



General Certificate of Education

Accounting ACC6

**Unit 6 Published Accounts of Limited
Companies and Accounting
Standards**

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 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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June 2007**ACC6****MARK SCHEME****INSTRUCTIONS TO EXAMINERS**

You should remember that your marking standards should reflect the levels of performance of Advanced Level candidates, mainly 18 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.

Synoptic Assessment

Synoptic assessment is located in the last question. Candidates will be required to integrate their knowledge, understanding and skills learned in different parts of the A Level course.

1

Total for this question: 20 marks

The share capital and reserves sections from the balance sheets of two companies are shown below.

	Rites plc	Bonus plc
Share capital and reserves	£000	£000
Issued ordinary shares of 25p each	4 000	2 000
Share premium account	5 000	5 000
Revaluation reserve	3 000	3 000
Profit and loss account	<u>256</u>	<u>256</u>
	<u><u>12 256</u></u>	<u><u>10 256</u></u>

Immediately after these balance sheet extracts were prepared, the following occurred:

- (i) The directors of Rites plc declared a rights issue of ordinary shares on the basis of one share for every two held at a premium of 10p per share. The rights issue was fully subscribed.
- (ii) The directors of Bonus plc restructured the balance sheet by making a bonus issue on the basis of four shares for every one held. The directors maintained the reserves in their most distributable form.

REQUIRED

- 1(a) Prepare the share capital and reserves section of the balance sheet of Rites plc to show the effect of the rights issue.
- 1(b) Prepare the share capital and reserves section of the balance sheet of Bonus plc to show the effect of the bonus issue.

	Rites plc		Bonus plc	
Share capital and reserves	£000		£000	
Issued ordinary shares of 25p each	6 000	(6)W ¹	10 000	(6)W ³
Share premium account	5 800	(3)W ²	0	(1) OF
Revaluation reserve	3 000		0	(1) OF
Profit and loss account	<u>256</u>		<u>256</u>	(1)
	<u><u>15 056</u></u>	(1)CF	<u><u>10 256</u></u>	(1)CF
	<u>10 marks</u>		<u>10 marks</u>	

Workings

W1 $4\,000\,000 \times 4 = 16\,000\,000$ (1) $\div 2$ (1) = $8\,000\,000$ shares (1) OF
Share capital $8\,000\,000 \times 25p$ (1) = $\pounds 2\,000\,000$ (1) OF
Plus 1 mark for adding to issued share capital

W2 $8\,000\,000$ shares (1) OF $\times 10p$ (1) = $\pounds 800\,000$
Plus 1 mark for adding to share premium

W3 $\pounds 2\,000\,000 \times 4 = 8\,000\,000$ shares (1)
Bonus issue $8\,000\,000 \times 4$ (1) = $32\,000\,000$
 $32\,000\,000$ (1) OF $\times 25p$ (1) = $\pounds 8\,000\,000$ (1) OF
Plus 1 mark for adding to issued share capital

20 marks

2

Total for this question: 30 marks

The following extracts are taken from the published accounts of Scottish & Newcastle plc and UK COAL PLC. Scottish & Newcastle plc is one of the world's leading brewers and the principal activity of UK COAL PLC is surface and underground coal mining.

Extract 1 Scottish & Newcastle plc

Notes to the accounts:

Intangible assets

The Kronenbourg brand was initially recognised at its fair value on acquisition in 2002. The brand has a long history in a long-established industry and has a significant share of the European beer market. These factors, together with the scale of the business, contribute to the brand's durability. Consequently, the useful life of the brand is considered by the directors to be indefinite and no annual amortisation is provided.

Source: Scottish & Newcastle plc Annual Report 2004

Extract 2 UK COAL PLC

Extract from the profit and loss account:

	£000
Loss for the year	(51 579)
Dividends	<u>(8 786)</u>
Loss sustained for the year	(60 365)

Extract from notes to the accounts:

Tangible fixed assets and depreciation

Freehold land is not depreciated. Mineral rights are depreciated on a depletion basis related to coal extraction.

Source: UK COAL PLC Annual Report and Accounts 2004

REQUIRED

2 (a) Identify and explain **two** reasons why public limited companies publish their accounts.

Descriptor	Marks	Possible answers
Identify two reasons	0-2	Law Publicity Potential investors Shareholders
Explain/develop each reason	0-2 per reason	Law - legal requirement of the Companies Act 1985 required because of the divorce of ownership and control – the directors report to the shareholders on the performance of the business. Publicity – to persuade current investors to retain their shares, potential investors to invest. Potential investors – show the results and plans for the future to persuade investors to invest.

6 marks

2(b) Explain, with reference to FRS 10, the general accounting treatment of intangible assets and also the specific treatment of the Kronenbourg brand in **Extract 1**.

Descriptor	Marks	Possible answers
Explanation of intangible assets	0-2	Intangible assets are fixed assets that are not physical – such as goodwill, brand names.
Explanation of the treatment of purchased intangible assets	0-3	Purchased intangible assets can be capitalised on the balance sheet and should then be amortised over their estimated economic life. Alternatively, they could be written off to the profit and loss account immediately, if the directors choose.
Explanation of the treatment of non-purchased intangible assets	0-3	Internally generated intangible assets should not be capitalised and should be written off to the profit and loss account unless they have a readily ascertainable market value.
	Max 6	
Explain the accounting treatment of the brand in Extract 1 – asset life is infinite	0-3	If the company can demonstrate the asset does have an infinite life, it does not have to be amortised. In this case, the directors believe that brand Kronenbourg has an infinite life.

Overall max 8 marks

- 2(c) Explain why, in **Extract 2**, a company can declare a dividend payment despite incurring a loss.

Descriptor	Marks	Possible answers
Explain that dividends are declared out of realised profits	0-2	Dividends can only be declared from realised profits – these can be current or past, eg from revenue reserves.
Application to UK COAL PLC	0-4	In this case, the company has made a loss this year so the dividend must be declared from past profits, eg using the balance on the profit and loss account or any other revenue reserve.

max 4 marks

- 2(d) Outline, with reference to FRS 15, the accounting treatment of fixed assets and explain the depreciation policies of UK COAL PLC given in **Extract 2**.

Descriptor	Marks	Possible answers
Cost	0-2	Assets should be included in the accounts at cost, with an example or explanation.
Revaluation	0-3	Assets can be revalued, all assets in that class must be revalued and depreciation charged on the revalued amount.
Depreciation	0-4	Depreciation should be charged on all assets to reflect the use of the asset – the method can be chosen by the company, eg reducing balance or straight line.
Treatment of freehold land in general terms	0-2	Freehold land does not have a finite life and therefore does not need to be depreciated.
Application to UK COAL PLC	0-2	
Explanation of the treatment of mineral rights in UK Coal PLC	0-3	The company depreciates its mineral rights by calculating the amount used up in the accounting period – this is an accurate reflection of the cost of using the asset in the period and therefore complies with FRS 15.

max 12 marks

Answers written solely in general terms (i.e without reference to UK Coal PLC) = max 9 marks

3

Total for this question: 50 marks

Harry and Jim are the only shareholders of Ston Ltd. The business is run by the manager, Mr Woodward.

Harry and Jim have just received the final accounts of Ston Ltd for the year ended 31 December 2006. They are concerned about the performance of the business. Despite the company making a profit, and Harry and Jim investing more capital in the business, the balance sheet shows that the company's bank balance has fallen from £16 700 at 31 December 2005 to an overdraft of £20 at 31 December 2006.

The following information is available.

Liquidity ratios at 31 December 2005

Current ratio	1.57:1
Acid test ratio	1.36:1
Debtor's collection period	45 days
Stock turnover	7.5 times

Summarised profit and loss account for the year ended 31 December 2006

	£
Turnover	120 000
Cost of sales	<u>40 000</u>
Gross profit	80 000
Operating expenses	<u>60 482</u>
Net profit	<u>19 518</u>

3

Balance sheets		
	at 31 December	at 31 December
	2006	2005
	£	£
Fixed assets	<u>188 250</u>	<u>186 500</u>
Current assets		
Stock	8 760	5 600
Debtors	24 528	18 780
Bank		16 700
	<u>33 288</u>	<u>41 080</u>
Creditors: amounts falling due within one year		
Creditors	13 500	18 080
Proposed dividends	2 000	4 000
Taxation	2 000	4 000
Bank	20	
	<u>17 520</u>	<u>26 080</u>
Net current assets	<u>15 768</u>	<u>15 000</u>
Total assets less current liabilities	<u>204 018</u>	<u>201 500</u>
Creditors: amounts falling due after more than one year		
Bank loans	<u>31 000</u>	<u>69 000</u>
Net assets	<u>173 018</u>	<u>132 500</u>
Share capital and reserves		
Ordinary shares of £1 each fully paid	120 000	100 000
Share premium	20 000	15 000
Profit and loss account	<u>33 018</u>	<u>17 500</u>
	<u>173 018</u>	<u>132 500</u>

REQUIRED

3(a) Calculate the following ratios for the year ended 31 December 2006. State the formulae used.

- (i) Gross profit margin
- (ii) Net profit margin
- (iii) Return on capital employed
- (iv) Current ratio
- (v) Acid test ratio
- (vi) Debtors' collection period
- (vii) Stock turnover

(i) Gross profit margin	$\frac{\text{Gross profit} \times 100}{\text{Turnover}}$ (1)	$\frac{80\,000 \times 100}{120\,000}$	66.7%	(1)
(ii) Net profit margin	$\frac{\text{Net profit} \times 100}{\text{Turnover}}$ (1)	$\frac{19\,518 \times 100}{120\,000}$	16.3%	(1)
(iii) Return on capital employed	$\frac{\text{Net profit} \times 100}{\text{Capital employed}}$ (1)	$\frac{19\,518 \times 100}{173\,018 + 31\,000}$	9.6%	(2)
(iv) Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$ (1)	$\frac{33\,288}{17\,520}$	1.9:1	(1)
(v) Acid test ratio	$\frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}}$ (1)	$\frac{24\,528}{17\,520}$	1.4:1	(1)
(vi) Debtors' collection period	$\frac{\text{Debtors} \times 365}{\text{Turnover}}$ (1)	$\frac{24\,528 \times 365}{120\,000}$	75 days	(1)
(vii) Stock turnover	$\frac{\text{Cost of sales}}{\text{Average stock}}$ (1)	$\frac{5600 + 8760}{2}$ = $\frac{40\,000}{7180}$ (1)	5.6 times	(1)

16 marks

3(b) Calculate the gearing ratios at 31 December 2005 and 31 December 2006. State the formula used.

		2006	2005
Gearing ratio	$\frac{\text{Debt} \times 100}{\text{Equity}} (1)$	$\frac{31\,000 \times 100}{173\,018} = 18\% (1)$	$\frac{69\,000 \times 100}{132\,500} = 52\% (1)$

OR

		2006	2005
Gearing ratio	$\frac{\text{Debt} \times 100}{\text{Capital employed}} (1)$	$\frac{31\,000 \times 100}{204\,018} = 15\% (1)$	$\frac{69\,000 \times 100}{201\,500} = 34\% (1)$

3 marks

Cash flow statement for the year ended 31 December 2006

	£	£
Net cash flow from operating activities		21 780
Returns on investment and servicing of finance		
Interest paid		(3 500)
Taxation		(4 000)
Capital expenditure and financial investment		
Payment to acquire fixed assets		(14 000)
Equity dividends paid		<u>(4 000)</u>
Cash flow before the use of liquid resources		(3 720)
Financing		
Issue of share capital	25 000	
Repayment of loans	<u>(38 000)</u>	<u>(13 000)</u>
Decrease in cash		<u><u>(16 720)</u></u>

REQUIRED

3 (c) Write a report to Harry and Jim:

Report format: 2 marks

To: Harry and Jim

From: A student

Date: 15 June 2007

Subject: Analysis of cash flow statement and assessment of financial performance

4 items = 2 marks

2-3 items = 1 mark

0-1 items = 0 mark

2 marks

(i) analysing the cash flow statement for the year ended 31 December 2006;

Descriptor	Marks	Possible answers
Identification of sources and uses of cash	0-3	Operating profits contribute £21 780 of cash. Shares issued contribute £25 000. Could include any of uses.
Analysis of significant uses	0-3	Repayment of loans £38 000 consumes nearly all the cash generated from shares and profits. Purchase of fixed assets at £14 000 means that more cash is used than generated.
Assessment of cash flow position	0-5	There has been a decrease in cash flow of £16 720. The business generates funds from operating activities and these are sufficient to pay the interest, dividends and tax. However, the repayment of the loan and purchase of fixed assets mean that the business has suffered a decrease in cash in the year. The repayment of the loan should reduce interest payments in future. Overall the liquidity position appears to be acceptable.

max 9 marks

- 3(c) (ii) assessing the financial performance of the business, use the ratios given and those calculated in (a) and (b).

Descriptor	Marks	Possible answers
Profitability Description of profitability ratios	0-3	Ratios show that Ston Ltd makes 67p profit per £1 of sales and 16p net profit per £1 of sales. The ROCE shows that for every £1 invested, the company earns 9.6p.
Liquidity Comparison of the liquidity ratios	0-4	The current ratio shows a slight increase from 1.57:1 to 1.9:1. The acid test ratio is stable at approx 1.4:1. The debtors' collection period has deteriorated from 45 to 75 days. The stock turnover has deteriorated from 7.5 times to 5.6 times.
Gearing Comparison of gearing ratios	0-2	The gearing ratio has improved from 52% to 18% - this is low geared and low risk.

Assessment of profitability	0-4	The business is profitable. However, it is not possible to assess the profitability as we need other ratios to compare either from previous years or from other similar businesses. The ROCE ratio, however, compares favourably with risk-free investments.
Assessment of liquidity	0-6	The increase in the current ratio means the business has more current assets to pay current liabilities. However, the debtors' collection period has deteriorated, which would have a negative effect on cash flow. The stock turnover has deteriorated and this may have caused the current ratio to increase. Overall, despite the increase in the current ratio, it looks as if the liquidity position is worsening.
Assessment of gearing	0-4	The business is now lower geared than before, which should reduce future interest payments and increase profitability. There is less risk as loans are a smaller proportion of long term funding.
Overall assessment of financial performance	0-3	Reduced gearing is significant and increase in fixed assets may lead to future growth.

Overall max 20 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.
- 3-4** 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.
- 5** 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 (including spelling, punctuation and grammar)?

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

Are arguments logically argued?