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Accounting Unit 2
WAC02 or WAC12

Write your name here

Surname		Other names

Pearson Edexcel
International
Advanced Level

Centre Number

Candidate Number

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

Monday 25 January 2016 – Morning
Time: 3 hours

Paper Reference
WAC02/01

You must have:
Source Booklet

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **five** questions, choosing **two** from Section A and **three** from Section B.
- All calculations must be shown.
- Answer the questions in the spaces provided
  – *there may be more space than you need*.
- Do not return the insert with the question paper.

Information

- The total mark for this paper is 200.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.
- The source material for use with Questions 1 to 7 is in the enclosed source booklet.

Advice

- Read each question carefully before you start to answer it.
- Write your answers neatly and in good English.
- Check your answers if you have time at the end.

Turn over ▶

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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1 You are the accountant for Moratuwa Plastics plc. During the year ended
   31 December 2015, the directors of Moratuwa Plastics plc agreed the following:

   (1) The Statement of Comprehensive Income for the year ended 31 December 2015
        shows a loss of £8 million.

   (2) To revalue the company factory from a book value of £120 million, to a market
        value of £160 million.

   (3) Provide a final dividend for 2014 to Ordinary shareholders of 1 pence (£0.01) per
        share. The dividend was paid on 2 February 2015.

   (4) To transfer £25 million from the General Reserve to the Retained Earnings
        Reserve.

   (5) To transfer a sum of £30 million from Retained Earnings Reserve to the Capital
        Replacement Reserve, in order to replace worn out machinery.

   (6) Not to pay an interim or final dividend for the year ended 31 December 2015.
        Instead, the directors decided to issue Bonus Shares at par, at a rate of one share
        issued for every 50 shares held.

   Required:

   (a) Complete Journal entries for items (2) to (6) above.
        Dates and narratives are **not** required.

                                                                                    (12)

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The Statement of Changes in Equity of Moratuwa Plastics plc for the year ended 31 December 2015 is nearing completion and is shown below.

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	**A** £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		**B**
Comprehensive Income for the year			**C**					
Revaluation of property							**D**	
Final 2014 Dividend paid in year			**E**					
Transfer			**F**	**G**				
Transfer			**H**		**I**			
Bonus Issue of £1 ordinary shares	**J**		**K**					
Balance at 31 December 2015	**L**	**M**	**N**	**O**	**P**	**Q**	**R**	**S**

Required:

(b) Complete the table in the question paper to show the heading A and figures for the items labelled B to S.

(16)

There has only been one issue of shares in Moratuwa Plastics plc, when the company was started. The Capital Redemption Reserve was created in the year ended 31 December 2014, when a number of shares were redeemed at the same value as their issue. No other shares were issued at the time of the redemption. There have been no other entries made in the Capital Redemption Reserve.

Required:

(c) Calculate how many shares were redeemed when the Capital Redemption Reserve was created.

(6)

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A director asks you "I see we made a loss this year. Can we add the upward revaluation of the factory to the Statement of Comprehensive Income? That would turn the loss into a profit figure. Could we then use this to pay a dividend?"

Required:

(d) Prepare an explanation to the two questions asked by the director.

    (i) Can the upward revaluation of the factory be added to the Statement of Comprehensive Income?

                      (4)

    (ii) Can the upward revaluation of the factory then be used to pay dividends?

                      (2)

(e) Evaluate the decision to issue bonus shares to shareholders instead of paying a dividend on behalf of the company.

                      (12)

(Total for Question 1 = 52 marks)

Answer space for Question 1 is on pages 2 to 7 of the question paper.

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(b) Complete the table below to show the heading A and figures labelled B to S.

(16)

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	**A** £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		**B**
Comprehensive Income for the year			**C**					
Revaluation of property							**D**	
Final 2014 Dividend paid in year			**E**					
Transfer			**F**	**G**				
Transfer			**H**		**I**			
Bonus Issue of £1 ordinary shares	**J**		**K**					
Balance at 31 December 2015	**L**	**M**	**N**	**O**	**P**	**Q**	**R**	**S**

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SECTION A

1(a)

	Debit	Credit
	£m	£m
(2) Property	40 √	
Revaluation Reserve		40 √
(3) Statement of Comprehensive Income (SOCI) / Retained Earnings	7 √	
Ordinary Share Dividend/Dividend Payable		7 √
Ordinary Share Dividend/Dividend Payable	7 √	
Bank		7 √
(4) General Reserve	25 √	
SOCI / Retained Earnings		25 √
(5) SOCI / Retained Earnings	30 √	
Capital Replacement Reserve		30 √
(6) SOCI / Retained Earnings	14 √	
Ordinary Share Capital £1		14 √

(12)

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(b)

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	Revaluation Reserve √ £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		1 044√
Comprehensive Income for the Year			(8) √					
Revaluation of property							40 √	
Final 2014 Dividend Paid in year			(7) √					
Transfer			25 √	(25) √				
Transfer			(30) √		30 √			
Bonus Issue of Ordinary £1 shares	14 √		(14) √					
Balance at 31 December 2015	714 of	140 √ (need 2) of	1 √ of	0 of	30 √ (need 2) of	144 of	40 √ (need 2) of	1 069 √ of

(16)

(c) Shares issued at premium of $\frac{140m}{700m}$ x 100 √ = 20% √

So   X shares at 20% premium to give £144m

ie   X x 1.2 = £144m   X = $\frac{£144m}{1.2}$ √   √ = 120m shares √of √C

(6)

(d) Answers could include:

(i) Increase in value of factory cannot be added to profit, √ because it is an unrealised gain. √ This would go against the concept/principles of realisation √ i.e. gain has not been realised until property is sold. √ Also goes against prudence. √   **(4)**

(ii) Cannot be used to distribute as a dividend √ as in a capital reserve. √   **(2)**

(e) Answers may include

<u>For Bonus Issue</u>
Company has few funds available for dividends.√ Only £15m o/f in the Retained Earnings available. √
Shareholders are kept happy / quiet √ as they would have received free shares √ and these shares are eligible for dividends in the future. √
Maximum in Revenue reserves √ available for dividend is
£15m o/f + £30m = £45m o/f √ but reluctant to pay the £30m in Capital Replacement √ as this is set aside to replace worn out machinery. √
Company may be short of liquid funds √ especially if they have made a loss.√
May attract new investors (if they hear about the bonus shares). √
Bonus shares could be lower in total than the dividend payable. √
Makes the company look stronger (SOFP) if shares issued from revenue reserves. √

<u>Against Bonus Issue</u>
Bonus shares bring in no cash for the company. √
Issue of bonus shares sees share price fall √ Shareholders will be unhappy. √
Bonus shares will result in more shares eligible for dividends in the future √ so greater future payouts, √ or dividend per share may fall. √
The £14m could be used to give a dividend √ of 2 pence per share. √
It is possible to pay 6.43 pence per share maximum √ as a dividend from Revenue Reserves. √
If bonus shares are paid from revenue reserves √ this means there will be less funds available for future dividends/emergencies. √
Shares may fall in value in the future due to e.g. economic reasons√ so shareholders will be unhappy.
Administration/professional costs will rise. √

Maximum of 8 √ for arguing one side.

Conclusion
Bonus issue may/may not be best option for company √√

(12)

(Total: 52 marks)

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WAC02 or WAC12

SOURCE MATERIAL FOR USE WITH QUESTION 2

2   Jesorre Carpets plc produces carpets at its factory. The carpets are then delivered to the company's shops, before sale to customers. At 31 December 2015, the following balances were in the books.

	Debit	Credit
	£	£
Advertising	175 000	
Bad debts	23 000	
Bank		5 500
Bank interest	43 000	
Cash	38 000	
Direct materials	988 000	
Discount allowed	105 000	
Discount received		42 000
Factory buildings at cost	1 950 000	
Factory buildings – provision for depreciation		437 000
Head office expenses	296 000	
Inventory at 1 January 2015	931 000	
Long term bank loan		200 000
Machinery – net book value	712 000	
Motor vans at cost	198 000	
Motor vans – provision for depreciation		99 000
Ordinary shares £0.25		2 000 000
Other payables		12 000
Rent on shop premises	417 000	
Retained earnings		760 220
Revenue		5 472 000
Sales commission	54 720	
Trade receivables	241 000	
Trade payables		274 000
Transport costs	165 000	
Wages	2 965 000	
	9 301 720	9 301 720

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Additional information at 31 December 2015

- Inventory £889 000
- Rent on shop premises owing is £7 000
- Head office expenses include £24 000 paid in advance
- Wages consist of:

	£
Direct factory labour	1 007 000
Head office staff	382 000
Shop staff	1 357 000
Transport staff	219 000

- Assuming a nil residual value and using the straight line method
  – the factory building is to be depreciated over a 50-year life
  – the motor vans are to be depreciated over a five-year life
- Machinery is to be depreciated using the reducing balance method of 20% per annum
- All interest on the bank loan has been paid before the year end
- A Corporation tax provision is to be made for £10 000, which is to be paid by 30 April 2016.

Required:

(a) Prepare, in accordance with International Accounting Standard (IAS) 1 (Revised), a:

(i) Statement of Comprehensive Income for the year ended 31 December 2015

(25)

(ii) Statement of Financial Position at 31 December 2015.

(15)

(b) Evaluate the importance of the Directors' Report that accompanies the financial statements.

(12)

(Total for Question 2 = 52 marks)

Answer space for Question 2 is on pages 8 to 15 of the question paper.

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2(a)(i)			W1 Cost of Sales			
Statement of Comprehensive Income for			Direct factory labour	1 007 000		
Jesorre Carpets plc for y/e 31 December 2015			Direct Materials	988 000 √	need 2	
			Less Discount Received	(42 000) √		
Revenue	5 472 000 √		Factory Depreciation	39 000 √		
			Machinery Depreciation	142 400 √		
Cost of sales	(2 176 400) √ o/f		Inventory Adjustment	42 000 √		
				2 176 400	**5 x √**	
Gross profit	3 295 600 √ o/f					
			W2 Distribution Costs			
Distribution costs	(2 539 320) √ o/f		Advertising	175 000 √		
			Discount Allowed	105 000 √		
Administrative expenses	(677 000) √ o/f		Rent on shop premises	424 000 √		
			Depreciation on motor vans	39 600 √		
Financial cost	(43 000) √ o/f		Sales Commission	54 720 √		
			Transport costs	165 000 √		
Profit on ordinary activities before tax	36 280 √ o/f		Shop staff wages	135 7000		
			Transport staff wages	219 000 √	need 2	
Corporation tax	(10 000) √			2 539 320	**7 x √**	
Profit on ordinary activities after tax	26 280 √o/f		**W3Administrative Expenses**			
			Bad Debts Written Off	23 000 √		
			Head office expenses	272 000 √		
Total 25 x √	**9 x √**		Head office staff	382 000 √		
				677 000	**3 x √**	
			W5 Financial cost			
			Bank interest	43 000 √	**1 x √**	

(a)(ii) Statement of Financial Position of Jesorre Carpets plc as at 31 December 2015			
ASSETS			
Non-current assets			
Property, Plant & Equipment			
Buildings		1 474 000 √ of	
Machinery		569 600 √ of	
Motor vans		59 400 √ of	
		2 103 000	
Current Assets			
Inventories		889 000 √	
Trade and Other Receivables			
Trade receivables	241 000 √		
Prepayments	24 000 √		
		265 000	
Cash and Cash Equivalents			
Cash	38 000 √		
		38 000	
		1 192 000	
Total Assets		**3 295 000**	
EQUITY AND LIABILITIES			
Equity			
Share Capital			
Ordinary shares of £0.25		2 000 000 √	
Retained Earnings		786 500 √ of	
		2 786 500	
Non-Current Liabilities			
Long Term Borrowings			
Long term bank loan	200 000 √		
		200 000	
Current Liabilities			
Trade and other Payables			
Trade Payables	274 000 √		
Other payables	19 000 √		
		293 000	
Short Term Borrowings			
Bank		5 500 √	
Current Tax Payable			
Corporation Tax Payable		10 000 √	
		308 500	
Total Equity and Liabilities		**3 295 000** √ C	

Total 15 x √

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Past Paper (Mark Scheme)

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WAC02 or WAC12

2 (b)
Answers may include:

<u>Case For Directors' Report</u>

- Report gives information to e.g. shareholders which they could use to make a decision √ e.g. invest more funds in the company. √
- Shareholders / readers may be assured the company is acting in an ethical manner. √
- Other stakeholders e.g. pressure group √ may use information in the Report to bring about change in company policy √ e.g. treatment of disabled. √
- Disclosures may be required under Stock Exchange regulations, √ which may be appropriate in the Directors' Report √ e.g. legislation pending. √
- The Director's Report could be considered part of the corporate governance. √
- Information is given to shareholders which allows them to see in some detail how the company is performing √
    - E.g.company performance/principal activities,√ review of the position of the business √
    - Post balance sheet events,√ future developments √
    - Names of directors,√ interests of directors √
    - Employee involvement,√ disabled employees policy √
    - Political√ and charitable donations √
    - Creditor payment policy,√ creditor payment days √

    (Maximum of 4 marks for listing of items contained in Report)

<u>Case Against Directors' Report</u>

- Report costs personnel time √ to prepare and money to print etc.√
- Directors may use Report to "window dress" the accounts,√ ie give an inaccurate/unrealistic positive view of the company,√ as it is in their interest to do so. √
- There is a time delay before the Directors Report is published so events may have changed. √

Maximum   8 Marks for arguing one side only

<u>Conclusion</u>   2 Marks
Should relate to above points. E.g. Directors' Report is useful. √√

(12)

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Past Paper

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WAC02 or WAC12

SOURCE MATERIAL FOR USE WITH QUESTION 3

3 Classic Bathrooms Limited produces brass taps. All taps are produced to order and no inventory of taps is held. No inventory of brass material is held either.

For the month of December 2015, the following information is available.

Budget for December 2015:

- Each tap should use 5 kilograms of brass in production
- Brass is to be purchased from suppliers at a rate of £3.20 per kilogram
- Direct production workers are to be paid £6.60 per hour, and are to produce 3 taps per hour
- There are 10 direct production workers who each work 40 hours a week normal time
- There are 4 weeks in a month
- Fixed costs are expected to be £19 200.

Actual figures for December 2015:

- Brass used for production was purchased at a rate of £3.05 per kilogram, for a total cost of £74 664
- To meet production, all 10 direct production workers had to each work one hour overtime a week in each of the 4 weeks
- Overtime is paid at a rate of £9.90 per hour
- The budgeted number of taps produced and sold was achieved
- Each tap sells for £39.96
- Fixed costs for the month totalled £19 200.

Required:

(a) Calculate for December 2015 the:

    (i) total number of taps budgeted to be produced

        (2)

    (ii) actual amount of brass in kilograms used in production

        (3)

    (iii) total actual direct production labour cost.

        (3)

(b) Calculate for December 2015 the:

    (i) variances for materials usage, materials price, and total materials cost

        (10)

    (ii) variances for labour efficiency, labour rate, and total labour cost.

        (10)

(c) Calculate the actual profit for the month of December.

        (5)

(d) Calculate the budgeted mark-up on one tap for the month of December.

        (7)

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WAC02 or WAC12

The variance for total costs for December 2015 is favourable. The directors of Classic Bathrooms Limited expected the lower total cost figures for December to apply in January. The directors had to decide whether to keep the same percentage mark-up for January or keep the same selling price. The directors decided to keep the same percentage mark-up for January.

Required:

(e) Evaluate the decision to use the same percentage mark-up for January, rather than keep the selling price at £39.96.

(12)

(Total for Question 3 = 52 marks)

Answer space for Question 3 is on pages 16 to 24 of the question paper.

3

(a)
(i) Budgeted tap production = (10 x 40 x 4 x 3)√ = 4 800 √

(2)

(ii) Actual brass used in production = $\frac{£74\ 664\ \checkmark}{£3.05\ \checkmark}$ = 24 480 kgs √

(3)

(iii) Total direct production labour cost :

		£
Normal time = 10 x 40 x 4 x £6.60 =		£10 560 √
Overtime = 10 x 1 x 4 x £9.90 =		£396 √
Total		£10 956 √ o/f

(3)

(b) (i)
Materials usage variance = (24 000 √ - 24 480 √ o/f) x £3.20 √
= £1 536 Adverse √ o/f

(4)

Materials price variance = (£3.20 √ - £3.05 √) x 24 480 √ o/f
= £3 672 Favourable √

(4)

Total materials variance = (£1 536 Adverse + £3 672 Favourable)√ o/f
= £2 136 Favourable√ o/f

(2)

(ii)
Labour efficiency variance = (1 600 √ - 1 640 √) x £6.60 √
= £264 Adverse √

(4)

Labour rate variance = (£6.60 √ - $\frac{£10\ 956\ \checkmark}{1\ 640}$) x 1 640 √
= £132 Adverse √

(4)

Total labour variance = (£264 Adverse + £132 Adverse) √ o/f
= £396 Adverse √ o/f

(2)

(c) Sales = 4 800 o/f x 39.96 = £191 808 √ o/f
Less
Materials Cost	=	£74 664 √
Labour Cost	=	£10 956 √ o/f
Fixed Cost	=	£19 200 √
		104 820
Profit	=	£86 988 √ o/f

(5)

(d)   Cost of producing one tap :
Material cost = 5 x £3.20   =   £16.00 √
Labour cost   = £6.60   =   £2.20 √
                        3
Fixed cost   = £19 200   =   £4.00 √
                     4 800 o/f

                   Total cost per tap   =   £22.20 √ o/f

                   Selling price per tap =   £39.96

                   Mark-up per tap   =   £17.76 √ o/f

                   Mark-up percentage = (£17.76 o/f x 100 √) = 80% √ o/f
                                              (£22.20)

(7)

(e)

Keeping the same percentage mark-up
FOR:
- Result will be a fall in price √ of £0.65 √√ and this may lead to more customers √ and an overall increase in sales revenue. √
- New price may be below that of rival firms √ which may be crucial if market is competitive. √

AGAINST:
- The profit measured in £s per item sold will decrease √ and this may reduce overall profit √ even if more items are sold. √
- Demand may be price inelastic, √ and there may be only a small rise in demand if price falls.√
- Price will be lower so consumers may think quality is lower. √

Keeping the same selling price
FOR:
- Customers will not be aware of fall in production costs √ so are unlikely to feel unhappy √ especially given inflation/rising prices √
- Profit will be higher √ because costs are lower √
- Easier to keep same selling price, inertia √

AGAINST:
- Price could mean firm's price higher than rivals√ so there may be a fall in customers √

Maximum of 8 √ for one side of argument.

Conclusion
Keeping same percentage mark up is correct/incorrect √√

(12)
(Total: 52 marks)

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WAC02 or WAC12

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4 On 1 January 2013, Mikele Zammitt borrowed a three-year loan to finance the opening of a shop to repair vacuum cleaners. Trade has not been as good as expected, and Mikele is concerned about break-even point and profits.

The information for the year ended 31 December 2015 is as follows:

- Price charged to customer for a repair, £110
- Number of repairs per week, 5
- Rent of shop premises, £620 per month
- Insurance per year, £560
- Cost of parts per repair, £30
- Loan repayments, £275 per month
- Other fixed costs, £65 per month
- Assume 4 weeks per month.

Required:

(a) Calculate the number of repairs Mikele had to complete to break even in the year ended 31 December 2015.

(8)

(b) Calculate the profit or loss made by Mikele in the year ended 31 December 2015.

(4)

For the year starting 1 January 2016, Mikele is considering closing the shop and working from home. This would result in the following changes:

- Number of repairs would fall by 60%
- Insurance would be £400 per year
- Other fixed costs would fall by £25 per month
- A motor van would have to be purchased for £4 000 in cash. This would last 5 years before being sold for £400. The motor van is to be depreciated using the straight line method.

Required:

(c) Calculate the number of repairs Mikele would have to complete to break even in the year ended 31 December 2016.

(8)

(d) Calculate the expected profit or loss for Mikele in the year ended 31 December 2016.

(4)

(e) Evaluate the possibility of Mikele closing the shop and working from home.

(8)

(Total for Question 4 = 32 marks)

Answer space for Question 4 is on pages 26 to 30 of the question paper.

SECTION B

4

(a)	
Fixed Costs	£(620 x 12) + 560 √(both) + (275 x 12) + (65 x 12) √(both) = £12 080√
Variable Costs	= £30 √
Contribution	(£110 - £30) = £80 √ o/f
Break-even point	12 080 √ o/f 80 √
	= 151 √ o/f
	8 marks
(b) Sales	240 x £110 = £26 400 √
Less Fixed Costs	= (£12 080) √ o/f
Less Variable Costs	(240 x £30) = (£7 200) √ o/f
= Profit	= £7 120 √ o/f
OR	
Contribution x Sales	(£80 x 240) √ = £19 200 √ o/f
Less fixed Costs	(£12 080)√ o/f
= Profit	£7 120 √ o/f
	4 marks

(c)	
Fixed Costs	(£400 + £720) √ + (40 x 12) √ = £1600√ o/f
Variable Costs	= £30 √
Contribution	(£110 - £30) = £80 √ o/f
Break-even point	1600 √ o/f 80 √ o/f = 20 √ o/f
	8 marks
(d) Sales	96 x £110 = £10 560 √
Less Fixed Costs	= (£1 600) √ o/f
Less Variable Costs	(96 x £30) = (£2 880) √ o/f
= Profit	= £6 080 √ o/f
OR	
Contribution x Sales	(£80 x 96) √ = £7 680 √ o/f
Less fixed Costs	(£1 600) √ o/f
= Profit	£6 080 √ o/f
	4 marks

Winter 2016
Past Paper (Mark Scheme)

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WAC02 or WAC12

(e)

For closing shop and working from home

Break-even point is lower √ by 131 units o/f √ because fixed costs are much lower. √

It may be possible to build up sales √ by advertising and word of mouth recommendations etc. √

Flexibility/relax etc. working from home. √

For keeping shop open

Profit is higher (using 2015 figure) √ by £1 040 √ o/f.

Because the loan is paid off √ £3 300 interest will not be paid √ so profit is would be higher by £4 340 in 2016√ which is more realistic.

Will need to buy a van for £4 000 if working from home. √

More chance of passing trade/ higher footfall √ as shop presence acts as an "advert" itself. √

Profit is more important than break-even. √√

Margin of safety falls √ from 89 in 2015 (240-151) in the shop, to 76 (96-20) o/f if working from home in 2016 √

Maximum of 4 marks for argument of one side.

Conclusion

Should keep shop open √√

(8)

(Total: 32 marks)

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WAC02 or WAC12

SOURCE MATERIAL FOR USE WITH QUESTION 5

5 Forestwood Kitchens plc manufactures kitchen units. As demand may fluctuate, the Cost Accountant produces a flexible budget at the start of each month, using the latest figures available.

The following information for an output of 1 400 units is available for the month of February 2016.

- Timber cost per unit £24.00
- Labour cost per unit £18.00
- Semi-variable costs:
  - Delivery costs £2 000 per month plus £1.55 per unit
  - Power £1 400 per month plus £0.90 per unit
- Fixed costs £26 800 per month
- Selling price £120 per unit
- For every 100 extra units produced, the cost of timber per unit reduces by 15% **on all units**, i.e. the cost of timber for all 1 500 units is 15% lower per unit than for all 1 400 units; and the cost of all 1 600 units is 15% lower per unit than for all 1 500 units.
- For every 100 extra units produced, the cost of labour per unit increases by 10% **on all units**, i.e. the cost of labour for all 1 500 units is 10% higher per unit than for all 1 400 units; and the cost of all 1 600 units is 10% higher per unit than for all 1 500 units.
- For every 100 extra units sold, the selling price reduces by 5% **on all units**, i.e. the selling price for all 1 500 units is 5% lower per unit than for all 1 400 units; and the selling price of all 1 600 units is 5% lower per unit than for all 1 500 units.

Required:

(a) Using the columns provided in the question paper, prepare a flexible budgeted Statement of Comprehensive Income for the month of February for the following output levels:

- 1 400 units
- 1 500 units
- 1 600 units.

(22)

(b) State, and briefly explain, **one** advantage to Forestwood Kitchens plc of using a flexible budget.

(2)

(c) Evaluate which of the three output levels would be the most appropriate for Forestwood Kitchens plc for the month of February 2016.

(8)

(Total for Question 5 = 32 marks)

Answer space for Question 5 is on pages 32 to 34 of the question paper.

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Accounting Unit 2
WAC02 or WAC12

If you answer Question 5 put a cross in the box ⊠ .

Source material for Question 5 is on page 11 of the source booklet.

5 (a) Using the columns provided below, prepare a flexible budgeted Statement of Comprehensive Income for the month of February for the following output levels:

- 1 400 units
- 1 500 units
- 1 600 units.

(22)

5(a) <u>Budget Statement of Comprehensive Income for February</u>

OUTPUT	**1400**	**1500**	**1600**	
Revenue	168 000 √	171 000 √	173 280 √	
Materials	33 600 √	30 600 √	27 744 √	
Labour	25 200 √	29 700 √	34 848 √	
Delivery	4 170 √	4 325 √	4 480 √	
Power	2 660 √	2 750 √	2 840 √	
Fixed Costs	<u>26 800</u>	<u>26 800</u>	<u>26 800</u>	√ (all three)
Total Costs	92 430 √ o/f	94 175 √ o/f	96 712 √o/f	
Profit	75 570 √ o/f	76 825 √ o/f	76 568√ o/f	
				22 marks

(b)
Possible answers could include:
Allow good decision making √ as "like compared to like" e.g. similar output levels. √
May save time and money by allowing √ "Management by Exception" i.e. action only if a variance at that output level. √
Allows workforce to meet target for given output level √ so motivates workforce. √

(2)

(c)
Output of 1500 units may be the best √ as it gives the highest profit o/f √
However, output of 1600 units probably means greatest market share√ and competitors will suffer. √
Output of 1 400 units gives the lowest figures for costs o/f √
1600 units gives lowest costs per unit √ at £60.45 o/f √ with 1400 the highest √ at £66.02 o/f √
1400 units gives the highest profit per √ unit at £53.98 o/f √ with 1600 the lowest √ at £47.86 o/f √
1600 units gives the highest factory capacity utilisation figure, √ which means not so many assets are being left idle √
Output may simply be determined by demand. √
Output at 1 600 may see benefits of economies of scale.√ for example, spreading the fixed costs over a larger output. √

Maximum of 4 marks for arguing for only one output level.

Conclusion
1500 units is the best output level as it gives the most profit – 2 marks

(8)
(Total: 32 marks)

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Accounting Unit 2
WAC02 or WAC12

SOURCE MATERIAL FOR USE WITH QUESTION 6

6 You are the Chief Accountant at Greco Engineering plc, and have asked a junior accountant to help you draw up the Statement of Cash Flows in accordance with IAS 7, as part of his training. You have drawn up two sections, which are the Cash Flows from Investing Activities and the Cash Flows from Financing Activities.

You have asked the junior accountant to draw up the section titled "Cash Flows from Operating Activities". The junior accountant shows you his draft, but you notice it contains a number of errors. The draft is shown below.

Statement of Cash Flows for year ended 31 December 2015	£
Cash Flows from Operating Activities	
Profit from operations	273 000
Less Depreciation	(77 000)
Add Profit on sale of non-current assets	42 000
Less Loss on sale of non-current assets	(35 000)
Operating cash flows before working capital changes	**203 000**
Decrease in inventories	(31 000)
Increase in trade receivables	66 000
Decrease in trade payables	(27 000)
Decrease in non-current assets	(757 000)
Cash generated from operations	**(343 000)**
Add Interest paid	44 000
Add Tax paid	39 000
Increase in Cash and Cash Equivalents	**260 000**

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Past Paper
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Accounting Unit 2
WAC02 or WAC12

You also have the Statements of Financial Position for the last two years, which you can refer to. Extracts are shown below.

	31 December 2014	**31 December 2015**
ASSETS	£	£
Non-current assets at cost	5 548 000	4 791 000
Provision for depreciation	(1 346 000)	(1 269 000)
Non-current assets carry over	4 202 000	3 522 000
Current assets		
Inventories	1 020 000	989 000
Trade and Other receivables	841 000	907 000
Cash and Cash Equivalents	---------	139 000
	1 861 000	2 035 000
Current liabilities		
Bank overdraft	121 000	----------
Trade and Other payables	656 000	629 000
Current Tax payable	323 000	362 000
	1 100 000	991 000

Additional information

- On 1 January 2015, plant was bought for £1 053 000

- On 31 December 2015, equipment that cost £970 000 with depreciation to date of £360 000 was sold for £575 000

- On 31 December 2015, plant that cost £840 000 with a net book value of £630 000 was sold for £672 000

- Profit after interest for the year ended 31 December 2015 was £273 000

- Interest on the bank overdraft was £12 000 for the year

- On 1 April 2015, a four-year bank loan for £400 000, at a fixed interest rate of 8%, was taken out

- Cash Flows **used** in Investing Activities was £158 000

- Cash Flows **from** Financing Activities was £44 000

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Past Paper
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Accounting Unit 2
WAC02 or WAC12

You decide to show the junior accountant the correct way to complete the task.

Required:

(a) Prepare:

   (i) the Provision for Depreciation Account for the year ended 31 December 2015

       (6)

   (ii) a corrected Cash Flows from Operating Activities section of the Statement of Cash Flows, in accordance with IAS 7.

       (15)

The junior accountant asks, "What items would be found in the Financing Activities section of the Statement of Cash Flows?"

(b) State **three** items that would be found in the Financing Activities section of the Statement of Cash Flows.

       (3)

The junior accountant states "The company seems to have done well in the last year as the liquidity position of the company has improved".

(c) Evaluate the statement made by the junior accountant concerning the liquidity position of the company.

       (8)

(Total for Question 6 = 32 marks)

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Past Paper (Mark Scheme)

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Accounting Unit 2
WAC02 or WAC12

6 (a) (i)

Provision for Depreciation account

Date	Details	£000		Date	Details	£000	
Dec 31	Disposals	360	√	Jan 1	Balance b/d	1 346	√
Dec 31	Disposals	210	√	Dec 31	Statement of Comprehensive Income	493	√ o/f
Dec 31	Balance c/d	1 269	√				
		1 839				1 839	√ o/f

(6)

(a) (ii)

Statement of Cash Flow for y/e 31 December 2015		
Cash Flows from operating activities		
Profit from operations (273 √ + 12 √ + 24 √)	309 000	
Add Depreciation	493 000	√ o/f
Less Profit on Sale of Non-current Asset	(42 000)	√
Add Loss on Sale of Non-current Asset	35 000	√
Operating cash flow before working capital changes	795 000	√ o/f
Decrease in inventories	31 000	√
Less Increase in trade receivables	(66 000)	√
Less Decrease in trade payables	(27 000)	√
Cash generated from operations	733 000	√ o/f
Less Interest Paid (12 √ + 24 √)	(36 000)	
Less Tax Paid	(323 000)	√
Net Cash from Operating Activities	374 000	√ o/f

(15)

(b)
Items found in the Financing Activities section include:
Issue of shares, premium on share issue, issue of debenture, taking out a bank loan, redemption of shares, repayment of a bank loan, repayment of a debenture, dividends paid,
(and can include interest paid).   One √ per correct item.

(3)

(c)

For statement

Profit after interest was £273 000 √

Company has generated £374 000 o/f from Operating activities. √

Cash and cash equivalent has risen from (£121 000) to £139 000√, a rise of £260 000√

Financing activities show an inflow of £44 000. √

2014 current ratio is 1.69:1, acid ratio is 0.76:1 √

2015 current ratio is 2.05:1, acid ratio is 1.06:1 √ i.e. improved √

(or both current ratios correct = √ and both acid ratios = √)

Against statement

Financing activity shows a loan of £400 000 was taken out, √ which goes a long way to explain the improvement in liquidity in the year.√

Cash flow used in Investing Activities was an outflow of £158 000 √, however this could generate future inflows. √

Cash and cash equivalents at the end of 2015 are not enough to pay the current tax bill, √ although the position was worse in 2014. √

Maximum of arguing for one side 4 marks

Conclusion
Company has done well and liquidity position has improved. – 2 marks

(8)

(Total: 32 marks)

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Accounting Unit 2
WAC02 or WAC12

SOURCE MATERIAL FOR USE WITH QUESTION 7

7 Gulf Catering Supplies Limited is a new business and has won a contract to supply a major airline with in-flight meals. The initial costs involved in delivering the contract are £2 000 000.

The following information relates to the contract:

- In year one, the contract will be to supply meals for 220 flights a week, serving one meal per passenger

- The average number of passengers per flight is 150

- In the first two years, meals will be supplied at an average selling price of £0.52

- In years two and three, there will be 240 flights a week

- In years four and five, there will be 260 flights a week

- In years three and four, meals will be supplied at an average selling price of £0.55

- In year five, meals will be supplied at an average selling price of £0.58

- The cost of producing the meals in all five years will be £0.25

- In years one and two, running costs (including depreciation) will be £6 750 a week

- In years three, four and five, running costs (including depreciation) will be £6 950 a week

- Depreciation will be £235 000 per year for each of the five years

- Assume 52 weeks in a year.

Required:

(a) Calculate the payback period for the contract, giving your answer in years and months.

(20)

Gulf Catering Supplies Limited financed the contract as follows:

- £0.50 Ordinary shares   £500 000
- £1 Redeemable Preference shares   £600 000
- 9% Bank Loan   £900 000

(b) Calculate, stating the formula used, the gearing ratio for Gulf Catering Supplies Limited.

(4)

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WAC02 or WAC12

A prospectus was sent to potential shareholders, to persuade them to invest in the new company. The prospectus states "Gulf Catering Supplies Limited is not a company that takes financial risks".

(c) Evaluate the statement "Gulf Catering Supplies Limited is not a company that takes financial risks".

(8)

(Total for Question 7 = 32 marks)

Answer space for Question 7 is on pages 42 to 45 of the question paper.

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WAC02 or WAC12

7 (a)

Sales	Flights	Passengers	Weeks	Sales Price	Total Revenue
Year 1	220	X 150	X 52	X 0.52	=892 320 √
Year 2	240	X 150	X 52	X 0.52	=973 440 √
Year 3	240	X 150	X 52	X 0.55	=1 029 600 √
Year 4	260	X 150	X 52	X 0.55	=1 115 400 √
Year 5	260	X 150	X 52	X 0.58	=1 176 240 √
Running costs	Cost	Weeks	Depreciation	Meal Cost	Cash Outflow
Year 1	(6 750	X 52)	-235 000	+ 429 000	=545 000 √
Year 2	(6 750	X 52)	-235 000	+ 468 000	=584 000 √
Year 3	(6 950	X 52)	-235 000	+ 468 000	=594 400 √
Year 4	(6 950	X 52)	-235 000	+ 507 000	=633 400 √
Year 5	(6 950	X 52)	-235 000	+ 507 000	=633 400 √
Net Cash Flow	Total Revenue	Outflow	Net Cash Flow		Cumulative Cash Flow
Year 0					-2 000 000
Year 1	(892 320	-545 000)	=347 320	√ o/f	-1 652 680
Year 2	(973 440	-584 000)	=389 440	√ o/f	-1 263 240
Year 3	(1029 600	-594 400)	=435 200	√ o/f	-828 040
Year 4	(1 115 400	-633 400)	=482 000	√ o/f	-346 040
Year 5	(1 176 240	-633 400)	=542 840	√ o/f	196 800

Payback period=4 years(346 040 o/f x 12)√=4 years o/f √ 7.65 months √√o/f
(542 840) √

(20)

(b)
Gearing ratio= Prior Charge Capital x100 √ = £1 500 000 x 100 √ = 75% √o/f
　　　　　　　　　Capital Employed 　　　　£2 000 000 √

(4)

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WAC02 or WAC12

(c)

For statement

The contract shows a positive cash flow every year. √
The contract makes a profit every year, √ even when depreciation is taken into account. √
The contract pays back in the fifth year. √
The contract has fixed prices agreed with the airline. √
As long as the airline stays in business the contract must be honoured by the airline√ therefore giving security to Gulf Catering. √

Against statement

Some figures are only estimates √ e.g. cost of producing meals. √
The gearing ratio at 75% is very risky √ because it is over 50%. √
The airline could go out of business, so contract will be worthless. √
Payback is after more than four years, which may be considered quite lengthy. √

Maximum 4 marks for arguing only one side of the contract.

Conclusion
Company probably is taking a risk √√

(8)

(Total: 32 marks)