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General Certificate of Education

Accounting ACC3

**Unit 3 Financial Accounting: Determination
of Income**

Mark Scheme

2007 examination - June 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 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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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: 10 marks

Gabrielle has just started a business. She intends to depreciate her vehicles by 20%, using the straight-line method. Her accountant has suggested that she should use 20% reducing balance, as it is a more appropriate method.

REQUIRED

1(a) State how the change in depreciation method would affect her profits in the first year of use **and** in the third year of use.

(i) In the first year after the change in depreciation policy, Gabrielle's profits would **remain unchanged.** 1 mark

(ii) In the third year after the change in depreciation policy, Gabrielle's profits would **increase.** 1 mark

1(b) Identify **two** concepts or principles used in the provision of depreciation of fixed assets.

Concept 1 – **consistency** 1 mark

Concept 2 - **accruals (matching)** 1 mark

1(c) Explain why it is necessary to apply the two concepts identified in (b) when preparing final accounts.

It is necessary to apply the concept of **consistency** because **it ensures that the final accounts may be used for comparative purposes (2), thus allowing appropriate decisions to be made (1).** 3 marks

It is necessary to apply the concept of **accruals** because **all expenditures (1) that are involved in generating profits (1) should be included in the profit and loss account to which they relate (1).** 3 marks

If prudence given then:

Not overstate profits (1), not overstate value of fixed assets shown on balance sheet (1) on both counts, so not to overstate capital of business (1).

2

Total for this question: 27 marks

The directors of Ben Novice Ltd provide the following information.

Trial balance extract at 31 December 2006

	Dr	Cr
	£	£
Ordinary shares of 50 pence each		2 000 000
Taxation paid for the year ended 31 December 2006	157 300	
Sales		3 932 210
Cost of sales	2 163 420	
Rent receivable		14 500
Office expenses	500 000	
Directors' fees	310 000	
Selling and distribution expenses	270 000	
8% debentures (2015)		700 000
Debenture interest	56 000	
Interim dividend paid	50 000	

Additional information at 31 December 2006

- (1) The authorised share capital was 10 000 000 ordinary shares of 50 pence each.
- (2) The directors:
- (i) wish to make provision for corporation taxation of £142 500;
 - (ii) propose a final ordinary dividend of 3 pence per share.

REQUIRED

- 2 (a) Prepare a profit and loss account **and** an appropriation account for year ended 31 December 2006.

Ben Novice Ltd**Profit and loss and appropriation account for the year ended 31 December 2006**

	£		£	
Gross profit W ₁			1 768 790	(3)
Rent receivable			<u>14 500</u>	(1)
			1 783 290	
Office expenses	500 000	(1)		
Directors' fees	310 000	(1)		
Selling and distribution costs	<u>270 000</u>	(1)	1 080 000	
Operating profit			703 290	
Debenture interest			<u>56 000</u>	(1)
Profit before taxation (1)			647 290	(1) OF
Corporation tax			<u>142 500</u>	(1)
Profit after taxation (1)			504 790	(1) OF
Interim dividend	50 000	(1)		
Final dividend (4 000 (1) x 3p(1))	<u>120 000</u>	(1)	170 000	
Retained profit for the year (1)			<u><u>334 790</u></u>	(1) OF
W1	3 932 210	(1)		
	<u>(2 163 420)</u>	(1)		
	1 768 790	(1)		

max 18 marks

- 2 (b) Explain fully the terms:

- (i) 8% debentures (2015);

Long term liability (1)

Loan to the company (1)

Creditor of the company (1)

Paying 8% interest per annum (1), £56 000(1) whether profits are made or not (1)

Will be repaid in 2015 (1)

From investor's point of view less risky (1)

From company's point of view, more risk involved (1)

max 4 marks

- (ii) interim dividend paid;

Dividend actually paid part way through the year (1)

Usually based on profits earned half way through the year (1)

Does not need to be paid (1) if profits are too low

max 2 marks

- (iii) authorised share capital of 10 000 000 ordinary shares of 50 pence each.

Sets the upper limit to the number of ordinary shares that the company can issue (1); so Ben Novice Ltd can only issue 10 million ordinary shares

(1); shareholders' permission is needed to exceed this amount (1);

50 pence indicates the nominal value of each share (1).

max 3 marks

3

Total for this question: 14 marks

Zoe Moss owns and runs a manufacturing business. Finished goods are transferred from the manufacturing account to the trading account at factory cost plus 50%.

She provides the following information for the year ended 31 December 2006.

	at 1 January 2006	at 31 December 2006
	£	£
Stocks – Raw materials	110 000	120 000
Work in progress	75 000	80 000
Finished goods	25 200	37 200

REQUIRED

3(a) Calculate the amount to be charged to the profit and loss account for the year ended 31 December 2006 for the provision for unrealised profit.

The amount to be charged is **£4000**.

Workings

$$\begin{array}{r}
 25\,200 \quad (1) \quad \times \frac{50}{100} \quad (1) \quad = \quad 12\,600 \quad (1) \quad \text{OF} \\
 \hline
 37\,200 \quad (1) \quad \times \frac{50}{100} \quad (1) \quad \text{OF} \quad = \quad 18\,600 \quad (1) \quad \text{OF} \\
 \hline
 \underline{4\,000} \quad (1) \quad \text{OF}
 \end{array}$$

7 marks

3(b) State how the amount calculated in (a) should be treated in the profit and loss account.

Deducted from profit on manufacture (2)

Included as an expense (1)

max 2 marks

3(c) Prepare an extract from the balance sheet at 31 December 2006, showing stocks and how the provision for unrealised profit should be treated.

Balance sheet extract at 31 December 2006

	£	£
Current assets		
Raw materials		120 000
Work in progress		80 000
Stocks of finished goods	37 200 (1)	
Less provision for unrealised profit (1)	<u>12 400 (1) OF</u>	24 800 (1) OF

5 marks

4

Total for this question: 25 marks

Polly Flanders provides the following information for her business at 31 October 2006.

	£
Gross profit for the year ended 31 October 2006	90 647
Discount allowed	342
Discount received	701
Carriage outwards	812
Vehicle at cost	20 000
Provision for depreciation of vehicle at 1 November 2005	10 000
Motor expenses	32 163
Rent and rates	7 400
General expenses	23 651

Additional information for the year ended 31 October 2006

- (1) Included in the figure for motor expenses is a second-hand vehicle purchased at a cost of £18 000 in April 2006.
- (2) Depreciation of vehicles is provided at 25% per annum on cost at the financial year end.
- (3) At 31 October 2006:
 - (i) rent amounting to £600 remained unpaid for September and October 2006;
 - (ii) rates amounting to £1000 had been paid for the following financial year.

REQUIRED

4 (a) Prepare a profit and loss account for the year ended 31 October 2006.

Polly Flanders
Profit and loss account for the year ended 31 October 2006

	£		£	
Gross profit			90 647	(1)
Discount received			<u>701</u>	(1)
			91 348	
Less expenses				
Discount allowed	342	(1)		
Carriage outwards	812	(1)		
Motor expenses	14 163	(2)		
Rent and rates W ₁	7 000	(4)		
General expenses	23 651			
Depreciation of motor vehicles W ₂	<u>9 500</u>	(3)OF	<u>55 468</u>	
Net profit			35 880	(1)OF
W ₁ 7 400	(1)	W ₂ 38 000	(1)OF	
600	(1)	<u>x 25%</u>	(1)	
<u>(1 000)</u>	(1)	9 500	(1)OF	
7 000	(1)			

14 marks

4

Polly's friend, Deryk, has suggested that Polly should change her business into a private limited company. She asks your advice.

4(b) Discuss whether or not Polly should change her business into a private limited company.

Advantages include:

- she would have limited liability (1); her liability would be limited to the amount of her investment (1); her private assets are not at risk (1)
- access to more capital (1) by selling more shares (1)
- if there are other shareholders (1), she can discuss decisions (1)
- able to raise loans and overdrafts (1) from banks more easily (1), often more cheaply (1) because of reduced risk (1)
- more status? (1).

max 6 marks

Disadvantages include:

- if other shareholders are involved (1), she may lose control (1) because of diluted ownership (1)
- may receive less of a return (1), since profits may have to be shared with other shareholders (1)
- longer to make decisions (1) if other shareholders are involved (1)
- more paperwork (1), audited (1), filing (1).

max 6 marks

**Max 9 marks for discussion
Judgement based on discussion (0-2)**

Overall max 11 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 and 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)?
