

AAT Professional Diploma Synoptic Assessment

Sample assessment and mark scheme

Assessment book

Qualification Specification: AAT Professional Diploma in Accounting
Version 1.1 published 7 September 2018

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Notes for students

This is a sample assessment and mark scheme which is reflective of the question types, depth of content coverage, the level of demand, duration and mark allocation of tasks that will be in the live assessment

It is not designed to be used on its own to determine whether students are ready for the live assessment.

Assessment information

You have **3 hours** to complete this sample assessment.

- This assessment contains **6 tasks** and you should attempt to complete **every** task.
- Each task is independent. You will not need to refer to your answers to previous tasks.
- Read every task carefully to make sure you understand what is required.
- Where the date is relevant, it is given in the task data.
- Both minus signs and brackets can be used to indicate negative numbers **unless** task instructions state otherwise.
- You must use a full stop to indicate a decimal point. For example, write 100.57 **not** 100, 57 or 10057.
- You may use a comma to indicate a number in the thousands, but you don't have to. For example, 10000 and 10, 000 are both acceptable

Task 1 (20 marks)

(a) Complete the sentence below to identify which one of the following is the most effective method of internal control when carrying out bank reconciliations?

The Cash Book should be reconciled to the:

	✓
bank statements on a regular basis.	<input checked="" type="checkbox"/>
bank statements and paying in books on a regular basis.	<input type="checkbox"/>
bank statements at random times during the year.	<input type="checkbox"/>
bank statements and paying in books at random times during the year.	<input type="checkbox"/>

(2 marks)

Some commercial organisations engage in the practice of 'window dressing' when producing their published accounts. One way of doing this is to defer paying suppliers in the last few weeks before the year end, while at the same time, collecting as much money from customers as possible.

This widespread legal practice makes the year-end bank balance look better and improves key performance indicators, such as the trade receivables collection period and trade payables payment period.

(b) This practice is an example of what?

	✓
Complying with accounting standards.	<input type="checkbox"/>
Complying with banking requirements.	<input type="checkbox"/>
Engaging in unethical behaviour.	<input type="checkbox"/>
Engaging in fraudulent behaviour.	<input type="checkbox"/>

(2 marks)

(c) The security settings for an employee working in an organisation's credit control department should permit them access to which of the following?

	✓
The Accounts Receivable Ledger	<input type="checkbox"/>
The Accounts Receivable Ledger and the Cash Book	<input type="checkbox"/>
The Accounts Receivable Ledger and the General Ledger	<input type="checkbox"/>
The Accounts Receivable Ledger, the Cash Book and the General Ledger	<input type="checkbox"/>

(2 marks)

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(d) Why should the Accounts Receivable (Sales Ledger) control account be reconciled to the individual account be reconciled to the individual Accounts Receivable (Sales Ledger) balances?

	✓
To detect posting errors in the Accounts Receivable Ledger.	<input type="checkbox"/>
To detect missing sales invoices.	<input type="checkbox"/>
To detect posting errors in the Cash Book.	<input type="checkbox"/>
To detect missing credit notes.	<input type="checkbox"/>

(2 marks)

(e) Why should a cashier carry out a bank reconciliation?

	✓
To prove there are no errors in recording either sales or purchases.	<input type="checkbox"/>
To check the organisation's Cash Book against an external source.	<input type="checkbox"/>
To prove there are no errors in recording assets or liabilities.	<input type="checkbox"/>
To check the organisation is correctly segregating duties.	<input type="checkbox"/>

(2 marks)

Hina Khan, the Cashier of SL Products Ltd, is preparing a cashflow forecast. She asks which of the following are cash flow items.

(f) Identify whether each of the following items should be included in a cash flow forecast by placing a tick in the correct column against all four items.

	Include in cash flow forecast ✓	Do not include in cash flow forecast ✓
Revaluation of premises	<input type="checkbox"/>	<input type="checkbox"/>
Bonus issue of shares in SL Products Ltd	<input type="checkbox"/>	<input type="checkbox"/>
Payment of dividend on ordinary shares	<input type="checkbox"/>	<input type="checkbox"/>
Write off obsolete inventory	<input type="checkbox"/>	<input type="checkbox"/>

(8 marks)

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(g) Which one of the following internal control procedures over sales and subsequent receipts is most likely to be effective for a business in reducing the risk of fraud?

	✓
The Accounts Receivable clerk accounts for the sales transactions and receives customers' cheque payments.	
The Accounts Receivable clerk accounts for the sales transactions; the Cashier, receives customers' cheque payments.	
The Cashier accounts for the sales transactions and receives customers' cheque payments.	
The Cashier accounts for the sales transactions and the appropriate Sales Manager receives the customers' cheque payments.	

(2 marks)

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Task 2 (15 marks)

S.L. Products Ltd has recently acquired a controlling interest in a small manufacturing business called Merville Ltd.

You have been given a copy of the Operating Statement (below) and Commentary (also below) about their most recent year's trading. You are advised that a management bonus is linked to these results, but has not yet been authorised for payment.

As budget accountant for S.L. Products Ltd, you have been asked to review these documents and comment on the adequacy of Merville Ltd's budgeting procedures and provide recommendations for improvement.

Operating Statement for year ended 31 December 20X1	Budget	Actual	Variance
Sales volume	8,300	7,950	350
	£	£	£
Sales revenue	1,162,000	1,128,000	33,100
Costs:			
Materials	249,000	246,450	2,550
Labour	415,000	409,425	5,575
Production overheads	149,400	144,690	4,710
Depreciation	78,600	46,800	31,800
Marketing	27,600	18,640	8,960
Administration	73,000	92,600	19,600
Total	992,600	958,605	33,995
Operating profit	169,400	170,295	895

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The budget committee is pleased to present the results for a challenging but successful financial year.

At the outset, we were aware that cost pressures were increasing. We decided to introduce a robust system of financial control. We formed a budget committee, comprising the production manager, purchasing manager and human resources manager. We prepared a detailed budget and agreed to monitor progress against this budget at monthly meetings. In order to demonstrate our commitment to this regime, we decided to link to our own remuneration to the achievement of the budgeted operating profit.

It soon became clear that competitive pressures were increasing that that it would be difficult to achieve the budgeted sales revenue. We decided to review all lines of expenditure:

- Material and labour costs were both rising faster than we had anticipated. Consequently, the budgets for these two items were revised. 3% was added to the material budget and 4.5% to labour. These increases are included in the budget shown above.
 - Most of the marketing budget was to be spent on three themed advertising campaigns. The marketing manager agreed to delay the third of these until after the financial year end.
 - The production manager reviewed the depreciation policy and decided to increase the expected lives of our main production equipment. This not only reduced the annual charge but gave a once only saving through reducing past provisions.
 - Savings of £1,400 were found in administration overheads. The profit-related management bonus of £21,000, which was not budgeted, has been accrued under this heading.
- The Operating Profit of £170,295 is 0.5% better than budget.

The chief accountant of S.L Products Ltd has asked you to comment on the adequacy of Merville Ltd's budgetary procedures.

Task 3 (15 marks)

Most of S.L. Products Ltd.'s manufacturing turnover is from regular customers who have a credit account with the company and buy regularly from it. These customers are given open credit terms of between 30 and 60 days from the end of month invoice.

Ray Massey, the Credit Controller, is responsible for credit checking all new customers with a reference agency. He then has authority to open any new account and allocate a credit limit balance of up to £50,000 without any need to refer to senior management. To approve credit limit balances above this amount, he has to get the approval of Louise Harding, the Finance Director, or Cynthia Moss, the Sales Director.

As well as carrying out the credit control role, Ray and his staff are also responsible for maintaining the Accounts Receivable Ledger.

The credit control function involves investigating the credit worthiness of potential new customers, and opening new accounts with an appropriate credit limit.

The Accounts Receivable Ledger work involves producing invoices and credit notes, issuing these to customers and updating the customer files.

Ray is supported by one full-time Accounts Receivable clerk and two part-time Accounts Receivable/Credit Control clerks who report directly to him.

The Accounts Receivable section undertake the following regular tasks each month:

- Invoices are issued to customers within two weeks of a sale being made.
- Credit notes are raised and approved by Ray.
- Invoices and credit notes are entered into the customers' accounts in the Accounts Receivable Ledger as issued.
- Customer statements are sent out at the end of the month.
- Customer master files are kept up to date.
- BACS receipts are entered into the ledgers as received.
- Cheques received are entered into the customers' accounts in the Accounts Receivable Ledger once they have been banked.

Although the company requests that customers pay by BACS, many still insist on paying by cheque. When these cheques are posted to the company, they are sent to Ray and his staff who bank them usually once a week. Once these are banked, Ray and his staff then make the postings to the Accounts Receivable Ledger, and for the associated entries in the General Ledger.

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(a) Identify FIVE systemic weaknesses in the company's internal controls for the procedures underpinning its accounting for sales, including its Accounts Receivable Ledger and banking procedures. (5 marks)

(b) Explain how EACH weakness may cause the company problems. (10 marks)

Weakness	Potential problem for the company
.....
.....
.....

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Weakness	Potential problem for the company
.....
.....

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Task 4 (15 marks)

One of S.L. Products Ltd's divisions manufactures and distributes electronic equipment. The market is traditionally fast moving with an average product life cycle of three years. The information for the last quarter has been prepared by the management accounts department and distributed to the production department for review.

The manufacturing facility consists of two types of machine:

- Machines which are general and can be used to manufacture any of the products
- Specialist machines required for part of the production of specific products

The general fixed production costs are simply apportioned by dividing the total budgeted cost for the period by the number of different product types manufactured during the period. This policy was set by the production manager. The specific overheads are allocated to the appropriate products. The period just ended had five product types. The budgeted general fixed production costs were £350,000 for the period. The production capacity of the factory is estimated at 60,000 units per quarter for the foreseeable future.

The current product cost and profit information is shown below.

Product	A901	A701	A501	A401	A201	Total
Sales volume (units)	1,050	5,000	20,400	18,000	9,600	54,050
Sales price	£50	£60	£40	£40	£30	
Sales revenue	£52,500	£300,000	£816,000	£720,000	£288,000	£2,176,500
Production volume (units)	1,050	5,000	20,400	18,000	9,600	54,050
Production costs:						
Material costs	£7,350	£50,000	£195,840	£138,600	£216,000	£607,790
Labour costs	£10,500	£35,000	£61,200	£54,000	£48,000	£208,700
Specific fixed costs	£5,000	£15,000	£70,000	£40,000	£20,000	£150,000
General fixed costs	£70,000	£70,000	£70,000	£70,000	£70,000	£350,000
Total production costs	£92,850	£170,000	£397,040	£302,600	£354,000	£1,316,490
Gross profit	(£40,350)	£130,000	£418,960	£417,400	(£66,000)	£860,010

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Unit production costs	A901	A701	A501	A401	A201
Material cost	£7.00	£10.00	£9.60	£7.70	£22.50
Labour cost	£10.00	£7.00	£3.00	£3.00	£5.00
Specific fixed cost	£4.76	£3.00	£3.43	£2.22	£2.08
General fixed cost	£66.67	£14.00	£3.43	£3.89	£7.29
Full production cost	£88.43	£34.00	£19.46	£16.81	£36.88
Profit/(Loss) per unit	(£38.43)	£26.00	£20.54	£23.19	(£6.88)

The production manager has reviewed the results and provided the following proposals:

- 1) The loss on product A901 is £38.43 per unit and this means that if the demand increases in line with products A501 or A401, the total loss on the product will be huge. I therefore recommend that the manufacture and sales of this product is ceased.
- 2) The profit on product A701 is £26 per unit and this should carry on as the demand increases over the next few quarters. I recommend that we continue selling at this price.
- 3) The profit per unit on product A501 is £20.54 per unit which is great news. We have received an order from an overseas company offering to purchase 500 units per quarter of product A501 on the condition that they are given a competitive price and a contribution to a marketing campaign. They estimate that the sales price in the overseas country could be as high as £35 per unit if a marketing campaign costing £200,000 per quarter is undertaken. I don't think we should undertake this contract as the sales price is lower than the current sales price of £40.
- 4) Product A201 has been produced and sold for four years and demand has recently been falling. I think that the product should be withdrawn from the market.

The Chief Accountant has asked you to review the production manager's recommendations and to provide a briefing note addressing the following:

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Task 5 (20 marks)

Louise Harding, the Finance Director, is preparing a presentation for the board of directors. She has asked you to complete a comparative 'score card' of key financial ratios which she will use as part of her presentation.

Relevant data has been extracted from the last two years' accounts. These extracts do not include the results of Merville Ltd.

Extracts from accounts of SL Products Ltd	Year ended 31 December 20X1 £000	Year ended 31 December 20X2 £000
Sales revenue	20,000	20,900
Cost of sales	14,322	15,144
Profit from operations	1,265	470
Assets		
Non-current assets	4,330	4,234
Inventories	3,614	3,908
Trade receivables	2,976	3,032
Cash and equivalents	8	6
Total	10,928	11,180
Equities and liabilities		
Equity	6,025	5,550
Non-current liabilities	1,200	1,400
Trade payables	3,360	3,730
Bank overdraft	124	260
Tax liabilities	219	240
Total	10,928	11,180

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(a) Complete the scorecard by calculating:

- the FOUR missing ratios
- the working capital cycle.

SL Products Ltd Scorecard	Year ended 31 Dec 20X1	Year ended 31 Dec 20X2
Profitability & gearing (correct to 1 dp):		
Gross profit %	28.4%	%
Operating profit %	6.3%	2.2%
Return on capital employed	17.5%	%
Gearing	16.6%	20.1%
Liquidity ratios (correct to 1 dp):		
Current ratio	1.8 : 1	: 1
Acid test / Quick ratio	0.8 : 1	: 1
Working capital days (correct to nearest day):		
Inventory holding period	92 days	94 days
Trade receivables collection period	54 days	53 days
Trade payables payment period	86 days	90 days
Working capital cycle	60 days	days

(10 marks)

(b) Select the ONE correct observation below about each aspect of business performance.

Profitability	✓
This has been a year of steady, if unspectacular, progress. Although profitability has dipped, the return on capital employed has been kept under control.	
The profitability ratios give cause for concern. The small increase in sales revenue has not improved the gross profit percentage. Operating expenses have increased, reducing operating profit and return on capital employed.	
Some profitability ratios have improved and some have deteriorated. Further investigation is required to understand whether profitability is improving.	

Gearing	✓
The increased gearing ratio is entirely due to the increase in non-current liabilities.	
It is likely that the interest cover ratio has increased.	
The increased gearing ratio shows that the company has become more risky.	

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Liquidity	✓
Both ratios have deteriorated which indicates that the company is less solvent.	
Both ratios remain too high, indicating that working capital is not being used effectively.	
The ratios are contradictory. Further investigation is required.	

Working capital	✓
The working capital cycle has worsened. The inventory holding period has improved but the other ratios indicate a lack of financial control.	
There is a welcome improvement in the working capital cycle, mainly due to the changed in the payment period for payables.	
The working capital cycle is worse than a year ago because of the increased cost of sales.	

Overall performance	✓
Profitability has declined in 20X2, mainly due to competitive pressures. However, the gearing and liquidity measures show an improving financial position.	
20X2 has been a bad year. Profitability has declined and finances are coming under pressure.	
Steady progress has been made in 20X2. The ratios show that the company is being better managed.	

(10 marks)

Task 6 (15 marks)

Tony Clark, S.L. Products Ltd.'s Purchasing Manager, is responsible for identifying and liaising with suppliers, and negotiating all contracts and prices with them. He has been employed in this position for the past eight years.

Until two years ago, the company followed a policy of buying its raw materials and other requirements from the cheapest source available on the day of purchase. This had involved Tony dealing with over 50 suppliers and encouraging them to compete against each other so as to buy at the lowest possible price available for that individual transaction.

However, two years ago, Tony convinced the directors to change S.L. Products Ltd.'s buying policy to one of 'partnership sourcing'. This means it now deals with a much smaller number of suppliers who are on two or three year contracts, with prices set each year via annual price negotiations. Tony claimed that the advantage of this policy to the company was that it could get to know and understand a small number of suppliers far better and also that it could get medium-term stability in buying prices. Tony alone agrees the prices with these 'partnership' suppliers without any reference to senior management.

Whenever a new supplier has been identified, they are checked for financial stability by Liz Hall, the Accounts Payable Clerk. Almost all purchases are negotiated to be on 60 day credit terms from end of month of purchase.

Once Tony places a purchase order, he enters the details into the company's inventory system. When the goods arrive in the warehouse, the accompanying goods received note is then dealt with by the goods inwards warehouse staff who check against the inventory system that the correct quantities have been received. They then record on the system the actual quantities received and note any discrepancies.

A copy of the goods received note is then sent to Tony who will also later receive the supplier's invoice. He is then responsible for conducting a second check to ensure that the quantities received match the quantities ordered, and that the invoiced prices are correct.

Once Tony has approved the invoices, he then passes them to Liz who enters them into the Accounts Payable Ledger. At the same time, she also makes the appropriate General Ledger postings.

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At the end of each month, Liz uses the Accounts Payable system to produce an aged creditors (trade payables) listing which identifies those suppliers who are now due for payment according to their agreed terms. Sue Hughes, the Chief Accountant, then reviews the company's cash position at the time and approves the actual creditor payments to be made.

Once the final list of approved payments has been agreed, Hina Khan, who is in charge of the Cash Book, produces the Bank Automated Clearing System (BACS) transfer authority and cheques.

All BACS and company cheques for any purpose including supplier payments, need one signature from one of the authorised signatories. These consist of the directors and the Chief Accountant, Sue Hughes.

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Qualification Specification: AAT Professional Diploma in Accounting (is this needed?)
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Mark scheme

Task 1 (20 marks) (ASYC LO1, LO2)

- (a) Complete the sentence below to identify which one of the following is the most effective method of internal control when carrying out bank reconciliations?

The Cash Book should be reconciled to the:

	✓
bank statements on a regular basis.	
bank statements and paying in books on a regular basis.	✓
bank statements at random times during the year.	
bank statements and paying in books at random times during the year.	

(2 marks)

- (b) This practice is an example of what?

	✓
Complying with accounting standards.	
Complying with banking requirements.	
Engaging in unethical behaviour.	✓
Engaging in fraudulent behaviour.	

(2 marks)

- (c) The security settings for an employee working in an organisation's credit control department should permit them access to which of the following?

	✓
The Accounts Receivable Ledger	✓
The Accounts Receivable Ledger and the Cash Book	
The Accounts Receivable Ledger and the General Ledger	
The Accounts Receivable Ledger, the Cash Book and the General Ledger	

(2 marks)

Why should the Accounts Receivable (Sales Ledger) control account be reconciled to the individual account be reconciled to the individual Accounts Receivable (Sales Ledger) balances?

	✓
To detect posting errors in the Accounts Receivable Ledger.	✓
To detect missing sales invoices.	
To detect posting errors in the Cash Book.	
To detect missing credit notes.	

(2 marks)

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(d) Why should a cashier carry out a bank reconciliation?

	✓
To prove there are no errors in recording either sales or purchases.	
To check the organisation's Cash Book against an external source.	✓
To prove there are no errors in recording assets or liabilities.	
To check the organisation is correctly segregating duties.	

(2 marks)

Hina Khan, the Cashier of SL Products Ltd, is preparing a cashflow forecast. She asks which of the following are cash flow items.

(e) Identify whether each of the following items should be included in a cash flow forecast by placing a tick in the correct column against all four items.

	Include in cash flow forecast ✓	Do not include in cash flow forecast ✓
Revaluation of premises		✓
Bonus issue of shares in SL Products Ltd		✓
Payment of dividend on ordinary shares	✓	
Write off obsolete inventory		✓

(2 marks per correct row; maximum 8 marks)

(f) Which one of the following internal control procedures over sales and subsequent receipts is most likely to be effective for a business in reducing the risk of fraud?

	✓
The Accounts Receivable clerk accounts for the sales transactions and receives customers' cheque payments.	
The Accounts Receivable clerk accounts for the sales transactions; the Cashier, receives customers' cheque payments.	✓
The Cashier accounts for the sales transactions and receives customers' cheque payments.	
The Cashier accounts for the sales transactions and the appropriate Sales Manager receives the customers' cheque payments.	

(2 marks)

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Task 2 (15 marks) (ASYC LO1, LO2, LO3; MABU LO3; MDCL LO1, LO2)

Q	Answer
2a	<p><u>Indicative content</u></p> <p>Criticisms could include:</p> <ul style="list-style-type: none"> • Not possible for reader to make valid comparison of actual and budgeted response • Budget profit referred to in commentary cannot be seen on the statement • Impact of the 4.2% shortfall in sales volume has not been identified in the statement meaning that movements in unit revenue and unit costs are not clear • Requires analysis to discover that the average selling price of £142 was £2 above budget • Similarly, material, labour and production overhead costs per unit were all above budget • Although variances are shown, there is no indication of whether they are favourable or adverse, or of their significance. <p>Recommendation could include:</p> <ul style="list-style-type: none"> • If a budget revision is approved, the original budget should also be shown in the Operating Statement • The impact of volume changes should be highlighted (either by flexing the variable budget elements of the budget (revenue and variable costs) or by adding two columns to the statement to show the budgeted and actual revenue and variable costs per unit) • Separate variable and fixed costs and show contribution • Each variance should be identified as favourable or adverse • Large variances are highlighted or each variance is shown as a percentage of its budget
Marks	Descriptor
0	No response worthy of credit.
1 – 2	Answer states that the layout and presentation of the Operating Statement is poor but with limited evidence provided to support the judgement. To access the higher marks in the band, the answer will give a simple explanation of why the layout and presentation is poor. No recommendation is given in the answer.
3 – 4	Answer states that the layout and presentation of the Operating Statement is poor and includes a detailed assessment of the Operating Statement with a range of relevant points identified to justify their answer. To access the higher marks in the band, the answer demonstrates a good understanding of what an effective Operating Statement should include/look like and will also include one recommendation for improvements to the layout and presentation.
5 – 7	Answer states that the layout and presentation of the Operating Statement is poor and includes a comprehensive assessment of the Operating Statement layout, including a range of well explained, relevant points as evidence for their judgement. Their assessment is clearly justified throughout the answer and demonstrates a thorough understanding of Operating Statements. To access the higher marks in the band, the answer will also include a well justified recommendation for improvements to the layout and presentation of the Operating Statement.

Model answers for 2a

Lower band response (1 – 2 marks)

The statement is poorly constructed and no account is taken of the different volume of sales.

Middle band response (3 – 4 marks)

The statement is poorly laid out with no indication whether variances are positive or negative. The impact of volume being different is not considered. Would recommend that the budget should be flexed to the actual volume.

Higher band response (5 – 7 marks)

It is difficult to make valid comment when the budget and actual are based on such different outputs. It would seem that all costs are above budget. Also difficult to gauge the impact of the budget revisions. I would recommend that a flexed budget is used to compare against actual and that whether a variance is favourable or adverse is clearly shown.

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Q	Answer
2b	<p><u>Indicative content</u></p> <p>Criticisms of the budget committee's actions, constitution etc. could include:</p> <ul style="list-style-type: none"> • Not clear that the budget committee's actions have been effective • Expenditure review identified increase in material and labour costs – only action was to increase the budget • Favourable variance on marketing only achieved by deferring advertising campaign – what will happen in the following year? • Potential impact of the delay on sales revenue – cause for lower than expected sales volume? • Depreciation saving is merely an accounting adjustment • Correction to previous year's charges should be reported separately as an unbudgeted windfall • In the current year, it is inconsistent to revise the budget for material and labour but not for depreciation • Savings in administration are very small and not explaining • Original budgeted profit of £194,000 has not be achieved <p>Recommendations could include:</p> <ul style="list-style-type: none"> • Committee must be properly constituted to be representative of the organisation (Finance, marketing and chief executive to be involved) • Procedures developed to ensure that stretching but achievable budgets are agreed by all • Changes to accounting policy and procedures must be agreed with the chief accountant (and cleared with auditors where necessary) • The committee should meet regularly to monitor performance
Marks	Descriptor
0	No response worthy of credit.
1 – 3	Answer gives a simplistic judgement on the effectiveness of the budget committee's actions, however it has limited evaluative content. Answer should be doubtful of the effectiveness of the committee's actions. The answer demonstrates a basic understanding of budgetary control through identification of weaknesses in the budget committee's actions. No recommendations are given in the answer.
4 – 6	Answer evaluates the effectiveness of the budget committee's actions in detail and concludes that the effectiveness is doubtful or poor. It includes a range of valid criticisms of the budget committee's actions with clear justification. The answer demonstrates a good understanding of effective practice for budgetary control, evident through the student's explanation of weaknesses in the budget committee's actions. To access the higher marks in the band, the answer will include a reasonable and relevant recommendation to improve budgetary control.
7 – 8	Answer demonstrates a comprehensive evaluation of the budget committee's actions. It includes a wide range of valid criticisms with clearly explained justifications and evidence for the criticisms. To access the higher marks in the bank, the answer will include a reasonable and well justified recommendation to improve budgetary control. The best answers will demonstrate an excellent understanding of budgetary control.

Model answers for 2b

Lower band response (1 – 3 marks)

Saving on marketing only because advertising campaign has been delayed. Will this affect next year's sales?

Middle band response (4 – 6 marks)

The correction to the previous year's charges should be highlighted separately and not used to enhance this year's figures. The depreciation change is just an accounting adjustment. The decision on marketing spend may have a knock-on effect on sales. I would suggest the budget committee had clear procedures and proper representation across the organisation.

Higher band response (7 – 8 marks)

The budget committee seem unsure of their remit with many decisions being made as they go along; increasing budgets for material and labour with no clear explanation, cancelling advertising and changing accounting policies without reference to the chief accountant or the auditor, both of whom may have strong views on the subject. The committee must have proper guidelines, appropriate representation and a remit to set a fair budget.

Task 3 (15 marks) (ASYC L02, L03)

1 x mark for identification; 2 marks for explanation (maximum 3 marks per weakness)

Note: There are more suggested weaknesses shown below than are required to be given in the task.

Weakness 1: The company should insist on ALL customers paying by BACS (1). Cheque payments are less secure/may potentially get lost in the post (1), and cost the company bank charges and staff time (1).

Weakness 2: The customer credit terms given may be too long (1). Giving credit of 30 – 60 days from the end of month invoice means payments are taking 45 – 75 days to be made on average (1) and this worsens cash flow (1).

Weakness 3: Invoices should be issued immediately after a sale is made (1). Up to a two week delay in raising invoices (1) worsens the company's cash flow position (1).

Weakness 4: Cheques should not be sent to the Accounts Receivable staff (1). There is potential for fraud (1) as any member of the Accounts Receivable team is able to handle cheques and make entries in the customers' accounts (1).

Weakness 5: The Credit Controller who sets customer credit levels is also responsible for controlling the Accounts Receivable Ledger (1). There is potential for fraud (1) as Ray is able to both open an account and make all entries into it, including posting credit notes (1).

Weakness 6: Cheques should be banked immediately when they are received (1). Up to a one week delay in banking cheques worsens the company's cash flow position/company will lost out on interest it may have earned (1). It also makes the cheques more susceptible to being lost/stolen (1).

Other suitable weaknesses may also be awarded marks.

Task 4 (15 marks) (ASYC L01, L02, L03, L04; MDCL L02, L03, L04)

Q	Answer
4a	<p><u>Indicative content</u></p> <p>Possible discussion points</p> <ul style="list-style-type: none"> • Full production cost useful for price setting based on cost plus or market conditions – knowing specific fixed production cost will aid price setting but market conditions must be considered • Appropriate to allocate fixed costs directly to product and absorb them based upon units of production <ul style="list-style-type: none"> ○ approach enables an appropriate valuation for the inventory in the balance sheet ○ approach enables a more valid assessment of the profitability of the product • Current allocation of general fixed costs very simplistic and inappropriate because it takes no account of what is causing the cost • Cost per unit is not realistic – currently, low volume products (like A901) are absorbing the same total amount of overheads as the high volume products (like A501) but over a much smaller number of units <ul style="list-style-type: none"> ○ Fixed production cost per unit calculated to demonstrate point ○ A901 effectively subsidising A501 • Full production costs important for pricing decisions, especially in pre-introduction stages of the development of the product <p>Potential recommendations</p> <ul style="list-style-type: none"> • More appropriate way would be to absorb these general fixed production costs based on an activity measure (e.g. number of units produced in the period, total production time available, time to make each product) • Use of unit based absorption would avoid low production units having a significantly larger proportion of fixed production costs apportioned to them. <ul style="list-style-type: none"> ○ Could consider ABC – but possibly too cumbersome ○ Unit absorption rate and full production cost calculated for A901 (significantly lower than original) ○ Revised general fixed cost, revised product cost and revised profit per unit calculated for products A901, A701, A501, A401 and A201 to demonstrate point above • Current way of absorbing overheads deemed inappropriate and not to be used for decision making <ul style="list-style-type: none"> ○ Amending the absorption process would create a more appropriate product cost which would be better for decision making • Target costing may be appropriate at this stage • Fixed production costs and other specific non-production costs need to be considered to decide whether or not a product should be introduced • Often more appropriate to consider variable costs for short-term decision making as fixed costs may be unavoidable and therefore not relevant

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Marks	Descriptor
0	No response worthy of credit.
1 – 2	Discussion is limited but does reflect that the current method of overhead allocation is inappropriate with limited use of evidence or justification.
3 – 4	Discussion includes a range of relevant points, supporting the argument that the current method of overhead allocation is inappropriate. Points are well justified and supported by relevant evidence. Some understanding of the consequences of using an inappropriate method will be evident. To access the higher marks in the band, the answer will include relevant recommendations for improvements, supported by evidence or limited calculations.
5 – 7	A comprehensive discussion drawing on a wide range of highly relevant points to support the argument that the current method of overhead allocation is inappropriate. Answer provides a clear demonstration of why the current method is inappropriate and the consequences, balanced with well-supported, highly relevant recommendations for how this can be improved. The best answers will be fully supported by relevant calculations and will demonstrate a solid ability to assess the effectiveness of an organisation's systems and controls.

Model answers for 4a

Lower band response (1 – 2 marks)

The current allocation of fixed cost is misleading and should be re-allocated on a different basis.

Middle band response (3 – 4 marks)

Current allocation of fixed cost is misleading and gives the company no real indication of the profitability of each product. It would be better to look at profit before general fixed cost and subtract total to indicate overall profitability.

Higher band response (5 – 7 marks)

The table is misleading; general fixed cost should be allocated on a more realistic basis to be able to have some real idea of product profitability. It would seem that the general fixed cost should be allocated on some kind of per unit basis given the information available.

Total Gen Fix Cost = £350,000
Total units = 54,050

GFC per unit = £6.4755 per unit.

A901 would become $1050 \times 6.475 = £6,799$ (rounded) making GP £22,851. The other products would follow the same pattern to arrive at different gross profits to that calculated before.

	A901	A701	A501	A401	A201	TOTAL
	£	£	£	£	£	£
Profit before GFC	£29,650	£200,000	£488,960	£487,400	£4,000	£1,210,010
New GFC (per unit basis)	6,799	32,378	132,100	116,559	62,164	350,000
New gross profit	22,851	167,622	356,860	370,841	(58,164)	860,010
GP per unit	21.76	33.52	17.49	20.60	(6.06)	

If unit costs were inappropriate then might consider ABC.

Note: students are not expected to produce a table in their response – it is included here to demonstrate the types of calculations students may wish to include to support their response.

Q	Answer
4b	<p>Students are only required to assess TWO of the four proposals in their answer; no additional credit will be given if students address more than two of the proposals</p> <p>1 x mark per relevant point made; max 4 marks per proposal; total 8 marks available</p> <p>A901</p> <ul style="list-style-type: none"> • Product is not making a loss of £38.43 – because the fixed cost per unit of £66.67 is not appropriate (1) • Sales price is likely to fall when the demand increases (or reduce to encourage demand) (1) • Increased volume will reduce the fixed costs per unit – therefore two opposite effects creating a new profit per unit (1) • Reference to product lifecycle – product in early stages, normal for both cost and sales to be higher than at later stages; sales price often reduces in the growth and maturity phased to facilitate market penetration (1) • Volume increase significantly reduces the fixed cost per unit (1) • Potential alternative: <ul style="list-style-type: none"> ○ change in way overheads are absorbed into production (to aid decision making) (1) OR ○ revise fixed cost per unit immediately to create a new profit per unit (may be quantified) (1) <p>Max 4 marks</p> <p>A701</p> <ul style="list-style-type: none"> • After changes to fixed cost per unit, revised profit per unit is £33.52 (1) • Reference to importance of considering market data when deciding on price changes (1) • Interaction with the demand of products A901, A501 and A401 may also be important – are the products competing or complementing (1) • Potential alternative: good result but we may need to reduce price to increase demand in future periods (i.e. maturity stage of lifecycle) (1) <p>Max 4 marks</p> <p>A501</p> <ul style="list-style-type: none"> • Several issues to consider when making decision (1): <ul style="list-style-type: none"> ○ Current sales price ○ Capacity of the factory ○ Options for increasing sales volumes on other products ○ Sweating the fixed assets • More sales volume will lead to more production volume – fixed cost per unit will reduce and product profitability will increase (1) • Contribution analysis may be more appropriate (1): <ul style="list-style-type: none"> ○ Current contribution of A501 calculated (£27.40, £40 sales price less variable costs of £12.60)

- Sales price of £35 would mean contribution per unit of £22.50 – may still be worth having unless capacity can be used elsewhere to produce greater contribution
- Sales volume of 8,889 units would be required to cover additional fixed costs of £200,00 per quarter for the marketing campaign
- Other considerations:
 - Restrictions on cross border selling: could impact current demand of A501 and future growth (1)
 - Curtailment of product A201 would release production capacity of 9,600 units of A501 (1)
- Potential alternative: further work needed to gather data about the future demand of all products to inform the preparation of a detailed options analysis (1)

Max 4 marks

A201

- Production manager probably correct – product appears to be at end of its life (1)
- Highest variable cost per unit (1)
- Very low contribution of £2.50 per unit (1)
- Changes to way fixed costs are absorbed unlikely to make product profitable (1)
- Biggest issue – product may well create a capacity issue in future periods when demand for A901 and A701 grows (1)
- Potential alternative: capacity may be better used on taking the order for A501 (1)

Max 4 marks

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Task 5 (20 marks) (ASYC LO1, LO2, LO4; FSLC LO1, LO5; MDCL LO4)

(a) 2 x marks for each correct ratio; maximum 10 marks

SL Products Ltd Scorecard	Year ended 31 Dec 20X1	Year ended 31 Dec 20X2
Profitability & gearing (correct to 1 dp):		
Gross profit %	28.4%	27.5 %
Operating profit %	6.3%	2.2%
Return on capital employed	17.5%	6.8 %
Gearing	16.6%	20.1%
Liquidity ratios (correct to 1 dp):		
Current ratio	1.8 : 1	1.6 : 1
Acid test / Quick ratio	0.8 : 1	0.7 : 1
Working capital days (correct to nearest day):		
Inventory holding period	92 days	94 days
Trade receivables collection period	54 days	53 days
Trade payables payment period	86 days	90 days
Working capital cycle	60 days	57 days

(b) 2 x marks for each correct observation; maximum 10 marks

Profitability	✓
This has been a year of steady, if unspectacular, progress. Although profitability has dipped, the return on capital employed has been kept under control.	
The profitability ratios give cause for concern. The small increase in sales revenue has not improved the gross profit percentage. Operating expenses have increased, reducing operating profit and return on capital employed.	✓
Some profitability ratios have improved and some have deteriorated. Further investigation is required to understand whether profitability is improving.	

Gearing	✓
The increased gearing ratio is entirely due to the increase in non-current liabilities.	
It is likely that the interest cover ratio has increased.	
The increased gearing ratio shows that the company has become more risky.	✓
Liquidity	✓
Both ratios have deteriorated which indicates that the company is less solvent.	✓
Both ratios remain too high, indicating that working capital is not being used effectively.	
The ratios are contradictory. Further investigation is required.	

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Working capital	✓
The working capital cycle has worsened. The inventory holding period has improved but the other ratios indicate a lack of financial control.	
There is a welcome improvement in the working capital cycle, mainly due to the changed in the payment period for payables.	✓
The working capital cycle is worse than a year ago because of the increased cost of sales.	

Overall performance	✓
Profitability has declined in 20X2, mainly due to competitive pressures. However, the gearing and liquidity measures show an improving financial position.	
20X2 has been a bad year. Profitability has declined and finances are coming under pressure.	✓
Steady progress has been made in 20X2. The ratios show that the company is being better managed.	

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Task 6 (15 marks) (ASYC LO1, LO2, LO3, LO4; FSLC LO1; MABU LO3; MDCL LO4, LO5)

Q	Answer
6a	<p><u>Indicative content</u></p> <p>Potential improvements could include:</p> <ul style="list-style-type: none"> • Should be a mechanism for senior management to review and approve contracts over a certain value. <ul style="list-style-type: none"> ○ Tony Clark has too much individual authority to negotiate prices that can tie the company into a large supplier for up to 3 years ○ Since the supplier base has reduced, each individual contract is likely to be of significant value. • Another staff member (e.g. Accounts Payable clerk or Tony's boss) should check that the invoiced prices are as agreed <ul style="list-style-type: none"> ○ Tony should not be the only individual to check that invoice prices are as agreed since they have been agreed by him in the first place ○ There is the potential for Tony to collude with the supplier to inflate price in return for a bribe • Suppliers' invoices should be sent to the Accounts Payable clerk, not the purchasing manager <ul style="list-style-type: none"> ○ They can be entered onto the system before Tony is asked to approve them ○ Provides a more secure audit trail ○ Better segregation of duties • All company cheques and BACS authorities should be signed by more than one signatory from authorised signatories (directors and Chief Accountant) <ul style="list-style-type: none"> ○ Allowing payments against just one signature leaves the company open to mistakes or fraud
Marks	Descriptor
0	No response worthy of credit.
1 – 3	Recommendations made are of limited relevance to internal controls. Answer doesn't achieve the scope of the question (i.e. three recommendations); maximum of one relevant recommendation is fully explained in the answer. Others may be stated but not fully explained.
4 – 6	Answer makes at least two relevant recommendations and explains them in good detail. There is good use of the evidence provided to support the answer. Demonstrates a good understanding of internal controls. To achieve the highest marks in the band, the answer will need to include three recommendations.
7 – 9	Answer gives three, highly relevant recommendations, demonstrating a solid understanding of internal controls and improvements. Each recommendation is fully explained, drawing on evidence provided to support the answer. The best answers will state a benefit for each of their recommendations.

Model answers for 6a

Lower band response (1 – 2 marks)

Contracts over a certain value should be checked by someone from senior management. Tony Clarke has too much control and can tie the company in for up to three years.

Middle band response (3 – 4 marks)

Somebody else should check that the invoices are at the price agreed. Tony should not have such power over contracts and approving invoices. Over a certain value, senior management should become involved in the contract process. Supplier's invoices should go to accounts receivable and be approved after this step by the purchasing manager.

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Higher band response (5 – 7 marks)

Company cheques should always be signed by two people from an agreed pool of authorised signatories. There is a danger of fraud with only one signature. The whole purchasing system needs to be shaken up. Senior management should need to approve all contracts over a certain value. Invoices need to be checked for prices by an independent person. This could be done in accounts payable which is where invoices should be sent.

Q	Answer
6b	<p><u>Indicative content</u></p> <p>Possible analytical method:</p> <ul style="list-style-type: none"> • SWOT analysis • Examines the strengths, weaknesses, opportunities and threats embedded in the existing purchases control method • Possible strengths: <ul style="list-style-type: none"> ○ What advantages do our internal controls have? ○ What do they achieve that is better than the alternatives? ○ Consider strengths from both an internal perspective, and from view point of suppliers • Possible weaknesses: <ul style="list-style-type: none"> ○ What could we improve? ○ Consider from internal and external basis – do suppliers perceive weaknesses that we don't? • Possible opportunities: <ul style="list-style-type: none"> ○ Opportunities for improving internal controls ○ New developments in internal controls that could be adopted • Possible threats: <ul style="list-style-type: none"> ○ Obstacles faced ○ Changing technology making existing controls out of date ○ Could weaknesses seriously threaten the business?
Marks	Descriptor
0	No response worthy of credit.
1 – 2	Response simply identifies an analytical method (must be appropriate to the situation). Limited explanation of what the method would enable them to do.
3 – 4	Response successfully identifies an appropriate analytical method, e.g. a SWOT analysis, and explains how it would be used to evaluate the internal controls in the area specified. Response includes some relevant points relating to how the method would be applied/points that would be raised.
5 – 6	Response successfully identifies an appropriate analytical method, e.g. a SWOT analysis, and gives a clear explanation for how it would be used to evaluate the internal controls in the area specified. The best answers will include a range of highly relevant points relating to how the analytical method could be applied and the points that would be raised (albeit that they aren't required to carry out a full analysis themselves).

Model answers for 6b

Lower band response (1 – 2 marks)

SWOT analysis. This examines strengths, weaknesses, opportunities and threats.

Middle band response (3 – 4 marks)

SWOT or Cost Benefit Analysis. Cost Benefit analysis could be used to see if it is worth changing the internal controls within the purchasing area.

Higher band response (5 – 6 marks)

We could produce a SWOT analysis. This would enable us to examine the strengths, weaknesses, opportunities and threats around the internal controls for accounting for purchases. A SWOT analysis could be applied to the following areas:

Possible strengths:

What advantages do our internal controls have?

What do they achieve that is better than the alternatives?

Possible weaknesses:

What could we do better?

Should be considered from internal and external focus

Possible opportunities:

Opportunities for improving internal controls

New developments in internal controls that could be adopted

Possible threats:

Obstacles faced

Changing technology making existing controls out of date.