

Cambridge International AS & A Level

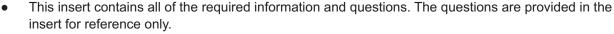
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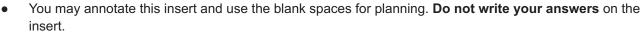
Paper 3 Structured Questions

October/November 2022

INSERT 3 hours

INFORMATION







Section A: Financial Accounting

Question 1

Source A1

Ajlal's hobby was making chocolates. She was considering giving up her employment to run a business selling her own chocolates.

She decided to sell them from a market stall for a month to assess the level of demand and entered into a joint venture with Daneen. They agreed to split the profit equally, as they planned to spend an equal number of hours running the stall.

They started running the stall on 1 August 2022. They opened a joint venture bank account. Ajlal paid in \$1000 and Daneen paid in \$1200.

On that date they paid rent for the stall of \$800, and purchased fittings for the stall costing \$420, paying both amounts from the joint venture bank account.

During the month the cost of ingredients amounted to \$1650. Ajlal paid \$550 of this from her own funds and the remainder was paid from the joint venture bank account.

By the end of the month sales had totalled \$3900. All receipts were paid into the joint venture bank account.

On 31 August 2022 the joint venture finished. Ajlal took over the fittings at a value of \$400. The profit on the joint venture was calculated and the bank account was closed.

Answer the following questions in the question paper. Questions are printed here for reference only.

- (a) Calculate:
 - (i) the profit on the joint venture [3]
 - (ii) the amount paid to each party when the joint venture bank account was closed. [5]
- (b) Prepare the joint venture bank account for the month of August 2022. [6]
- (c) Discuss whether the decision to share the profit equally was reasonable. [3]

Additional information

Ajlal was considering running another stall at a market in a different location, to assess whether demand might be stronger there.

(d) Advise Ajlal whether or not she should enter into another joint venture, or operate alone whilst employing an assistant to help her run the stall. Justify your answer. [4]

Additional information

Ajlal was considering if a joint venture requires the services of an auditor.

- (e) Explain which business entities would require the services of an auditor. [2]
- (f) State two points which should be covered in an unqualified audit report. [2]

Source A2

Sarah was a sole trader who agreed to sell her business to DB plc on 31 October 2021.

Their summarised statements of financial position immediately prior to the sale of Sarah's business showed the following:

	Sarah \$	DB plc \$
Non-current assets at net book value	120 000	722 000
Current assets		
Inventory	17000	101 000
Trade receivables	15000	76 000
Bank	12000	24000
Total current assets	44 000	201 000
Total assets	<u>164 000</u>	923 000
Capital	123 000	
Ordinary shares of \$1 each		400 000
Retained earnings		464 000
<u> </u>	123 000	864 000
Current liabilities		
Trade payables	21000	59000
Short-term bank loan	20000	
Total current liabilities	41000	59000
Total capital and liabilities	164 000	923 000

The terms of the sale of the business were as follows:

- 1 The purchase consideration was \$240,000. This was settled with \$30,000 in cash and 150,000 ordinary shares of \$1 each in DB plc.
- 2 DB plc took over all the assets and liabilities of Sarah's business except for the loan and the bank account.
- 3 Non-current assets were taken over at a value of \$203000 and inventory at a value of \$14000.

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Prepare the following ledger accounts in the books of Sarah to record the sale of her business and the settlement of the amount due to her.

(i) DB plc account [3]

(ii) Bank account [4]

(iii) Capital account [4]

(b) Prepare the statement of financial position of DB plc immediately after the purchase of Sarah's business. [7]

Additional information

A year later the market price of one ordinary share in DB plc had risen to \$1.80, but the dividend yield had fallen to 3%. Sarah was able to earn interest of 4% on funds she invested elsewhere.

- (c) Advise Sarah whether or not she should sell her shares in DB plc and invest the proceeds to earn interest. Justify your answer. [5]
- (d) Explain how stewardship affects a business purchase by a limited company. [2]

Source A3

The accountant of PS plc prepared draft financial statements for the year ended 31 March 2022. The following information was based on these draft statements.

Purchases	\$361000
Purchases returns	\$8 560
Inventory at 1 April 2021	\$68210
Inventory at 31 March 2022	\$71650
Mark-up	60%
Operating expenses to revenue ratio	25%
Expenses to revenue ratio (includes finance costs)	28%

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Prepare a summarised version of the draft income statement for the year ended 31 March 2022. [4]

Additional information

The draft financial statements did not take into account the following information items.

- During the year one of the company's delivery drivers had caused an accident resulting in repairs to another vehicle costing \$7000. Of this, \$5000 will be covered by the company's insurance. No payments have yet been made.
- 2 Another vehicle is recorded in the books with a book value of \$27000. It is now estimated that it has a value in use of \$22000 and could be sold for \$19000.
- 3 A credit customer who owed the company \$1000 at the year-end was discovered to have gone bankrupt and was not expected to pay any of the debt.
- 4 A dissatisfied customer was taking legal action and was suing the company for damages of \$10,000. The company had estimated that the customer had a 35% chance of success.
- Goods with a selling price of \$7200 were held by a credit customer on 31 March 2022 on a sale or return basis. These goods were treated in the draft financial statements as having been sold.
- 6 The premises were revalued on 31 March 2022 from \$400 000 to \$580 000.
- The draft financial statements showed a value of \$24000 for an intangible asset which had been bought by the company on 1 April 2021. The directors were of the opinion that this should be amortised (depreciated) over 20 years from the date of purchase.
- 8 A fire on 4 April 2022 destroyed the company's entire inventory.

- (b) Identify the **two** items from the information items 1 to 8 which should be disclosed by way of a note to the accounts. Explain the reason for their treatment. [6]
- (c) State what is meant by the term 'contingent asset'. Illustrate your answer with an example. [2]
- (d) Calculate the correct profit for the year. Start your answer with the draft profit from your answer to (a). [7]
- (e) Prepare the journal entry to record information item 6 from the list given. A narrative is required. [3]

Additional information

The value of trade receivables in the draft statement of financial position was \$81900.

(f) Calculate the correct value of trade receivables at 31 March 2022. [3]

Source A4

AZ Limited is a manufacturing business which adds factory profit to its cost of production. It manufactures and sells one product. It provided the following information.

Year ended 31 December	Cost of production (before factory profit)	Annual production (units)	Units in inventory at year-end	Rate of factory profit
2019	600 000	15000	500	20%
2020	714000	17000	850	20%
2021	765 000	18000	480	25%

No units remained in the inventory for more than two months.

Answer the following questions in the question paper. Questions are printed here for reference only.

- (a) Prepare the provision for unrealised profit account for **each** of the years ended 31 December 2020 and 2021. [8]
- (b) Complete the table (on the question paper). Identify which figures connected to factory profit were recorded in AZ Limited's income statement for the year ended 31 December 2021. State the amounts and their position in the income statement.
 [9]
- (c) Name **two** costs which might be included in a manufacturer's cost of production but would **not** be included in prime cost. [2]

Additional information

- 1 The directors use the value of factory profit to set the bonuses for senior factory staff.
- 2 In 2020 the units could have been bought in for \$44, and in 2021 for \$41.65.
- (d) Discuss whether the rates of factory profit being applied by AZ Limited are suitable. [6]

Section B: Cost and Management Accounting

Question 5

Source B1

DY Limited manufactures and sells one product. Each unit is sold in the month in which it is manufactured. Its budgeted information for the period from April to August is as follows:

	Production units	Unit selling price \$	Basic wage hourly rate \$
April	4000	25	10
May	5000	25	10
June	5500	28	10
July	4500	28	11
August	4200	26	11

Each unit takes 1 hour and 30 minutes of direct labour to complete.

Basic wages are paid in the month when they are earned, and overtime payments are paid one month in arrears. Overtime is payable on any hours above 6500 worked in the month. The overtime premium is 20%.

One quarter of sales are made for cash. Half of sales are paid in the month after sale and receive a cash discount of 5%. The remaining quarter is paid two months after sale.

Answer the following questions in the question paper. Questions are printed here for reference only.

- (a) Prepare the labour wages budget for **each** of the months June, July and August. [4]
- (b) Prepare extracts from the cash budget showing entries relating to sales **and** labour for **each** of the months June, July and August. [13]
- (c) State **two** advantages to a business of preparing a cash budget. [2]

Additional information

One of the directors has suggested adding a fixed amount of profit per unit when calculating the selling price so that profit is not affected by changes in production cost.

- (d) Advise the directors whether or not they should adopt this suggestion. Justify your answer.

 [4]
- (e) Name **two** budgets which would be affected by the creation of a provision for doubtful debts. [2]

Source B2

GH Limited is a manufacturing business which uses activity based costing (ABC).

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Explain why ABC is often considered a better costing method than absorption costing. [2]

Additional information

The company manufactures two products. The following information is available for the year.

1 Direct costs

	Product A	Product B
Production (units)	1500	4500
Direct material per unit	3 kilos at \$7.20 per kilo	5 kilos at \$4.80 per kilo
Direct labour per unit	2 hours at \$10.50 per hour	3 hours at \$10.50 per hour

2 Production overheads

Overhead	Total cost \$	
Machine servicing	13700	Three machines are used to manufacture product A and eight to manufacture product B. They are all serviced once a month.
Order processing	6400	Orders processed amount to 27 for product A and 93 for product B.
Quality inspections	11 200	Product A is subject to 34 quality inspections and product B to 126.

- 3 Rent costs \$48000 a year and is apportioned on the basis of floor area, 30% for product A and 70% for product B.
- 4 The business applies a mark-up of 50% on total cost when calculating selling price.
- **(b)** Calculate the selling price of **one** unit for **each** product. [12]

Additional information

The company's selling price for product B is \$3 higher than that of a competitor. The directors are worried that because of this the company will start to lose sales.

They are considering doubling production of product B whilst maintaining the same percentage mark-up. They believe that because of the increase in production they would be able to negotiate a purchase price for direct material of \$4.40 per kilo. There would be an increased requirement for labour and therefore the rate of pay would increase to \$11.50 per hour for all factory workers.

The increase in production would cause the following production overheads for product B to become:

	\$
Machine servicing	27900
Order processing	8 100
Quality inspections	16560
Total	52 560

The rent and its apportionment would be unchanged.

- (c) Calculate the selling price of **one** unit of product B which would be charged if its production was doubled in this way. [4]
- (d) Advise the directors whether or not they should double production of product B. Justify your answer. [7]

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