Pearson Edexcel
International Advanced Level

Accounting (Modular Syllabus)
Unit 2: Corporate and Management Accounting

Friday 16 January 2015 – Morning
Source Booklet for use with Questions 1 to 7

Paper Reference
WAC02/01

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PEARSON

SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1 ON PAGES 2–8 ON THE QUESTION PAPER

1 At the start of 2015, you are the new Chief Accountant for K Khan Trading plc. The company was founded by Kalyan Khan over 60 years ago, and the majority shareholding is still held by the Khan family, who are the directors and run the business.

You find the books of account contain the following information at 31 December 2014.

Authorised share capital of £1 Ordinary shares	£10 000 000
Issued share capital of £1 Ordinary shares	£5 000 000
Authorised 7% Redeemable Preference shares of £1	£2 000 000
Issued 7% Redeemable Preference shares of £1	£1 000 000
5% Bank Loan, repayable 2017	£4 000 000
6% Debenture, redeemable 2019	£5 500 000
Net profit for year before interest and tax, 2014	£650 000
Net profit for year after interest and tax, 2014	£90 000
Retained earnings	£78 000
Ordinary dividends for 2014 paid in year	£280 000
Market price of Ordinary share	£0.74

Required:

(a) Calculate the following ratios, clearly stating the formula used.

(i) Gearing ratio
(6)

(ii) Return on capital employed
(4)

(iii) Earnings per share
(4)

(iv) Price/earnings ratio
(4)

(v) Dividend per share
(4)

(vi) Dividend cover
(4)

(vii) Dividend yield.
(4)

The Khan family have asked you to evaluate the performance of K Khan Trading plc in 2014, and evaluate the present financial position of the company.

(b) Evaluate the performance of K Khan Trading plc for the year ended 31 December 2014.

(12)

You are requested to attend a board meeting to suggest actions to improve the company's performance and financial position in 2015. Your suggestions must be specific to the position of K Khan Trading plc.

Required:

(c) (i) Explain **one** action the company could take to improve the gearing ratio.

(2)

(ii) State **two** consequences of your suggested action.

(2)

(d) Select any **three** ratios, other than the gearing ratio, and briefly explain how each ratio could be improved.

(6)

(Total for Question 1 = 52 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 2
ON PAGES 9–14 ON THE QUESTION PAPER

2 Gulf Furnishings plc produces furniture at its factory. The furniture is then delivered to Gulf Furnishings plc shops, for sale to customers.

At 31 December 2014, the following balances were in the books:

	Debit £	Credit £
Advertising and marketing	142 765	
Bad debts written off	12 255	
Bank current account		72 380
6% Bank Loan, repayable 2018		800 000
Canteen Profit		122 767
Direct materials	843 216	
Discount allowed	16 548	
Discount received on materials		41 753
Dividends received from shares in other companies		27 258
Factory buildings (at cost)	2 350 000	
Factory buildings provision for depreciation		500 000
Factory machinery (carry over value)	1 110 000	
Fuel	218 646	
Hire of photocopiers	3 120	
Interest on bank current account	7 192	
Inventory of finished goods at 1 January 2014	127 952	
Maintenance of factory machinery	27 542	
Managers' salaries	209 000	
Motor lorries (carry over value)	376 000	
Ordinary shares of £1 each		2 000 000
Power	264 935	
8% Redeemable Preference shares of £1 each		1 000 000
Rent on office premises	48 971	
Retained earnings		3 078 712
Revenue		4 482 800
Shop buildings (at cost)	4 950 000	
Shop buildings provision for depreciation		600 000
Trade payables		71 185
Trade receivables	231 670	
Vehicle running costs	88 543	
Wages	1 768 500	
	12 796 855	12 796 855

Adjustments and additional information at 31 December 2014:

- Inventory of finished goods £131 875
- Inventory of direct materials £4 897
- Advertising and marketing £12 278 owing
- Rent on office premises includes £3 767 prepaid
- Managers' salaries consist of:

	£
Finance manager	59 000
Production manager	55 000
Sales manager	50 000
Transport manager	45 000

- Power is divided between the factory and the office in the ratio 4:1
- Fuel is divided between the factory and deliveries in the ratio 1:5
- Shop staff receive a commission of 1.5% as a year end bonus on all sales made. This has yet to be entered in the books
- Wages consist of:

	£
Accountancy staff	212 870
Factory staff	828 750
Office staff	202 130
Shop staff	435 790
Delivery staff	88 960

- Assuming a nil residual value in each case and using the straight line method:
  - the factory buildings are to be depreciated over a 50–year life
  - the shop buildings are to be depreciated over a 40–year life
- The following are to be depreciated using the reducing balance method:
  - motor lorries at 30%
  - factory machinery at 25%
- A corporation tax provision for £55 000 is to be made.

Required:

(a) Using **only** the appropriate balances and adjustments, prepare for Gulf Furnishings plc, in accordance with International Accounting Standard (IAS) 1 (Revised), the Statement of Comprehensive Income for the year ended 31 December 2014. Show all workings clearly.

(40)

The directors of Gulf Furnishings plc have announced the closure of the factory in June 2015. They intend to import the furniture for sale in the shops. The costs and revenues associated with the closure will have to be treated as Exceptional Items in the accounts ending 31 December 2015.

(b) Evaluate the usefulness of the treatment to the users of the published accounts of Gulf Furnishings plc.

(12)

(Total for Question 2 = 52 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 3
ON PAGES 15–21 ON THE QUESTION PAPER

3 Karnapul Mills Limited produces clothing at its factory. As a member of the finance department, you have been asked to look at the performance of the Blouse section for the first week of January 2015.

- The section employs 5 workers.
- The production target for the week is 600 blouses, which must be met.
- Each member of staff has a target output of 120 blouses per week.
- The standard cost of producing one blouse is:
  - 20 minutes labour, with labour being paid £5.90 per hour.
  - 3 square metres of cotton material at 26 pence per square metre.
- Labour is scheduled to work 8 hours a day, 5 days a week
- Any overtime worked over and above 40 hours a week is paid at the rate of £8.10 per hour.

The staff production sheets for the Blouse section for the first week of January 2015 show the following details.

Staff Production Sheet		
Name	Hours	Production Units
Rubia Banerjee	40	120
Mohon Biswas	40	112
Susmita Ghosh	43	120
Zahir Huq	44	111
Chadni Sengupta	40	137

Required:

(a) For the planned production of 600 blouses for the first week in January, calculate the:

(i) standard labour cost of production
(2)

(ii) actual labour cost of production
(3)

(iii) labour efficiency variance
(4)

(iv) labour rate variance
(4)

(v) total labour variance.
(2)

The Delivery Notes for the Blouse section for the first week of January 2015 show:

Delivery Notes		
Date	Supplier	Quantity (square metres)
January 3	Chattigong Textiles Ltd	720
January 5	Chattigong Textiles Ltd	720
January 6	Nazir Looms Ltd	720

- Opening stock of cotton material at the start of the week was 220 square metres, purchased at £0.28 per square metre.
- Closing stock of cotton material at the end of the week was 460 square metres.

The Purchases Day Book shows the following entries:

Purchases Day Book			
Date	Supplier	Invoice No.	£
January 3	Chattigong Textiles Ltd	0006	£201.60
January 5	Chattigong Textiles Ltd	0018	£201.60
January 6	Nazir Looms Ltd	0023	£201.60

All cotton material purchased in the first week of January was bought for the same price.

Required:

(b) Calculate the purchase price of cotton material per square metre.
(3)

(c) For the planned production of 600 blouses for the week, calculate the:

(i) actual material cost of production
(3)

(ii) standard material cost of production
(2)

(iii) material usage variance
(4)

(iv) material price variance
(4)

(v) total material cost variance.
(2)

(d) Calculate for the first week of January the:

(i) total standard cost of producing 600 blouses.
(2)

(ii) total actual cost of producing 600 blouses.
(2)

Consider the information shown on the Staff Production Sheet.

(e) Recommend possible changes to the allocation of overtime to each member of staff that would improve the performance of the Blouse section.
(3)

(f) Evaluate the performance of the Blouse section for the first week of January, including recommendations for the future of the Blouse section.
(12)

(Total for Question 3 = 52 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 4
ON PAGES 23–26 ON THE QUESTION PAPER

4 East African Newspapers plc is to take over KKC News Ltd on 1 January 2015. East African Newspapers plc will acquire all the assets, except cash and cash equivalents, and all the liabilities except the overdraft. Some of the assets and liabilities of KKC News Ltd will be revalued.

The Statement of Financial Position of KKC News Ltd at 31 December 2014 is shown below.

Statement of Financial Position of KKC News Ltd at 31 December 2014		
Assets	£	£
Non-current Assets		
Property, plant and equipment	79 095 000	
Intangible assets	2 100 000	
		81 195 000
Current Assets		
Inventories	1 100 000	
Trade and Other receivables	560 000	
Cash and cash equivalents	990 000	
		2 650 000
Total Assets		**83 845 000**
Equity and Liabilities		
Equity		
Ordinary Shares of £1 each	50 000 000	
Share Premium	17 500 000	
General reserve	1 000 000	
Retained earnings	2 640 000	
Total Equity		71 140 000
Non-current liabilities		
Bank Loan	10 000 000	
		10 000 000
Current Liabilities		
Trade and Other payables	230 000	
Current tax payable	275 000	
Overdraft	2 200 000	
		2 705 000
Total Equity and Liabilities		**83 845 000**

Additional information:

The assets and liabilities of KKC News Ltd were revalued as follows:

- Property with a book value of £11 500 000 to a current market value of £12 700 000
- Plant with a book value of £2 450 000 was reduced by £165 000
- Equipment with a book value of £1 760 000 was reduced by 20%
- Intangible assets were reduced to a figure of £525 000
- Inventories were reduced to a net realisable value of £863 000
- Trade Receivables were reduced by 10% to cover bad debts
- Current tax payable agreed with tax authorities was reduced to a figure of £210 000

Goodwill was agreed at £4 000 000

Required:

(a) (i) Define the accounting term goodwill.

(2)

(ii) State **two** reasons why goodwill may occur.

(2)

(b) Calculate the purchase price of KKC News Ltd.

(10)

The purchase of KKC News Ltd is to be financed by the issue of £1 Ordinary shares in East African Newspapers plc. The shares are trading at a premium of £1.50 per share, and this trading value was the price agreed for the shares used to purchase KKC News Ltd.

(c) Calculate the number of shares to be issued by East African Newspapers plc to shareholders of KKC News Ltd.

(4)

(d) Prepare the Acquisition Account in the books of East African Newspapers plc to show the purchase of KKC News Ltd.

(6)

East African Newspapers plc financed the purchase of KKC News Ltd by an issue of shares in East African Newspapers plc.

(e) Evaluate the use of issuing shares to finance the purchase of another company.

(8)

(Total for Question 4 = 32 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 5
ON PAGES 27–31 ON THE QUESTION PAPER

5 Andros owns a business producing and selling ice cream. The ice cream is produced in a factory and ice cream sellers then sell from bicycles, trays and freezers in areas popular with tourists. Andros is reviewing the accounts for 2014, and considering changes for 2015.

The following information is available for the year ended 31 December 2014.

- Rent of factory £775 per month
- Depreciation on assets £2 800 per year
- Direct labour in production was paid £0.25 per ice cream
- Electricity bill £935 a quarter (3–month period) plus £0.02 per ice cream
- Insurance for the year £1 420
- Material costs per ice cream £0.16
- The manager's salary £1 000 per month
- Selling price of an ice cream £1.30
- Sales of ice creams are 1400 ice creams per seller per month.
  There are 11 ice cream sellers
- Ice cream sellers receive a direct wage of £0.40 for each ice cream sold
- Loan interest £225 per month
- All production was sold.

Required:

Calculate for the year ended 31 December 2014 the:

(a) number of ice creams to be sold to break even
(11)

(b) margin of safety in sales units
(3)

(c) profit for the year.
(5)

Andros wishes to increase his profit by 5% next year. His believes that all costs and revenues will stay the same next year, except rent. The rent for 2015 will be £800 per month. However, Andros is reviewing the performance and the salary of the manager.

Required:

(d) Calculate how much Andros would need to pay the manager per year to achieve his profit target.
(5)

Andros is considering whether to move the manager from a fixed salary to a payment related to the number of ice creams sold.

Required:

(e) Evaluate the possible decision to move the manager from a fixed salary to a payment related to the number of ice creams sold.

(8)

(Total for Question 5 = 32 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 6
ON PAGES 32–35 ON THE QUESTION PAPER

6 The directors of Asia Telecoms plc are considering installing a broadband connection to the city of Alzapur. The following information is available.

- The initial cost of the project will be £50 million.
- The city of Alzapur has an estimated 500 000 computer users.
- In year 1, market research shows 25% of computer users will connect and pay the annual subscription fee.
- After purchase, all customers will continue to pay the annual subscription fee for future years.
- In year 2, **another** 20% of computer users will connect and pay the annual subscription fee.
- In years 3, 4, and 5, **another** 10% of users will sign up **each** year.
- Users will be charged £9 a month for a broadband subscription.
- To connect each user there will be a once only expense to the company of £50
- **Other** running costs for the project will be:
  - Year 1 – £10m including £5m depreciation
  - Year 2 – £16m including £5m depreciation
  - Year 3 – £20m including £6m depreciation
  - Year 4 – £22m including £6m depreciation
  - Year 5 – £24m including £7m depreciation.
- The cost of capital for the project is 8%
- The directors of Asia Telecoms plc require major projects to have a positive net present value after 5 years.

The discount factors for 8% are

Year 1 0.926 Year 2 0.857 Year 3 0.794 Year 4 0.735 Year 5 0.681

Required:

(a) Calculate the net present value of the project after 5 years.
(24)

(b) Evaluate the project on behalf of Asia Telecoms plc.
(8)

(Total for Question 6 = 32 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 7
ON PAGES 36–39 ON THE QUESTION PAPER

7 Footprint Ltd produces four different types of footwear at its factory: shoes, boots, trainers, and sandals.

The following information is available for the factory for the month ended 31 December 2014:

	Shoes	Boots	Trainers	Sandals
Direct labour	£65 000	£32 000	£96 000	£24 000
Direct materials	£50 000	£36 000	£72 000	£27 000
Semi-variable costs	£5 per unit + fixed element £10 000	£2 per unit + fixed element £2 000	£4 per unit + fixed element £8 000	£1 per unit + fixed element £3 000
Fixed costs	£25 000	£4 000	£32 000	£3 000
Output (units)	5 000	2 000	8 000	3 000
Selling price	£30	£35	£39	£18

All output was sold.

Required:

(a) Calculate the profit or loss for **each** of the four types of footwear, for the month ended 31 December 2014.

(8)

(b) Calculate the contribution and the profit or loss made by **each** of the four types of footwear, **per unit**, for the month ended 31 December 2014.

(16)

(c) Evaluate the calculations in (b) and make a decision about the future production of **each** of the four types of footwear.

(8)

(Total for Question 7 = 32 marks)

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