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ACCOUNTING

9706/33

Paper 3 Structured Questions

May/June 2018

INSERT

3 hours

READ THESE INSTRUCTIONS FIRST

This Insert contains all of the required information and questions. The questions are provided in the Insert for reference only.

Anything you write in this Insert will not be marked.

The businesses described in this Insert are entirely fictitious.

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This document consists of **13** printed pages and **3** blank pages.

Section A: Financial Accounting**Question 1****Source A1**

JH Limited is a manufacturing business producing a single product. The transfer price of finished goods to the income statement is cost plus a fixed percentage for factory profit. This percentage has remained unchanged for many years.

The following information is available for the year ended 31 October 2017.

| | \$ |
|---|-----------|
| Prime cost | 252 000 |
| Work in progress | |
| at 1 November 2016 | 28 000 |
| at 31 October 2017 | 32 000 |
| Inventory of finished goods at transfer price | |
| at 1 November 2016 | 108 000 |
| at 31 October 2017 | 96 000 |
| Revenue | 1 860 000 |
| Factory overheads | 461 000 |
| Distribution costs | 216 000 |
| Administrative expenses | 412 000 |
| Finance charges | 28 000 |
| Provision for unrealised profit | |
| at 1 November 2016 | 18 000 |

The following information is also available.

- 1 Included in the distribution costs are:

| | \$ |
|-------------------|--------|
| Carriage inwards | 18 000 |
| Carriage outwards | 34 000 |

- 2 Administrative expenses include an amount for buildings insurance of \$60 000. The following items relating to building insurance have not been adjusted:

an outstanding unpaid invoice of \$3000 for the year ended 31 October 2017

a payment in advance of \$1000 brought forward from the year ended 31 October 2016

the allocation of 75% of the total amount to the factory.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

- (a) Explain why a manufacturing business might prepare a manufacturing account as part of its financial statements. [4]
- (b) Prepare the manufacturing account for the year ended 31 October 2017 in as much detail as possible. [5]
- (c) Prepare the income statement for the year ended 31 October 2017. [9]

Additional information

The selling price of one unit is based on the transfer price from the factory plus a mark-up.

Bob, the financial director of JH Limited, has been notified that their main competitor has increased prices. He wishes to increase the fixed percentage of the transfer price by 5%. The other directors are concerned that this will affect profit.

- (d) Advise the directors whether or not they should increase the transfer price. Justify your answer using any relevant calculations. [7]

[Total: 25]

Question 2**Source A2**

The directors of D plc are preparing the end of year financial statements including the notes to the accounts.

The following information is available at 1 January 2017:

| | \$ |
|---|-----------|
| Ordinary share capital (shares of \$2 each) | 2 000 000 |
| Share premium | 300 000 |
| Revaluation reserve | 400 000 |
| General reserve | 100 000 |
| Retained earnings | 1 500 000 |

During the year ended 31 December 2017 the following took place:

- 1 On 1 June an interim dividend of \$0.20 per ordinary share was paid.
- 2 On 1 October an issue of 500 000 ordinary shares was made at \$2.40 per share to raise money to purchase an additional factory.
- 3 On 1 November there was a rights issue of 2 shares for every 5 currently held at \$2.25. The rights issue was necessary to fund the unexpected costs on the purchase of the factory. The issue was fully subscribed.
- 4 On 1 December there was a bonus issue of 4 shares for every 10 held on that date. The reserves were maintained in their most flexible form.

On 31 December 2017 the finance director informed the other directors that:

- 1 The profit from operations for the year was \$520 000.
- 2 Finance charges of \$64 000 had been paid during the year.
- 3 The end of year tax liability on profits had been calculated as \$93 000.
- 4 There had been a transfer to the general reserve of \$47 000.
- 5 A final dividend of \$0.10 per ordinary share had been proposed.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

- (a) State **three** uses of the notes to the accounts within the financial statements. [3]
- (b) Prepare the statement of changes in equity for the year ended 31 December 2017. A total column is **not** required. [15]

Additional information

After the share issues there was a decrease in the market price of one ordinary share to \$2.10. One of the shareholders at the Annual General Meeting (AGM) stated that instead of the share issues the directors should have carried out the following:

- 1 Financed the purchase of the new factory through a loan of \$2 200 000 repayable over 5 years with total interest payable of \$68 000.
 - 2 Paid the shareholders an extra \$0.50 per share in their final dividend rather than a bonus issue of shares.
- (c) Advise whether or not the directors acted in the best interests of the shareholders. Justify your answer with relevant calculations. [7]

[Total: 25]

Question 3**Source A3**

The directors of K Limited provided information on the following balances at 31 December 2017:

| | \$ |
|---------------------------------------|---------|
| Plant and machinery at net book value | 654 000 |
| Human asset (see note 1) | 116 000 |
| Inventory | 146 000 |
| Trade receivables | 182 000 |
| Cash and cash equivalents | 56 000 |
| \$1 Ordinary shares | 600 000 |
| Retained earnings at 1 January 2017 | 215 000 |
| Profit for the year | 98 000 |
| Trade payables | 166 000 |
| Other payables | 75 000 |

During the course of the year-end audit, the external auditor obtained the following information from the directors (notes 1 to 3).

- 1 During the year, K Limited paid a deposit of \$70 000 for a 6-month training programme commencing on 1 November 2017. The balance of \$50 000 will be paid on completion of the programme. This had been included in 'other payables'.

The directors believed that the training would benefit the company for 5 years. The total payments were regarded as an intangible asset and recorded as a 'human asset'. Amortisation of \$4 000 had been provided.

- 2 Inventory at 31 December 2017 included some obsolete goods. These had been included in the inventory at their original cost of \$12 000. They could only be sold at half of the normal selling price which was 25% above cost.
- 3 On 1 July 2017, K Limited paid \$60 000 for acquiring the right to use computer software for three years. The full amount had been charged as an expense in the income statement.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

- (a) Explain the role of an external auditor. [2]
- (b) Explain the correct accounting treatment of the items in notes 1 and 2. [5]
- (c) Calculate the revised profit for the year ended 31 December 2017 after taking into account notes 1, 2 and 3. [8]

(d) State the values at which the following should be included in the statement of financial position at 31 December 2017.

- | | |
|-------------------------|-----|
| (i) Software licence | [2] |
| (ii) Inventory | [1] |
| (iii) Retained earnings | [1] |
| (iv) Other payables | [1] |

Additional information

K Limited needs additional computer software. The directors are considering whether to buy the computer software or acquire the right to use the new software for three years.

(e) Evaluate whether the directors should buy the computer software or acquire the right to use it for three years. Justify your answer. [5]

[Total:25]

Question 4**Source A4**

A Social Club provides activities for the elderly. It also provides them with meals and organises coach trips.

The ledger accounts of the club for the year ended 31 December 2017 included the following:

Subscription account

| Details | \$ | Details | \$ |
|--------------------------------|--------|---------------------|--------|
| Balance b/d | 400 | Balance b/d | 100 |
| Income and expenditure account | 26 300 | Bank | 25 800 |
| Balance c/d | 50 | Irrecoverable debts | 250 |
| | | Balance c/d | 600 |
| | 26 750 | | 26 750 |
| | | | |

Fixtures and fittings account

| Details | \$ | Details | \$ |
|-------------|--------|-------------|--------|
| Balance b/d | 12 000 | Balance c/d | 15 300 |
| Bank | 3 300 | | |
| | 15 300 | | 15 300 |
| | | | |

Provision for depreciation of fixtures and fittings account

| Details | \$ | Details | \$ |
|-------------|-------|--------------------------------|-------|
| Balance c/d | 3 930 | Balance b/d | 2 400 |
| | | Income and expenditure account | 1 530 |
| | 3 930 | | 3 930 |
| | | | |

The following information was also available.

- 1 The club owned its own premises which had an original cost of \$100 000. These were not depreciated.
- 2 On 1 January 2017 the bank account had a debit balance of \$4700 and the accumulated fund amounted to \$114 850.
- 3 The sale of meals to members during the year amounted to \$21 500 and made a profit of \$2600. Inventory of food remained constant at \$250. No purchases of food were made on a credit basis. All receipts and payments for meals were made through the bank account.
- 4 The club organised two coach trips every month. For **each** trip it hired a 50-seater coach (with driver) at a cost of \$1000. During 2017 the club sold 620 coach trip tickets for \$25 each.

All receipts and payments for trips were made through the bank account.
- 5 Other running costs paid during the year totalled \$18 100. These included staff costs.
- 6 Staff costs of \$200 were accrued at the end of the year.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

- (a) State **two** differences between a club and a limited company. [4]
- (b) Prepare the income and expenditure account for the year ended 31 December 2017. [7]
- (c) Prepare the statement of financial position at 31 December 2017. [10]

Additional information

The management committee of the club is considering increasing the price of the coach trip tickets to members.

- (d) Advise the management committee whether or not it should increase the price of the coach trip tickets. Justify your answer. [4]

[Total: 25]

Section B: Cost and Management Accounting**Question 5****Source B1**

C Limited is a small manufacturing company which operates a budgetary control system.

The following information is available:

- 1 The budgeted sales in **units** for the first five months of 2019 are expected to be:

| Jan | Feb | Mar | Apr | May |
|------|------|------|------|------|
| 3500 | 4000 | 4750 | 3750 | 4250 |

- 2 The inventory of finished goods at 1 January 2019 is expected to be 10% of the budgeted January sales.

The monthly closing inventory of finished goods is to be maintained at the same percentage of the following month's budgeted sales.

- 3 There is a maximum inventory holding of 450 units.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

- (a) State **three** advantages and **two** disadvantages of operating a budgetary control system. [5]

- (b) Prepare the production budget in **units** for **each** of the four months from January to April 2019. [6]

Additional information

Each unit produced requires 3 kilos of raw material which is expected to cost \$2 per kilo.

The opening inventory of raw material at 1 January 2019 is expected to be 200 kilos. The closing inventory of raw material is expected to remain the same for January. It is then expected to increase by 10% for February and a further 10% for March. After that it will remain unchanged.

- (c) Prepare the purchases budget in **both** kilos and dollars for **each** of the four months from January to April 2019. [6]

Additional information

The directors are expecting an increase in demand later in the year and are considering a proposal to increase the storage capacity of the warehouse. The proposal will be beneficial to the company as it will allow an increase in the maximum inventory of finished goods holding to 500 units. The cost associated with the storage of each unit (holding cost) is \$10.

- (d) Calculate for the month of February the difference between the current holding cost for the closing inventory of finished goods and the holding cost if the proposal is accepted. [4]

Additional information

The cost of increasing the storage capacity is expected to be \$20 000. A cash budget which includes this proposed cost has been prepared. This shows an overdrawn bank balance of \$18 000 at the end of February.

However, the bank has refused to give the business an overdraft. The directors are now considering investing their own money as a loan to the business to finance the proposal.

- (e) Discuss the advantages and disadvantages to the directors of investing their own funds into the business. [4]

[Total: 25]

Question 6**Source B2**

B Limited manufactures two products Alpha and Omega. The following budgeted figures are available.

| | Alpha | Omega |
|-------------------------------------|--------|---------|
| Budgeted production and sales units | 20 000 | 8 000 |
| Direct materials used per unit | 5 kilo | 11 kilo |
| Direct materials cost per kilo | \$20 | \$11 |
| Labour hours per unit | 2 | 1 |
| Direct labour cost per hour | \$12 | \$6 |

The fixed overheads are forecast as \$396 000 and are allocated on the basis of labour hours.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Calculate for **each** product:

(i) the total production costs [3]

(ii) the production cost per unit [1]

Additional information

The sales price per unit is calculated by adding 50% to the cost.

(b) Calculate the selling price per unit for **each** product. [2]

Additional information

The directors of the company have been advised that they should adopt activity based costing to allocate the production overheads. They have identified the four major activities involved in the production cycle as machine set-up, materials handling, maintenance of machinery and production inspection and packing. The costs of each activity have been established and the overheads apportioned between the activities as follows:

| | Production Overheads | Alpha | Omega |
|------------------------|----------------------|------------|-------------|
| | \$ | | |
| Machine set-up | 90 000 | 15 times | 10 times |
| Materials handling | 80 000 | 6 receipts | 14 receipts |
| Machine maintenance | 46 000 | 130 hours | 100 hours |
| Inspection and packing | <u>180 000</u> | 40 hours | 20 hours |
| | <u>396 000</u> | | |

(c) State **two** disadvantages to a business of adopting activity based costing. [2]

(d) Calculate the **total** production overhead to be allocated to **each** product using activity based costing. [4]

(e) Recalculate the cost per unit and selling price of each product maintaining the 50% mark-up. [3]

(f) Explain **three** reasons why B Limited should change the method of allocating overheads to using activity based costing. [6]

Additional information

It has been suggested that customers will not accept the increase in price of Omega. The directors are therefore considering changing the profit margins to 60% on Alpha and 30% on Omega.

(g) (i) Calculate the new **total** profit for **each** product if this change is adopted. [2]

(ii) Give **two** reasons why B Limited should adopt this change. [2]

[Total: 25]

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