{0/f} \times 100 = 7\% \sqrt{0/f}$ 

(12)

(2) (2)

#### b)

- (i) Purple Waves plc should choose package A  $\sqrt{\sqrt{}}$ (ii) This is because the cost of capital is lower than Package B  $\sqrt{\sqrt{}}$

c)

	£(millions)			Discount	<b>Discounted</b>
<u>Year</u>	Income	Expenditure	Net	Factor	<u>Value</u>
0	0	400	-400	1	-400.00 √√
1	180 √	205 √	-25 √ o/f	0.943	-23.575
2	342 √	220 √	122 √ o/f	0.890	108.58 √ o/f both
3	342	220	122	0.840	102.48
4	440 √	260 √	180 √ o/f	0.792	142.56 √ o/f both
5	440	260	180	0.747	134.46 √ o/f
				NPV	64.505 √o/f

#### d) Average Rate of Return (£m)

Total Surplus of Project	=	£ 1 744 √o/f - £ 1 5	565	$\sqrt{o/f} = \pounds 179 \sqrt{o/f}$
Average Annual return	=	<u>£179_</u> o/f √ 5 years  √	=	£35.8 per year o/f √
Accounting rate of returr	า =	<u>£35.8</u> o/f √ x 100 £400 √	=	8.95% √o/f

(e) Answers may include :

#### Against Investment

ARR states do not invest  $\surd$  as project fails to meet the percentage o/f return figure of  $10\% \checkmark$ 

#### For Investment

NPV states invest  $\checkmark$  as project has a positive NPV after 5 years. o/f  $\checkmark$ NPV a good method of appraisal  $\checkmark$  as it takes account of the falling value of money over time. $\checkmark$ Project is profitable overall  $\checkmark$  having total cash inflow £179 000  $\checkmark$  o/f How realistic is the 10% return target of the company?  $\checkmark$  It is higher than the returns given to the providers of capital to the company.  $\checkmark\checkmark$ Mobile phones is a growing sector of the economy.  $\checkmark$ Payback period is within 5 years $\checkmark$ Increases brand awareness $\checkmark$ 

Other Relevant Points : Accuracy of predictions?  $\checkmark$ May be better investment projects available  $\checkmark$ Objectives/strategy of company?  $\checkmark$ What happens after 5 years? – renewal of contract? $\checkmark$  Any other/further business?  $\checkmark$ Other appraisal techniques are available  $\checkmark$  e.g. payback period and IRR (need both)  $\checkmark$ 

Total of 8 marks for arguing one side only.

<u>Conclusion</u>: 2 marks Must relate to points made above

12 marks

(9)

Total 52 marks

Q4 Mark scheme							
(a)							
	July	<u>August</u>	September	<u>October</u>	November	December	
Income							
Farm shop	2240	2240					$\checkmark$
Wheat sales			8775				$\checkmark$
Fruit sales				2500	2500		$\checkmark$
Vegetable sales				900	900	900	$\checkmark$
Animal sales					650	650	$\checkmark$
Total Income	2240	2240	8775	3400	4050	1550	√o/f
<u>Expenditure</u>							
Farm shop expenses	280	280					$\checkmark$
Farm worker	700	700	700				$\checkmark$
Feed and fertiliser	235	235	235	235	235	235	$\checkmark$
Power and fuel	175	175	175	175	175	175	$\checkmark$
Other fixed costs	100	100	100	100	100	100	$\checkmark$
Drawings	1440	1440	1440	1440	1440	1440	$\sqrt{}$
Total Expenditure	2930	2930	2650	1950	1950	1950	√o/f
Net Monthly	(( )	(( )	(105	4.450	0.1.0.0	((00))	11115
Cash Flow	(690)	(690)	6125	1450	2100	(400)	$\sqrt{\sqrt{\sqrt{0}}}$
Balance b/f	(4000) 🗸	(4690)	(5380)	745	2195	4295	√√√ o/f
Balance c/f	(4690)	(5380)	745	2195	4295	3895	√√√ o/f

#### b)

For the loan

Will ensure that they are not overdrawn.  $\checkmark$ 

Allows some room/ "spare capacity" in case figures turn out worse than expected.  $\checkmark$  Keeps business on good terms with the bank.  $\checkmark$ 

Interest rate likely to be less  $\checkmark$  than rate on an overdraft.  $\checkmark$ 

#### Against the loan

Do not need a 6 month loan,  $\sqrt{}$  as overdrawn for less than 3 months.  $\sqrt{}$  Will be paying interest for 3 months  $\sqrt{}$  that is not necessary.  $\sqrt{}$ 

Do not need a loan of £6 000, as only £5 380 o/f overdrawn.  $\checkmark$ 

The bank may ask for assets as collateral  $\sqrt{}$  which may be seized if loan is not repaid  $\sqrt{}$ 

Maximum of 4 marks for arguing one side only.

<u>Conclusion</u> (2 marks) Should relate to points made. Business should (not) take the loan.

#### 8 marks

Total 32 marks

#### 24 marks

#### Q5. Mark scheme

(a) Purchase price = 24 000 000  $\sqrt{x}$  4  $\sqrt{x}$  £1.03  $\sqrt{x}$  = £98 880 000  $\sqrt{x}$  4 marks

(b)

(~)									
Acquisition account									
1 Apr	Property, Plant + Equipment	82 932 000	$\checkmark$	Apr 1	Bank loan	20 000 000	both		
	Intangibles	14 000 000	$\checkmark$		Trade Payables	524 000	$\checkmark$		
	Inventories	3 120 000	both √		Short term provisions	125 000	both		
	Trade Receivables	561 600			Purchase price		$\checkmark$		
	Goodwill	<u>18 915 400</u>	√o/f		Cash	<u>98 880 000</u>	o/f		
		<u>119 529000</u>				119 529000			

6	marks
---	-------

<u>(c)</u>				
	Middle Ea	<u>ast Me</u>	<u>edical p</u>	<u>lc</u>
Assets				
Non-current Assets				
Property, plant and equipment	437 932 000	$\checkmark$		
Intangible assets	112 000 000	$\checkmark$		
Goodwill	18 915 400	√ o/f		
			568 84	7 400
Current Assets				
Inventories	30 920 000	$\checkmark$		
Trade and Other Receivables	15 221 600	$\checkmark$		
Cash and Cash equivalents	159 237 000	$\checkmark$		
_			205 37	8 600
Total Assets			774 22	6 000
Equity and Liabilities				
Equity				
Ordinary Shares of £1 each	250 000 000	$\checkmark$		
Share Premium	100 000 000	$\checkmark$		
Retained earnings	286 595 000	$\checkmark$		
Total capital and reserves			636 59	5 000
-				
Non-current liabilities				
Mortgage	100 000 000	$\checkmark$		
Bank Loan	20 000 000	$\checkmark$		
			120 00	0 0 00
Current Liabilities				
Trade and Other payables	12 787 000	$\checkmark$		
Current tax payable	4 719 000	$\checkmark$		
Short term provisions	125 000	$\checkmark$		
			17 63	1 000
Total Equity and Liabilities			774 22	6 000

14 marks

### (d)

#### For financing using cash

Buyer may be able to afford purchase using cash / be cash rich  $\checkmark$  better to use this cash than to have lying idle  $\checkmark$ 

Only uses up about 40% of Middle East Medical plc's cash,  $\sqrt{}$  so they will still be liquid after purchase  $\sqrt{}$ 

Memorandum of Association  $\checkmark$  may mean it is not possible to issue more shares,  $\checkmark$  or may need to get approval from Stock Exchange Council  $\checkmark$  to alter Memorandum and issue more shares.  $\checkmark$ 

If issue more shares in buying company instead  $\checkmark$  number of shareholders in buyer rises  $\checkmark$  so dilution of powers of existing shareholders.  $\checkmark$  and share price falls.  $\checkmark$  and extra dividends may have to be paid in the future  $\checkmark$ 

Quicker/easier/cheaper  $\checkmark$ 

#### Against financing using cash

Use of cash is a drain on liquid resources.  $\checkmark$  May need to take out loan etc to finance purchase.  $\checkmark$ 

May not have enough cash to trade normally  $\!\!\!\sqrt{}$  and enjoy discounts for early payments etc  $\!\!\!\sqrt{}$ 

Maximum of 4 marks for arguing one side only

Conclusion – 2 marks

Financing purchase of another company using cash is good/ not good idea.

8 marks

Total 32 marks

#### Q6. Mark Scheme

<u>(a)</u>			
	<u>BUDGET</u>	<u>ACTUAL</u>	<u>VARIANCE</u>
	£	£	£
Revenue	165 000	162 500	(2 500) ADV √
Less			
Material Costs	(47 890)	(49 910)	(2 020) ADV √
Labour Costs	(24 640)	(24 057)	583 FAV √
Variable Overheads	(36 620)	(38 880)	(2 260) ADV √
= Cost of Sales	(109 150)	(112 847)	(3 697) ADV √
Gross Profit	55 850	49 653	6 197 ADV √
Less Fixed Overheads	(54 750)	(54 750)	0
Net Profit	1 100	(5 097)	6 197 ADV √

#### 7 marks

(b)

(i) Labour Efficiency Variance = (Actual Hours - Standard hours) x Standard Rate

=  $[(165\sqrt{x} 27\sqrt{}) - (160 \times 28)\sqrt{}] \times \pm 5.50 \sqrt{}$ 

= (4455 - 4480) x £5.50

= £137.50 Favourable $\sqrt{}$ 

#### 5 marks

(iii) Labour Rate Variance = (Actual Rate - Standard Rate) x Actual Hours =  $(5.40\sqrt{-15.50\sqrt{}} \times (27\sqrt{\times 165\sqrt{}})$ =  $(-0.10) \times 4455$ = 1445.50 Favourable  $\sqrt{}$ 

5 marks

(c)

(i) Fixed costs do not change with output, but they do change over time.  $\sqrt{}$ 

#### 1 mark

(ii) Rent √ may be increased each year/when lease is renewed. √
 Salaries √ may rise during annual pay review/ in line with inflation. √
 Depreciation √ may rise if more non-current assets are purchased in year. √

#### 6 marks

d) Answers may include.

FOR usefulness

Allows performance to be compared  $\sqrt{}$  with predetermined standards.  $\sqrt{}$  Variances can be analysed  $\sqrt{}$  and action taken to control costs.  $\sqrt{}$  Helps eliminate waste,  $\sqrt{}$  idle time, inefficiency etc  $\sqrt{}$ 

Allows management by exception,  $\sqrt{}$  which sees action taken only for large variances.  $\sqrt{}$ Helps estimate production costs and therefore helps when giving a quotation  $\sqrt{}$ 

Allows targets for workers to be set  $\checkmark$  which may motivate workers when achieved  $\checkmark$ 

#### AGAINST usefulness

Takes expertise  $\sqrt{}$  and time/money to prepare.  $\sqrt{}$ 

Inaccurate standards set  $\sqrt{}$  may be misleading and unhelpful.  $\sqrt{}$ 

Some variances may be outside the control of the business,  $\checkmark$  and time may be wasted investigating them.  $\checkmark$ 

Allows targets for workers to be set  $\sqrt{}$  which can demotivate if not achieved  $\sqrt{}$ 

Maximum of 4 marks for arguing one side. <u>Conclusion</u> Standard costing is useful  $\sqrt{\sqrt{}}$ 

8 marks Total 32 marks

7. Mark scheme  
(a)  
(i) Return on Capital employed = Net profit before interest and tax x 100  
Capital employed  

$$= \frac{f5}{260000} \sqrt[4]{} \times 100 = 9.6\% \sqrt[4]{}$$
(3)  
(ii) Earnings per ordinary share = Net profit after interest and tax  
Issued ordinary shares  

$$= \frac{f4}{4} \frac{320000}{6000000} \sqrt[4]{} = 7.2p \text{ per share } \sqrt[4]{}$$
(3)  
(iii) Price/earnings ratio = Market price of share  
Earnings per share =  $\frac{120p}{7.2p} \sqrt{4} = 16.67$  times o/f  $\sqrt{7.2p}$  o/f $\sqrt{$ 

(i) oupling guilt (22.10 2.107) V X 000 V 2.10100 V (3)

(ii) Revenue gain - 500 
$$\sqrt{x}$$
 6.3p  $\sqrt{o/f} = \pm 31.50 \sqrt{3}$ 

(c)

<u>Case For Buying Kowloon Investments plc shares</u> Dividend yield is better/higher  $\checkmark$  by 1% point  $\checkmark$  (K 4% CC 3%) o/f ROCE is better/higher  $\checkmark$  by 1.5% points  $\checkmark$  (K 9.6% CC 8.1%) o/f Price/Earnings ratio is better/higher  $\checkmark$  by 2.67 points  $\checkmark$  (K 16.67 times CC 14 times) o/f which indicates higher market confidence in Kowloon  $\checkmark$ Dividend cover is lower by 0.88 times  $\checkmark$  meaning a more generous dividend policy.  $\checkmark$ (K 1.5 times CC 2.38 times) o/f

She holds 500 shares in CC paying a dividend of 6.3p per share=  $\pm 31.50\sqrt{16}$ If she sells her 500 shares in CC at  $\pm 2.10$  each, she receives  $\pm 1050$ . With this amount she can buy  $875\sqrt{16}$  shares in Kowloon. These shares pay a dividend of  $875 \times 4.8p = \pm 42\sqrt{16}$ Therefore she receives  $\pm 10.50$  more in dividends from Kowloon $\sqrt{16}$ 

#### Case for holding on to China Capital plc shares

Dividend cover is higher by 0.88 times  $\sqrt{}$  meaning a safer dividend policy.  $\sqrt{}$  (K 1.5 times CC 2.38 times) o/f

Using current share prices, and earnings per share, China Capital would "earn" the price paid in 14 years (210/15)  $\sqrt{}$  compared to 16.6 years in Kowloon ((120/7.2)  $\sqrt{}$  which is 2.6 years quicker.  $\sqrt{}$ 

#### Maximum of 4 marks for arguing one side only

#### **Conclusion**

Best to sell shares in China Capital plc and buy shares in Kowloon Investments plc as a business has performed better.  $\sqrt{\sqrt{}}$ 

8 marks

Total 32 marks

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