



2010 Accounting

Advanced Higher – Solutions

Finalised Marking Instructions

© Scottish Qualifications Authority 2010

The information in this publication may be reproduced to support SQA qualifications only on a non-commercial basis. If it is to be used for any other purposes written permission must be obtained from the External Print Team, Centre Services, Dalkeith.

Where the publication includes materials from sources other than SQA (secondary copyright), this material should only be reproduced for the purposes of examination or assessment. If it needs to be reproduced for any other purpose it is the centre's responsibility to obtain the necessary copyright clearance. SQA's External Print Team, Centre Services, at Dalkeith may be able to direct you to the secondary sources.

These Marking Instructions have been prepared by Examination Teams for use by SQA Appointed Markers when marking External Course Assessments. This publication must not be reproduced for commercial or trade purposes.

2010 ADVANCED HIGHER ACCOUNTING

MARKING CONVENTIONS

CONVENTION	EXPLANATION	MARK(S) ON CANDIDATES PAPER
Extraneous	Items entered which should not be in the answer	-1E
Consequential	If a figure in a question is wrong, any further calculations are awarded marks if correct, as a consequence of using that figure	C
Nomenclature	The details in an account are wrong/missing	-1N
Dates	The date of an entry is wrong/missing	-1D
Complete Reversal	All the ledger entries are made the wrong way round The question is marked as if correct and then the total mark is divided by 2	R eg Total Mark = 12 Divided by 2 Mark awarded = 6
Plus/Minus Rule	If an entry is shown correctly it is awarded the mark (+) If the same entry then appears in another part of the question the mark is deducted (-) ie no mark is gained and there is no penalty	eg Correct entry £60,000 Sales in the Trading Account – Mark awarded 1 (+) Wrong entry £60,000 Sales also entered in the Balance Sheet – Mark deducted -1 (+)
Penalty	The answers given are more than required (4 given instead of 3) and one of them is wrong A heading is wrong/missing from a final account The answer is correct but not given in the format requested ie the question asks for an account or a statement and a list is given	-1P

GENERAL INSTRUCTIONS

- 1 Assess pencil figures and working. If the script is predominantly in pencil refer to the Principal Examiner.
- 2 A maximum of 10% of marks gained on any individual question may be deducted for untidy work and poor style. This penalty should only be applied in exceptional circumstances.
- 3 Work which has been deleted gains no marks, even if correct. Exceptional cases may be drawn to the attention of the Principal Examiner.
- 4 Consequential errors **MUST NOT** be penalised, subject to the marking instructions for each question.
- 5 Mark workings whether or not they are incorporated into the final answer. Deduct a penalty of -1 mark per question for working which is not incorporated in the final answer.
- 6 Incorrect figures, supported by adequate workings – award marks for any correct operations performed.
- 7 Incorrect figures, not supported by adequate workings – lose awards, unless the marking instructions specify otherwise. If arithmetic error lose 1 mark.
- 8 **EXTRANEIOUS ITEMS** – see instructions for specific questions.
- 9 If right and wrong – give value of award where figure is correct, deduct value of award where figure is wrong (cross reference +/- against relevant figures).
- 10 Indicate awards given for each item next to the appropriate figure eg £1500¹

In essay type questions indicate the marks awarded beside the point made by the candidate – **NOT IN THE MARGIN.**

Sub-totals for each section should be indicated and encircled, eg

5/6

Final totals should be clearly indicated and easy to check, eg Q1 = 42/50.

**2010 Accounting
Advanced Higher
Solutions**

Question 1

Part A

Working Notes

DISTRIBUTION OF EXPENSES

	COGS	Admin	Distrib	Marks
Wages and Salaries	30%	30%	40%	
33750 + 6000 = 39750	11,925	11,925	15,900	1 each
Rent and Rates	50%	25%	25%	
12000 – 4600 = 7400	3,700	1,850	1,850	1 each
Depreciation Machinery	60%		40%	
20% of 320000 = 64,000	38,400		25,600	1 each
Depreciation Delivery Vans				
10% × (100,000 – 7,500)			9250	1

NB marks above transferred to appropriate section below.

Cost of sales

	£	Marks
Opening Stock	11,250	1
Add Purchases	174,000	1
	185,250	
Less Closing Stock	24,000	1
	161,250	
Wages and Salaries	11,925	1
Rent and Rates	3,700	1
Depreciation Machinery	38,400	1
Cost of Sales	215,275	(6)

Distribution Expenses

	£	
Wages and salaries	15,900	1
Carriage out	4,500	1
Rent and Rates	1,850	1
Sundry Distribution Expenses	9,750	1
Depreciation Delivery Vans	9,250	1
Depreciation Machinery	25,600	1
Delivery Van Expenses	3,375	1
	70,225	(7)

Administration Expenses	£		Investment Income	£	
Wages and Salaries	11,925	1	Income received	5,625	1
Rent and Rates	1,850	1	Bank Interest	1,875	1
Directors emoluments	4,875	1		7,500	(2)
Sundry Admin Expenses	6,375	1			
Audit Fees	8,400	1	Debenture Interest = 80000*10%		
Net Discounts (2850 – 3375)	-525	2			
	32,900	(7)		= 8,000	(1)

Dividends	£	£	
Preference Dividend = 10% of 75000 × 0.5		3,750	} 1 for both
Preference Dividend due 10% × 75000 × 0.5		3,750	
Ordinary Dividend			
Interim	3,000		1
Due = 150,000*6p =	6,000	9,000	1
		16,500	(3)

TURRIFF PLC

Profit and Loss Account for year ended 31 December Year 2

	£	Marks
Turnover	380,000	1
Less Cost of Sales	215,275	6
Gross Profit	164,725	
Less Expenses		
Distribution	70,225	7
Administration	32,900	7
Operating profit	61,600	1
Investment income	5,625	1
Bank interest	1,875	1
	69,100	
Interest payable	8,000	1
Profit on ordinary activities	61,100	1
Corporation Tax on ordinary activities	42,000	1
Profit after tax	19,100	1
Dividends	16,500	3
Retained Profits	2,600	
		(31)

Part B

	Preference Share Capital Account	Dr	Cr	Balance	Marks
July 1	Balance		375,000	375,000	1
Sept 3	First and Final Call		125,000	500,000	1
Oct 20	Forfeiture of Shares	10,000		490,000	1
Oct 30	Alan Grey		10,000	500,000	1

	Bank Account				
July 1	Balance	750,000		750,000	1
Sept 3	First and Final Call (490,000 × 25p)	122,500		872,500	1
Oct 30	Alan Grey (10,000 × 60p)	6,000		878,500	1

	First and Final Call Account				
Sept 3	Preference Share Capital	125,000		125,000	1
Sept 3	Bank (490,000 × 25p)		122,500	2,500	1
Oct 20	Forfeiture of shares		2,500	0	1

	Forfeiture of Shares Account				
Oct 20	First and Final Call (10,000 × 25p)	2,500		2,500	1
Oct 20	Preference share capital (10,000 × £1)		10,000	7,500	1
Oct 30	Alan Grey	4,000		3,500	1
Oct 30	Profit on Reissue of Shares	3,500		0	1

	Alan Grey's Account				
Oct 30	Bank (10,000 × £0.60)		6,000	6,000	1
Oct 30	Forfeiture of shares		4,000	10,000	1
Oct 30	Preference Share Capital	10,000		0	1

	Profit on Reissue of Shares				
Oct 30	Forfeiture of Shares		3,500	3,500	2

(19)

OR

	Share Premium Account				
July 1	Balance		375,000	375,000	
Oct 30	Forfeiture of Shares		3,500	378,500	2

Working Notes

Share income received 10,000 × 75p	7,500	}	1
From Grey (10,000 × 60p)	6,000		
Total income on shares	13,500		
Less Nominal Value	10,000		1
Profit on reissue	<u>3,500</u>		

(50 marks)

Question 2

(a) (i) Current Gearing Ratio for issued capital

Marks

	Orion plc $\frac{500 + 500}{500}$	Mercury plc $\frac{200 + 300}{800}$	Saturn plc $\frac{200 + 200}{400}$	
<u>FIBC</u> Ordinary Shares				

2:1 **1** 0.625:1 **1** 1:1 **1** **3**

(ii) Mercury plc has the lowest gearing ratio **1**

(iii) In periods of high profits the ordinary shareholders in:

Orion plc shareholders would receive the best return in periods of high profits (**1**) because a small percentage of profits would be taken up paying Debenture Interest and Preference Dividends leaving more profit available to the ordinary shareholders (**1**). Orion plc has the highest gearing ratio (**1**).

3

(iv) <u>FIBC</u> Ordinary Shares	<u>Orion plc</u> $\frac{500 + 500}{1,000}$
-------------------------------------	---

1:1 **1**

The gearing ratio in Orion plc would change from 2:1 to 1:1
This results in the gearing ratio changing to lower gearing. **1**
Ordinary shareholder will receive lower dividends as there
are more shareholders to receive a share of the profits. **1**

3

(10)

(b) (i) Profit available for distribution to ordinary shareholders: Marks

	Orion plc		Mercury plc		Saturn plc	
Operating profit	£150,000		£150,000		£150,000	
Less Debenture Interest	£40,000	1	£24,000	1	£16,000	1
	£110,000		£126,000		£134,000	
Less Corporation tax (25%)	£27,500	1	£31,500	1	£33,500	1
Net Profit after tax	£82,500		£94,500		£100,500	
Less Preference Dividends (10%)	£50,000	1	£20,000	1	£20,000	1
Profit available to Ord Shareholders	£32,500		£74,500		£80,500	
Retained Profit (20%)	£6,500	1	£14,900	1	£16,100	1
(ii) Total dividend paid to ordinary shareholders:	£26,000		£59,600		£64,400	12
Less interim dividend paid	£10,000		£16,000		£8,000	
(iii) Final dividend proposed	£16,000	1	£43,600	1	£56,400	1 3
(iv) Total percentage dividend to be paid to shareholders						
<u>Total dividend paid</u> × 100	£26,000	× 100	£59,600	× 100	£64,400	× 100
Ordinary Share Capital	500,000	1	800,000	1	400,000	1
	5.20%		7.45%		16.10%	3
(v) Ordinary Dividend per share = Total dividend/number of ordinary shares						
Total dividend	£26,000	1	£59,600	1	£64,400	1
No of Ordinary shares	1,000,000		1,600,000		800,000	
Ordinary dividend per share	2.60p		3.73p		8.05p	3
(vi) Earnings per share						
<u>Net Profit after tax – Preference Dividends</u>	£82,500 –		£94,500 –		£100,500 –	
Number of Ordinary Shares	£50,000		£20,000		£20,000	
	= £32,500	1	= £74,500	1	= £80,500	1
	1,000,000		1,600,000		800,000	
per share	3.25p per share		4.66p per share		10.06p per share	3

(24)

(c) (i) Price Earnings Ratio

<u>Market Price per share</u>	£0.70		£0.60		£0.80	
Earnings per share	3.25p	1	4.66p	1	10.06p	1
	21.54	times	12.88	times	7.95	times 3

(ii) Dividend Yield

<u>Ordinary dividend per share</u> × 100	2.6 × 100	1	3.73 × 100	1	8.05 × 100	1
Market Price per share	70		60		80	
	3.71%		6.22%		10.06%	3

(6)

(40 marks)

Question 3

Part A

Marks

(a) (i) Calculation of Aggregate Depreciation	Machinery	Vehicles		
Cost Year 3	140,000	80,000		
Depreciation Year 3	14,000	16,000	1	
NBV 1 January Year 4	126,000	64,000		
Depreciation Year 4	14,000	12,800	1	
NBV 1 January Year 5	112,000	51,200		
Aggregate Depn 1 Jan Year 5	28,000	28,800		3
(ii) Aggregate depn $(55000 \times 10\%) \times 2$	<u>11,000</u>		1	1
(iii) Depreciation of Vehicles sold Year 5				
Cost	30,000			
Depn Year 3 – $(20\% \times 30000)$	6,000		1	
NBV Year 4	24,000			
Depn Year 4 $(20\% \times 24000)$	4,800		1	2
Aggregate depn on vehicle sold	10,800			(6)
(b) Profit or Loss on Sale of Assets	Machinery	Vehicles		
Cost	55,000	30,000		
Aggregate depn	11,000	10,800	1	
NBV 1 January Year 5	44,000	19,200		
Cash received	35,000	10,000	1	
Profit/Loss on sale of assets	<u>-9,000</u>	<u>-9,200</u>		4
(c) Working Notes				
Depreciation Machinery Year 5	Machinery			
Cost 31 December Year 5	160,000			
Depreciation 10% cost	16,000			
NBV	<u>144,000</u>			
Depn Vehicles Year 5				
Cost 31 December Year 5	50,000			
Less Agg Depn to date	18,000			
Net Book Value	<u>32,000</u>			
Charge for year $(20\% \times 25,800)$	6,400			
NBV 31 December Year 5	<u>25,600</u>			

Tangible Assets	Land and Buildings £000s		Machinery £000s		Vehicles £000s		Total £000s	
Cost								
At 1 January Year 5	200,000		140,000		80,000		420,000	
Additions	50,000	1	75,000	1			125,000	2
Revaluations	30,000	1					30,000	1
Disposals			-55,000	1	-30,000	1	-85,000	2
At 31 December Year 5	<u>280,000</u>		<u>160,000</u>		<u>50,000</u>		<u>490,000</u>	
Depreciation								
At 1 January Year 5	0		28,000	1	28,800	1	56,800	2
Depreciation on disposals			-11,000	1	-10,800	1	-21,800	2
Charge for year			16,000	1	6,400	1	22,400	2
At 31 December Year 5	<u>0</u>		<u>33,000</u>		<u>24,400</u>		<u>57,400</u>	
Net Book Value								
At 1 January Year 5	200,000	} 1 for both	112,000	} 1 for both	51,200	} 1 for both	363,200	
At 31 December Year 5	280,000		127,000		25,600		432,600	3

(14)

Part B

STOCK VALUATION

	Working Notes	£	£	
Stock at Cost on 1 January		250,000		1
Add purchases received		25,000		1
Add Goods Returned from B	500 (1) – (500 × 20% (1))	<u>400</u>		2
			275,400	
Less:				
Monthly Sales	100,000 (1) – (100,000 × 20% (1))	80,000		2
Customer A	6,000 (1) – (6,000 × 1/6 (1))	5,000		2
Customer B	10,000 (1) – (10,000 × 20% (1))	8,000		2
Charitable donations	cost	800		1
Wilson's Drawings	600 (1) – (600 × 20% (1))	480		2
Stock salvaged	40000 × 0.5	20,000		1
Value of Stock salvaged to be discounted	(40,000 × 0.5 (1) × 80% (1))	<u>16,000</u>		2
			130,280	
Value of Stock Lost			<u>145,120</u>	(16)

(40 marks)

Question 4

(a) **Goodwill**

Occurs:

Goodwill occurs when one company (parent company) gains control of another (subsidiary) by purchasing a controlling stake ie more than 50% of the subsidiary's voting shares. (2)

If the price paid for the stake is greater than the balance sheet value of the net assets acquired then positive goodwill has been created. (2)

Where the price paid is less than the balance sheet value of the net assets acquired then negative goodwill has been created. (2)

Calculation:

- When all the shares are purchased in the subsidiary ie a wholly owned subsidiary, goodwill is found by deducting the value of the Ordinary shares and reserves of the subsidiary from the total price paid by the parent company. (2)
- Where control is obtained, but not all the shares are purchased, the goodwill will be calculated by deducting the appropriate % of the value of the Ordinary shares and reserves of the subsidiary from the purchase price. (2)

Treatment:

- Goodwill will appear as an Asset in the Balance Sheet. (2)
- Goodwill should be written off over a period not exceeding 20 years. (2)

2 marks for each valid point – Max 6

(b) **Minority Interest:**

Occurs:

Minority Interests will occur when the parent company does not purchase all of the shares of the subsidiary but does acquire more than (2) 50% eg if the parent company acquires 60% of the shares in the subsidiary then the Minority Interest is the remaining 40% which have remained with the original shareholders of the subsidiary (2).

Treatment:

- Percentage applied to the Net Asset value of the subsidiary company to calculate the Minority Interest. (2)
- Minority Interest value will appear in the financed by section of the Consolidated Balance Sheet and should be shown separately from the Capital and Reserves of the Parent Company. (2)

2 marks for each valid point – Max 6

(c) Post-acquisition Profits:

Occurs:

Post-acquisition profits are profits made by the subsidiary after it has been purchased by the parent company. (2)

Treatment:

- The amount of post-acquisition profit is calculated by comparing the reserves and profit and loss balances of the subsidiary company at the date of acquisition with the value at the end of the trading year in question. (2)
- Increases will be treated as profits and the Group's share will be added to the consolidated reserves. (2)
- The remainder of the post-acquisition profits will be added to the Minority Interest. (2)

2 marks for each valid point – Max 6

(d) Unrealised Profits:

Occurs:

Unrealised Profits occur when goods have been sold by one company in the group to another company in the group, eg from parent company to subsidiary company and not sold on outside the group. (2)

Treatment:

- If the goods have not been sold on, the group will have made no profit. (2)
- The goods will be included in the subsidiary company's stock figure at the higher price they paid for them. (2)
- The price the goods are sold to the subsidiary company will be greater than the purchase price the parent company paid. (2)
- However from the group's point of view the goods should be valued at the lower cost or net realisable value ie the parent company's purchase price. (2)
- The unrealised profits must be deducted from the consolidated reserves and consolidated stock figure. (2)

2 marks for each valid point – Max 6

(e) Cash in Transit:

Occurs:

As a result of trading between group companies eg where the parent company sells goods on credit to a subsidiary, when the subsidiary sends the payment to the parent there will be a short period of time during which the money is in transit ie it will not appear as cash in either balance sheet.

Treatment:

If drawing up a balance sheet at this time a double entry is completed as if the money has been received by the parent company ie credit the account of the subsidiary to show the debt is cancelled and debit a cash in transit account.

2 marks for each valid point – Max 6

(30 marks)

Question 5

(a) Duties and responsibilities of an external Auditor:

The auditors are governed by the Auditing Practice Board which sets out the duties and responsibilities of an external auditor. (2)

The auditors have a duty and a responsibility to:

- provide an independent report on the accounts and balance sheet to the members of the company (2)
- ensure that the accounts present a true and fair view of the companies activities (2)
- provide a true and fair view of the company's state of affairs and its profit or loss for the financial year (2)
- ensure that financial statements have been prepared properly in line with the 1985 Companies Act (2)
- ensure that the final accounts for the financial year are accurate (although they will not be expected to uncover every error) (2)
- protect the shareholders from the possible effects of fraud or serious errors (2)
- carry out the audit in such a way that they are likely to uncover any significant errors or fraud. (2)

2 marks for each valid point – Max 10

(b) The auditors report is divided into 7 sections

The Title	Should identify: <ul style="list-style-type: none">• Who the report has been produced for – the shareholders or the creditors. (2)
Identification of the financial statements audited	<ul style="list-style-type: none">• Each financial statement audited should be listed in the report eg Trading and Profit and Loss Account. (2)
Outline of the respective responsibilities of the directors and the auditors	<ul style="list-style-type: none">• States the legal position of both the directors and auditors. (2)• Allows readers to be aware of each party's involvement in the preparation of the accounting statement. (2)
Basis of the auditor's opinion	<ul style="list-style-type: none">• Informs the readers of the report what the legal duties of the auditor are in terms of the 1985 Companies Act. (2)
The Auditor's opinion	<ul style="list-style-type: none">• Explicit statement of the auditor's opinion of the truth and fairness of the financial statements. (2)• Should state whether they are a true and fair view of the financial position of the company. (2)• Should state whether the accounts have been prepared in accordance with the 1985 Companies Act. (2)
Auditor's Signature	<ul style="list-style-type: none">• Report must be signed by the auditor providing evidence that they accept responsibility for the report. (2)
Date of the Report	<ul style="list-style-type: none">• Must be dated and identifies when the auditor was responsible for examining the accounts. (2)

2 marks awarded for each valid point – Max 20

(30 marks)

Question 6

Part A

(a) (i) EQUIVALENT PRODUCTION STATEMENT Marks

	Kg	Materials	Labour	Overhead
Normal Loss	1,000	-	-	-
Abnormal Loss	1,800 1	1,800	1,800	1,800 1
To Process 3	16,200 2	16,200	16,200	16,200 1
WIP	1,000 1	1,000 1	600 1	400 1
Total Equivalent Units		<u>19,000</u>	<u>18,600</u>	<u>18,400</u>

(ii) COST PER EQUIVALENT UNIT

	Materials	Labour	Overhead	Total	
	£	£	£		
Transfer In	48,000	-	-		1
Additional Costs	28,000	18,600	9200		3
Total Cost	<u>76,000</u>	<u>18,600</u>	<u>9200</u>		
Equivalent Production	<u>19,000</u>	<u>18,600</u>	<u>18,400</u>		
Cost per Unit	<u>£4.00</u>	<u>£1.00</u>	<u>£0.50</u>	<u>£5.50</u>	3

(16)

(b) (i) PROCESS 3 ACCOUNT FOR NOVEMBER YEAR 1

	£	£	£	
Inputs	Kg	Per Kg	Value	
Transfer from Process 2	12,000	4.00	48,000	1
Additional materials	8,000	3.50	28,000	1
Direct wages			18,600	1
Variable overheads			9,200	2
TOTAL INPUT COST	<u>20,000</u>		<u>103,800</u>	

	£	£	£	
Outputs	Kg	Per Kg	Value	
Normal Loss	1,000 1		1	
Abnormal Loss	1,800 1	£5.50 2	9,900	
Finished Goods	16,200 1	£5.50 2	89,100	
Work in Progress				
Materials	1,000	1,000 1	£4.00 1	4,000
Labour		600 1	£1.00 1	600
Overheads		400 1	£0.50 1	200
			4,800	
	<u>20,000</u>		<u>103,800</u>	

(ii) ABNORMAL LOSS ACCOUNT FOR NOVEMBER YEAR 1

	£	£	£	
	Kg	Per Kg	Value	
Process 3	1,800	5.50	<u>9,900</u>	1
			<u>9900</u>	
	£	£	£	
	Kg	Per Kg	Value	
Bank	1,800	2	3,600	2
Profit and Loss (Loss)			<u>6,300</u>	2
			<u>9,900</u>	

(24)

Question 6

Part B

EQUIVALENT PRODUCTION STATEMENT – FIFO

	Materials		Conversion	
Completion of opening WIP		-	800	2
Started and completed in November Year 1	18,500	1	18,500	1
Closing WIP	1125	1	750	1
Total Equivalent Units	<u>19,625</u>		<u>20,050</u>	

COST PER EQUIVALENT UNIT

	Materials		Conversion	
Cost in November Year 1	£23,550		£30,075	
Total Equivalent Units	19,625	2	20,050	2
Cost per Unit	<u>£1.20</u>		<u>£1.50</u>	

(10)

(50 marks)

Question 7

							Marks
Budgeted Production		A	B	C	D		
		2,000	3,000	4,000	3,000	12,000	
Weighting		1/6	1/4	1/3	1/4		
Hours		5000	24000	40000	6000	75000	
(a) (i)		PRODUCT					
		A	B	C	D		
Selling Price		£80.00	£200.00	£200.00	£80.00		
Less:							
Materials		£10.00	£20.00	£15.00	£25.00		
Labour		£30.00	£80.00	£100.00	£25.00		
Variable Overhead		£10.00	£32.00	£40.00	£8.00		
Total VC		£50.00	£132.00	£155.00	£58.00		
Contribution per Unit		£30.00	£68.00	£45.00	£22.00		4
Weighted Average per Unit		£5.00	2	£17.00	2	£15.00	2
						£5.50	2
						Total	8
						£42.50	
(ii) Total Contribution	£510,000			(42.50 × 12000)			2
Less Fixed Costs	£127,500						1
Total Profit	£382,500						
(iii) Breakeven Point		3000	units	(127,500/42.50)			2
							(17)
(b) (i) Profit before tax		220000		(165,000/3 × 4)			2
Total Contribution needed		£347,500		(220,000 + 127,500)			1
Sales necessary		8176	units	(347,500/42.50)			2
(ii) Days of production required		61		(8176/12,000 × 90)			2
							(7)

Question 8

				Marks
(a)		£		
	Budget Sales	500,000	(10,000 × £50)	1
	Costs:			
	Materials	105,000	(30,000 × £3.50)	1
	Labour	120,000		1
	Variable Overhead	45,000		
	Fixed Overhead	<u>60,000</u>		1
			<u>330,000</u>	
	Budgeted Profit		<u>£170,000</u>	(4)
(b)		£		
	Actual Sales	540,000	(12,000 × £45)	1
	Costs:			
	Materials	123,750	(33,000 × £3.75)	1
	Labour	140,000		1
	Variable Overhead	50,000		
	Fixed Overhead	<u>86,000</u>		1
			<u>399,750</u>	
	Actual Profit		<u>£140,250</u>	(4)
(c)	Standard Cost of Actual Sales			
		£		
	Materials	126,000	(105,000 × 12/10)	1
	Labour	144,000	(120,000 × 12/10)	1
	Variable Overhead	54,000	(45,000 × 12/10)	1
	Fixed Overhead	<u>72,000</u>	(60,000 × 12/10)	1
			<u>£396,000</u>	(4)
(d)	Variiances			
(i)	Sales Price	£60,000	(12,000 × 50) – (12,000 × 45)	Adverse 2
(ii)	Sales Volume	–£100,000	50 × (10,000 – 12,000)	Favourable 2
(iii)	Materials Price	–£8,250	33,000 × (3.50 – 3.75)	Adverse 2
(iv)	Materials Usage	£10,500	3.50 × (36,000 – 33,000)	Favourable 2
(v)	Labour Rate	£12,000	(19,000 × 8) – 140,000	Favourable 2
(vi)	Labour Efficiency	–£8,000	8 × (18,000 – 19,000)	Adverse 2
(vii)	Var O/h Exp	£7,000	(19,000 × 3) – 50,000	Favourable 2
(viii)	Var O/h Efficiency	–£3,000	3 × (18,000 – 19,000)	Adverse 2
(ix)	Fixed O/h Exp	–£26,000	(60,000 – 86,000)	Adverse 2
(x)	Fixed O/h Volume	£12,000	(72,000 – 60,000)	Favourable 2
				(20)

Question 8 (continued)

(e) Standard Costing Profit Statement

			£	
Standard (Budgeted) Sales			500,000	1
Sale Variances	Price	60,000	Adverse	
	Volume	<u>1000,00</u>	Favourable	1
			<u>40,000</u>	
Actual Sales			540,000	
Less Standard Cost of Actual Sales			<u>396,000</u>	1
Standard Profit for Actual Sales			144,000	1
Cost Variances				
Materials Price		-8,250		
Materials Usage		10,500		1
Labour Rate		12,000		
Labour Efficiency		-8,000		1
Variable Overhead Expenditure		7,000		
Variable Overhead Efficiency		-3,000		1
Fixed Overhead Expenditure		-26,000		
Fixed Overhead Volume		<u>12,000</u>		1
Net Variance			<u>-3,750</u>	
Actual Profit			<u>£140,250</u>	

(8)

(40 marks)

Question 9

- (a)
- Job costing and contract are similar, but job costing is smaller scale (2), lower value (2) and much shorter duration. (2)
 - In job costing many jobs will be completed within the accounting period. Contracts often run over several accounting periods. (2)
 - Jobs are usually undertaken by one firm, whereas contracts may have a main contractor and several subcontractors for specialist work. (2)
 - Job examples include kitchen fitting, car repair. (1)
 - Contract examples include construction of a large shopping mall, regular supply of materials over a long term. (1)

Max 8 8

- (b) Problems will relate to profit recognition and cash flow.

Profit Recognition

- Profits are calculated for each year the contract runs. (2)
- Must compromise between matching costs with revenue on one hand and prudence on the other. (2)
- Each year a notional profit needs to be calculated on the incomplete contract. (2)
- This is achieved by comparing the value of work completed with the costs incurred on the contract. (2)
- The value of work completed is assessed by architects/surveyors who will provide a certificate for each complete stage of the work. (2)
- The cost of work not yet surveyed is treated as work in progress. (2)
- Profit recognised in any one year is reduced by the use of a formula *to apply the principle of conservatism or prudence. (2)
- This recognises the possibility of future losses on the contract. (2)
- Notional loss for any one year are written off in full. (2)

*Formulae may include:

$\frac{2}{3}$ (Notional Profit \times Cash Received/Work Certified) (1)

Estimated Total Profit (Work Certified/Contract Price) (1)

Max 10

Cash Flow

- The contractor will require regular cash payment for stages of work completed throughout the life of the contract. (2)
- At each stage of completion a surveyor will inspect and agree the value of work completed (2) and issue a certificate to confirm this. (2)
- The contractee will then pay the contractor the value of work completed less an amount to cover the cost of any sub-standard (or incomplete) work which may become obvious in time. (2)
- This retention money is usually released to the contractor after an agreed period of time after the contract is complete. (2)

Max 6 16

- (c)
- Establishment charges cover preparing a contract site for the work to begin. (2)
 - This may include acquiring access rights, building roads, installing power, water, drainage and communications, drainage and erecting site buildings. (2)
 - These charges are very costly and may not be considered part of completed work. (2)
 - They are significant because they may represent a substantial outlay for the contractor (2) at a time when cash receipts from the contract are low or non-existent. (2)

Max 6 6

(30 marks)

Question 10

- (a) Absorption costing and marginal costing treat fixed costs and stock valuation differently.

Absorption Costing

- An amount for fixed cost is included in the unit cost of stocks. (2)
- Fixed costs are product costs. (2)
- Fixed costs are included as production costs to arrive at a total cost of production. (2)
- Fixed costs are charged to production at a predetermined absorption rate based upon estimated costs and production. (2)
- Actual costs and production are unlikely to match estimates used resulting in an over- or under-absorption of fixed cost in the production costs. (2)
- Profit is sales less total cost plus or less an adjustment made to account for the over- or under-absorbed fixed costs. (2)

Max 6

Marginal Costing

- Only includes variable costs in the unit cost of stocks. (2)
- Fixed costs are period or time costs. (2)
- Only variable costs are included to arrive at a marginal cost of production. (2)
- Contribution is shown in the profit statement. (2)
- Actual fixed costs are deducted from contribution to arrive at profit. (2)
- Over- under-absorption of fixed costs does not arise. (2)

Max 6 12

- (b)
- Profit will differ between marginal and absorption when production and sales for a period are different. (2)
 - Absorption costing carries the stock element of fixed costs into the next accounting period, (2) whereas marginal costing charges the whole of fixed costs to the period they are incurred. (2)
 - Stocks may either decrease or increase – when stocks are falling absorption costing will show a lower profit than marginal and vice versa. (2)
 - When stocks remain constant each method will show the same profit. (2)
 - Over the life of a business where stocks begin and end at zero there will be no difference due to method chosen. (2)

Max 10 10

(c) **Absorption Costing**

- Aids initial product pricing decisions. (Cost plus pricing.) (2)
- All job (or short-term project) costs must use absorption costing to ensure that all costs are covered by the price charged. (2)

Marginal Costing

- Useful for short-term decision making in respect of special price contracts within current capacity. (2)
- Contribution per unit may be used to assess the breakeven point for comparison with market potential – aiding production decisions. (2)
- Contribution per limiting factor may be used to help prioritise products for manufacture and to assist decision making in respect of make or buy etc. (2)

Max 8 8

(30 marks)

[END OF MARKING INSTRUCTIONS]