ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Accounting ACC3

Unit 3 Financial Accounting: Determination of Income

Mark Scheme

2007 examination - January series

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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Set and published by the Assessment and Qualifications Alliance.

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Registered address: AQA, Devas Street, Manchester M15 6EX *Dr Michael Cresswell Director General*

January 2007 **ACC3**

MARK SCHEME

INSTRUCTIONS TO EXAMINERS

You should remember that your marking standards should reflect the levels of performance of candidates, mainly 17 years old, writing under examination conditions.

Positive Marking

You should be positive in your marking, giving credit for what is there rather than being too conscious of what is not. Do not deduct marks for irrelevant or incorrect answers as candidates penalise themselves in terms of the time they have spent.

Mark Range

You should use the whole mark range available in the mark scheme. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **must** be given. A perfect answer is not required. Conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Alternative Answers / Layout

The answers given in the mark scheme are not exhaustive and other answers may be valid. If this occurs, examiners should refer to their Team Leader for guidance. Similarly, candidates may set out their accounts in either a vertical or horizontal format. Both methods are acceptable.

Own Figure Rule

In cases where candidates are required to make calculations, arithmetic errors can be made so that the final or intermediate stages are incorrect. To avoid a candidate being penalised repeatedly for an initial error, candidates can be awarded marks where they have used the correct method with their own (incorrect) figures. Examiners are asked to annotate a script with **OF** where marks have been allocated on this basis. **OF** always makes the assumption that there are no extraneous items. Similarly, **OF** marks can be awarded where candidates make correct conclusions or inferences from their incorrect calculations.

Quality of Written Communication

Once the whole script has been marked the work of the candidate should be assessed for the Quality of Written Communication, using the criteria at the end of the mark scheme. The mark should be shown separately on the candidate's script.

1 **Total for this question: 13 marks**

Samina Hussein is a trader. She provides the following information for the year ended 31 December 2006.

	£
Gross profit	110 707
Wages	62 400
Rent and rates	8 430
General expenses	9 477
Discounts received	388
Discounts allowed	307
Debtors at 31 December 2006	27 000
Equipment at cost at 31 December 2006	12 000
Provision for doubtful debts at 1 January 2006	700
Provision for depreciation on equipment at 1 January 2006	4 800

Additional information not yet recorded in the accounts at 31 December 2006

(1) Rates paid in advance amounted to £120.

(2) Rent owing amounted to £600.

(3) Samina maintains a provision for doubtful debts of 2 ½% of debtors outstanding at the year end.

(4) Samina provides for depreciation on equipment at 10% per annum using the straight-line method.

(5) During the year ended 31 December 2006, Samina took goods from the business for her own use valued at cost price £2783.

REQUIRED

1 Prepare a profit and loss account for the year ended 31 December 2006.

Samina Hussein
Profit and loss account for the year ended 31 December 2006

			£		£	
Gross profit			**113 490**	**(2) W1**	**W1 110 707**	
Provision for doubtful debts			**25**	**(3) W2**	**2 783**	
Discounts (may be shown separately)			**81**	**(2)**	**113 490**	
			113 596			
					W2 700	**(1)**
					675	**(1)**
					25	**(1)**
Less expenses						
Wages	**62 400**				**W3 8 430**	**(1)**
Rent and rates	**8 910**	**(4) W3**			**600**	**(1)**
General expenses	**9 477**				**(120)**	**(1)**
Provision for depreciation	**1 200**	**(1)**	**81 987**		**8 910**	**(1)**
Net profit			**31 609**	**(1OF)**		

13 marks

2 **Total for this question: 21 marks**

The directors of Stoulby Ltd provided the following information before the preparation of the final accounts for the year ended 31 December 2006.

	£
Authorised capital – 10 000 000 ordinary shares of 50 pence each	5 000 000
Issued capital – 4 000 000 ordinary shares of 50 pence each	2 000 000
Profit and loss account	410 000
General reserve	300 000
Share premium account	500 000
Ordinary dividend paid on 3 August 2006	63 000

Additional information

(1) Net profit for the year ended 31 December 2006 was £650 000.

(2) The directors wish to transfer £120 000 to the general reserve and propose a final dividend of 2.5 pence per share.

(3) The corporation tax charge for the year is expected to be £155 000.

REQUIRED

(a) Using the information in the box, prepare a profit and loss appropriation account for the year ended 31 December 2006.

Stoulby Ltd
Profit and loss appropriation account for the year ended 31 December 2006 (1)

	£			£	
Profit before taxation				**650 000**	
Corporation tax				**155 000**	**(1)**
Profit after tax				**495 000**	**(1)**
Transfer to general reserve	**120 000**	**(1)**			
Ordinary dividends – paid	**63 000**	**(1)**			
proposed	**100 000**	**(3)**	**W1**	**283 000**	
Retained profit for the year				**212 000**	**(1 OF)**

W1 4m (1) x 2.5 pence (1) = 100 000 (1)

9 marks

2 (b) Prepare the share capital and reserves section of the balance sheet at 31 December 2006.

Share capital and reserves at 31 December 2006

		£	
4 000 000 ordinary shares of 50 pence each fully paid		**2 000 000**	**(1)**
Share premium account		**500 000**	**(1)**
General reserve **(300 000 (1) + 120 000 (1))**		**420 000**	**(2)**
Profit and loss account **(410 000 (1) + 212 000 (1 OF))**		**<u>622 000</u>**	**(2 OF)**
	(Correct order)	**<u>3 542 000</u>**	**(1 OF)**

<u>7 marks</u>

(c) Explain the term 'revenue reserve'.

Revenue reserves are profits (1) that have been earned in the 'normal' course of business (1)). **<u>2 marks</u>**

(d) Identify **one** example of a revenue reserve from the information given for Stoulby Ltd.

Profit and loss account (1) or General reserve (1) **<u>1 mark</u>**

(e) Explain **one** way in which a revenue reserve may be used.

Shares issued (1) to shareholders out of reserves (1) or to fund dividends (1) when there are insufficient current profits (1), or any other acceptable answer. **<u>2 marks</u>**

3 **Total for this question: 8 marks**

When preparing the final accounts of a business, the concepts and principles of accounting should be applied.

REQUIRED

(a) Explain the concept of prudence.

The concept of prudence means not anticipating profit (1) until it is realised (1) but providing for known expenses (1). Not overstating profits (1). **0-2 marks**

(b) Explain, giving **one** example, how prudence is applied.

Prudence is applied when valuing stock by taking the lower of cost or net realisable value (1 mark for example, plus 1 mark for development). This ensures that profits are not anticipated until they are earned.

Other examples to be rewarded accordingly. **0-2 marks**

(c) Explain the concept of consistency.

The concept of consistency means that once an accounting policy has been decided, it should be adhered to in subsequent years. **0-2 marks**

(d) Explain, giving **one** example, how consistency is applied.

Consistency is applied when providing for depreciation (1 mark for example, plus 1 mark for development). This ensures that inter-year comparison of final accounts can be made.
0-2 marks

8 marks

4 **Total for this question: 34 marks**

Catherine Donovan manufactures furniture. Completed furniture is transferred from her manufacturing account to her trading account at cost plus 25%. She provides the following information for the year ended 31 December 2006.

	Dr £	Cr £
Stock at 1 January 2006 – raw materials	9 840	
finished goods	23 500	
Purchases of raw materials	126 430	
Direct wages	274 700	
Factory supervisors' wages	63 150	
Administrative staff wages	124 490	
Rates	6 400	
Indirect expenses – office	198 160	
factory	337 171	
Manufacturing royalties	55 000	
Machinery at cost	400 000	
Office equipment at cost	80 000	
Provision for depreciation – machinery		160 000
office equipment		30 000
Provision for unrealised profit		4 700

Additional information at 31 December 2006

(1) Rates paid in advance amounted to £400.

(2) Rates are apportioned ¾ to the factory and ¼ to the office.

(3) Depreciation is provided on all fixed assets at 10% using the straight-line method.

(4) Stocks of raw materials were £10 211.

(5) Stocks of finished goods were £25 600.

(6) Stocks of work in progress increased by £580 during the year.

REQUIRED

4 (a) Prepare a manufacturing account for the year ended 31 December 2006.

Catherine Donovan

Manufacturing account for the year ended 31 December 2006 (1)

	£		£	
Stock of raw materials			**9 840**	
Purchases of raw materials			**126 430**	**(1)**
			136 270	
Stock of raw materials (1 mark both stocks)			**10 211**	**(1)**
Cost of raw materials consumed			**126 059**	**(1)**
Direct wages			**274 700**	**(1)**
Royalties			**55 000**	**(1)**
Prime cost			**455 759**	**(1OF)**
Factory overheads*				
Indirect wages	**63 150**	**(1)**		
Rates	**4 500**	**(4) W1**		
Expenses	**337 171**	**(1)**		
Depreciation of machinery	**40 000**	**(1)**	**444 821***	
			900 580	
Less increase in work in progress			**580**	**(2)**
Total production cost			**900 000**	**(1OF)**
Factory profit			**225 000**	**(1OF)**
Transfer price			**1 125 000**	**(1OF)**

max 17 marks

W1 6400 (1)

(400) (1) x ¾ (1)

4500 (1)

*** Max 3 of possible 7 marks if factory overheads are deducted rather than added**

4 (b) Calculate the change in the provision for unrealised profit for the year ended 31 December 2006.

Closing balance	**5 120**	**(3) W1**
Opening balance	**4 700**	**(1)**
Change	**420**	**(1OF)**

W1 25 600 (1) x 25/125 (1) = 5120 (1)

5 marks

Catherine has calculated her gross profit on trading for the year ended 31 December 2006 to be £312 400.

REQUIRED

(c) Calculate the **total** gross profit from manufacturing **and** trading for the year ended 31 December 2006, showing how the provision for unrealised profit is treated.

Profit and loss account extract for the year ended 31 December 2006

	£		£	
Gross profit from trading			**312 400**	**(1)**
Gross profit on manufacture	**225 000**	**(1 OF)**		
Less provision	**420**	**(1 OF)**	**224 580**	
Total gross profit			**536 980**	**(1OF)**

4 marks

(d) Explain to Catherine the reason for making a provision for unrealised profit in her books of account.

Provision is needed when the production cost of goods is increased by adding a factory profit (0 – 2).

Means that the value of the stocks of finished goods is higher than cost (0 – 2).

Because of concept of prudence, the profit element needs to be removed from the value of stock of finished goods (0 – 2).

Stocks should be valued at the lower of cost and net realisable value ((0 – 2).

Increase in provision is taken from gross profit – to remove profit element from stock in trading account (1) so that profits are not overstated (1) by a profit that may not be realised (1), and total provision is deducted from stock of finished goods on the balance sheet (1) so that value on balance sheet is not overstated (1), so showing a true and fair value (0 – 2).

8 marks

QUALITY OF WRITTEN COMMUNICATION

After the candidate's script has been marked, the work should be assessed for the Quality of Written Communication, using the following criteria.

Marks

0	Accounts and financial statements are unclear and poorly presented. There is little or no attempt to show workings or calculations. Descriptions and explanations lack clarity and structure. There is very limited use of specialist vocabulary. Answers may be legible but only with difficulty. Errors in spelling, punctuation and grammar are such that meaning is unclear.
1-2	There is some attempt to present accounts and financial statements in an appropriate format. Workings are missing or are not clearly linked to the answers. Descriptions and explanations are understandable but they lack a logical structure. There is some use of specialist vocabulary but this is not always applied appropriately. In most cases answers are legible, but errors in spelling, punctuation and grammar are such that meaning may be unclear.
3	Accounts and financial statements are generally well presented but there are a few errors. Workings are shown and there is some attempt to link them to the relevant account(s). Descriptions and explanations are usually clearly expressed but there are some weaknesses in the logical structure. There is a good range of specialist vocabulary which is used with facility. Answers are legible. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed.
4	Accounts and financial statements are well organised and clearly presented. Workings are clearly shown and easy to follow. Descriptions and explanations are clearly expressed. Arguments are logically structured. There is wide use of specialist vocabulary which is used relevantly and precisely. Answers are clearly written and legible. Spelling is accurate and the standard conventions of punctuation and grammar are followed so that meaning is clear.

To help them to make judgements, examiners should focus on the following issues.

Are there clear presentations of formats and prose answers?

Are there clear and logical workings, where appropriate?

Is the whole script legible, understandable and logically argued (including spelling, punctuation and grammar)?

Is there a grasp of accounting terminology (eg avoiding slang, avoiding text language, avoiding abbreviations in prose answers)?