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**ACCOUNTING**

**9706/03**

Paper 3 Structured Questions

**For Examination from 2018**

SPECIMEN INSERT

**3 hours**

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**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 **10** printed pages.

## Section A: Financial Accounting

## Question 1

## Source A1

Ayanda and Bola have been in partnership for many years, sharing profits in the ratio of 3 : 2 respectively. The annual profit has been \$60 000 for some years.

On 1 June 2013 the partnership books of account showed the following balances.

		\$	
Capital account	Ayanda	40 000	
	Bola	25 000	
Current account	Ayanda	17 000	Cr
	Bola	2 500	Dr
Bank		3 500	Dr
Trade payables		4 000	

On that date the business was sold to Hetl Limited for a purchase consideration of \$140 000. This consisted of 50 000 \$1 ordinary shares in Hetl Limited with a market value of \$1.80, to be shared equally, and the balance in cash. Hetl Limited took over all the assets and liabilities of the business with the exception of the bank account and the trade payables.

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

- (a) Calculate the gain on realisation arising from the sale of the partnership.
- (b) Calculate the amount in cash due to **each** partner on the sale of the partnership.
- (c) Prepare the partnership bank account showing the entries to close the account.

**Additional information**

Bola thinks it is unfair that Ayanda received more cash than she did.

- (d) Give **four** reasons why it is fair that Ayanda received more cash than Bola.

**Additional information**

Hetl Limited pays a dividend of \$0.25 per share each year. Surplus funds can be put on deposit in a bank and earn 6% interest a year.

Ayanda has accepted a job with Hetl Limited at a salary of \$20 000 a year.

- (e) Compare Ayanda's current income with his earnings as a partner.
- (f) Suggest **one** non-financial reason why Ayanda might prefer to be an employee rather than a partner.

**Question 2****Source A2**

Lee started a business in Indonesia on 1 January 2013 selling lawn mowers.

During the first year of trading Lee bought 1000 lawn mowers at \$50 each. He shipped 400 of these to Albert, his agent in Jamaica. Lee also sold 550 lawn mowers in Indonesia.

The following additional information is available.

Freight charges paid by Lee	\$3600
Landing duties paid by Albert	\$400
Rate of commission paid to Albert	10%
Cash remitted by Albert to Lee	\$19000

Lee's income statement for the year ended 31 December 2013 included the following.

	\$
Gross profit	22000
Consignment profit	6720
Selling, distribution and administration costs (arising in Indonesia)	17600

Lee's statement of financial position at 31 December 2013 included the following inventory.

	\$
Jamaica	4800
Indonesia	<u>2500</u>
Total inventory	<u>7300</u>

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

- (a) Prepare the consignment account in the books of Lee for the year ended 31 December 2013.
- (b) Prepare Albert's account in the books of Lee for the year ended 31 December 2013.
- (c) Calculate the number of unsold lawn mowers Albert was holding on 31 December 2013.

**Additional information**

Lee is considering whether to concentrate his efforts on sales in Indonesia or in Jamaica.

- (d) Advise Lee where to concentrate his sales effort. Support your answer with calculations.

**Question 3****Source A3**

The following information is available about Whittlesford plc on 31 December 2011.

	\$
500 000 ordinary shares of \$1 each	500 000
Share premium	200 000
General reserve	70 000
Retained earnings	298 300

Further information is as follows:

- 1 The draft profit for the year ended 31 December 2012 was \$122 800.
- 2 On 1 January 2012 property was revalued from \$520 000 to \$780 000.
- 3 On 31 January 2012 a rights issue of 1 share for every 5 held was made at a premium of \$0.25 each.
- 4 On 30 June 2012 an interim dividend of \$0.08 per share was paid.
- 5 On 31 October 2012 a bonus issue of shares of 1 for every 4 held was made. The directors decided to keep the reserves in their most flexible form.
- 6 On 31 December 2012 \$40 000 was transferred to general reserve and a final dividend of \$0.12 per share was proposed.
- 7 On 5 January 2013 it was discovered that a customer who had owed \$4200 at the year end had been declared bankrupt. It was also discovered that goods in inventory at the year end, with a cost of \$3000, had been water damaged and could now only be sold for \$600.
- 8 On 17 January 2013 a burglary at the business premises resulted in the loss of computer equipment, \$15700.

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

- (a) Explain what is meant by keeping reserves in their most flexible form.
- (b) Prepare the statement of changes in equity for Whittlesford plc for the year ended 31 December 2012.
- (c) Explain whether the event on 17 January 2013 was an adjusting event or a non-adjusting event.
- (d) State **three** characteristics of an auditor's report.

**Additional information**

The auditor's report for Whittlesford plc did not give an unqualified opinion on the financial statements because \$150000 of investments included in non-current assets have become worthless but have not been written off.

(e) Assess the effect that this auditor's report will have on shareholders.

**Question 4****Source A4**

Five friends each have \$20 000 to invest and are considering whether to invest in ABC plc or DEF plc. The following information is available from the latest financial statements of ABC plc.

## Summarised income statement

	\$
Revenue	4 700 000
Cost of sales	<u>2 115 000</u>
Gross profit	2 585 000
Expenses	<u>1 645 000</u>
Profit from operations	940 000
Debenture interest	<u>50 000</u>
Profit for the year	<u>890 000</u>

## Summarised statement of financial position

	\$	\$
Non-current assets		2 100 000
Current assets		
Inventory	880 000	
Trade receivables	480 000	
Cash and cash equivalents	<u>10 000</u>	<u>1 370 000</u>
Total assets		<u>3 470 000</u>
1 000 000 ordinary shares of \$1 each		1 000 000
Share premium		400 000
Revaluation reserve		800 000
Retained earnings		<u>450 000</u>
		2 650 000
Non-current liabilities – debentures		500 000
Current liabilities – trade payables		<u>320 000</u>
		<u>3 470 000</u>

Other information about ABC plc is as follows:

- 1 The dividends paid in the year amounted to \$440 000.
- 2 All sales and purchases are made on credit.
- 3 The value of inventory has remained stable over several years.
- 4 The market value of one share is \$5.60.

The following information is also available about DEF plc.

Earnings per share	\$0.57
Dividend per share	\$0.48
Gearing ratio	43.4%
Income gearing	17.7%
Trade payables payment period	97 days
Price earnings ratio	7.18
Dividend cover	1.19 times
Dividend yield	11.7%
Par value of one share	\$1

The five friends all have different criteria for their investment decision.

Jazgul is an ethical investor and is concerned that suppliers get their money in good time.

Jackson needs a good cash flow and seeks a high return in terms of cash in the short term.

Khan seeks capital growth.

Madge wishes to be confident in a company's ability to maintain earnings in the future.

Bernard is risk averse and wants to invest in a company which is on a sound financial footing.

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

- (a) Identify and calculate for **each** potential investor the ratio for ABC plc which would **particularly interest** him or her.
- (b) Explain what the ratio you have calculated for **each** investor shows the investor.
- (c) Decide which is the most suitable investment for **each** investor.

## Section B: Cost and Management Accounting

## Question 5

## Source B1

Harko runs a successful retail business. His typical annual results have been as follows:

	\$
Revenue	210 000
Cost of sales	<u>115 500</u>
Gross profit	94 500
Variable selling and administrative expenses	48 000
Fixed expenses	<u>19 500</u>
Profit for the year	<u>27 000</u>

Harko is now considering building an extension to his premises.

The following information is available:

- 1 The building cost would be \$265 000.
- 2 Because of the increase in floor space he anticipates that sales volume would increase by 40%.
- 3 The gross profit margin would be maintained.
- 4 The inventory level would need to be increased by \$10 000 in year 1 only.
- 5 The existing variable expenses would increase by 30%.
- 6 The business would in future have to rent garage space for the delivery vehicle at a cost of \$2000 a year.
- 7 Harko intends to retire at the end of year 4 and sell the business as a going concern. He expects the purchase consideration for the business (including inventory) to be \$600 000 without the extension or \$910 000 if he proceeds with the extension.

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

- (a) Calculate the annual cash flows arising from the building of the extension.

**Additional information**

Harko's cost of capital is 10%. Discount factors are as follows.

Year	Discount factor
0	1.000
1	0.909
2	0.826
3	0.751
4	0.683

- (b) Calculate the net present value (NPV) of building the extension. Round calculations to the nearest dollar (\$).
- (c) Advise Harko whether he should proceed with the extension, based on your figures from (b).



- (d) Outline why Harko might have doubts about proceeding with the extension, based on the NPV.
  
- (e) Explain why Harko chose to use net present value as a basis for his decision rather than the payback method.

**Question 6****Source B2**

Aziz Manufacturing Limited produces one product.

The budgeted costs and revenues are as follows.

Units produced and sold	800 per month
Standard selling price	\$100 per unit
Standard direct materials	4 kilos at \$6 per kilo
Standard direct labour	3 hours at \$12 per hour

All overheads are fixed.

In April 850 units were produced and sold. Selling price was maintained at \$100 per unit. Actual costs were as follows.

Direct materials	3485 kilos costing \$19 516 in total
Direct labour	2720 hours costing \$35 360 in total

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

- (a) Prepare the original budget and the flexed budget for April to show total budgeted contribution.
- (b) Calculate the actual total contribution achieved in April.
- (c) Prepare a statement to reconcile the contribution from the flexed budget in (a) with the actual contribution from (b).
- (d) Suggest **one** reason why each of the following variances had arisen.
  - (i) Material usage variance
  - (ii) Labour rate variance
- (e) State **two** similarities in use between standard costing and activity based costing.

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