Pearson Edexcel

International Advanced Level

Accounting (Modular Syllabus)

Unit 2: Corporate and Management Accounting

Monday 16 January 2017 – 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

1 Westdownes Farms Limited owns four dairy farms, producing milk that is sold to a major supermarket. The supermarket sets the price it is prepared to pay in an annual contract. The contract commences on 1 February 2016 and ends on 31 January 2017. The price payable is 28 pence (£0.28) per litre of milk.

Information for the four farms for the year ended 31 January 2017:

Farm	**Berryfields**	**Highlands**	**Oaks**	**Woodgate**
Number of cows	155	120	148	132
	£	**£**	**£**	**£**
Direct materials	176 514	168 192	194 472	173 448
Direct labour	108 624	105 120	116 683	115 632

Additional information

- Each cow produces 8 760 litres of milk per year.

Required:

(a) Calculate the quantity of milk, in litres, produced by **each** of the four farms.

(4)

Fixed costs consist of the following:

(1) Farm managers' salaries:

Farm	**Berryfields**	**Highlands**	**Oaks**	**Woodgate**
Manager's salary	£12 000	£10 000	£11 000	£10 000

(2) Head office overheads – total £28 000. To be apportioned in the following ratio:

Farm	**Berryfields**	**Highlands**	**Oaks**	**Woodgate**
Ratio	4	3	4	3

(3) Depreciation – at a rate of 2% on cost of farm buildings:

Farm	**Berryfields**	**Highlands**	**Oaks**	**Woodgate**
Cost of farm buildings	£900 000	£100 000	£250 000	£300 000

Required:

(b) Calculate the total fixed costs for **each** of the four farms.

(9)

(c) Calculate the profit or loss for **each** of the four farms of Westdownes Farms Limited for the year ended 31 January 2017, rounding your answers to the nearest pound (£) where necessary.

(15)

The supermarket has now informed Westdownes Farms Limited that it will only pay 25 pence (£0.25) per litre in the next contract, starting on 1 February 2017 and ending on 31 January 2018.

All costs will remain the same for next year.

Required:

(d) Calculate the forecast contribution made by **each** of the four farms, **per litre** of milk for, the year ended 31 January 2018.

(12)

(e) Evaluate the future of **each** of the four farms, using the figures calculated in (d) and any other relevant factors.

(12)

(Total for Question 1 = 52 marks)

Answer space for Question 1 is on pages 2 to 8 of the question paper.

Section A

1(a) Milk Production	Berryfield	_	Highlands	_	Oaks	_	Woodgate	
Cows	155		120		148		132	
Production (litres)	1357800	√	1051200	√	1296480	√	1156320	√
							(4)	
1(b) Fixed costs								
Farm Manager	12000		10000		11000		10000	√all
Head Office	8000		6000	√both	8000		6000	√both
Depreciation	18000	√	2000	√	5000	√	6000	√
Total Fixed costs	38000		18000	√both	24000		22000	√both
							(9)	
1(c) Income statement								
Sales Revenue	380184	√	294336	√	363014	√	323770	√
Direct Materials	176514		168192		194472		173448	√all
Direct Labour	108624		105120		116683		115632	√all
Fixed Costs	38000		18000		24000		22000	√of all
Total Costs	323138	√of	291312	√of	335155	√of	311080	√of
Profit (Loss)	57046	√of	3024	√of	27859	√of	12690	√of
							(15)	

1(d) Pence per litre	Berryfield	_	Highlands	_	Oaks	_	Woodgate	
Sales Revenue	25		25		25		25	√ all
Direct Materials	13	√	16	√	15	√	15	√
Direct Labour	8	√	10	√	9	√	10	√
Total Direct Costs	21		26		24		25	√
Contribution	4		-1	√of both	1		0	√of both
							(12)	

(1e)

All comments own figure

Berryfields
Will be making a positive contribution √ of 4p per litre. Should continue in the short term and the long term. √
Still make a profit of £16 312 next year. √

Highlands
Will be making a negative contribution √ of 1p per litre. Should stop production on 1 February 2017. √
Would make a loss of £28 512 next year. √

Oaks
Will be making a positive contribution √ of 1p per litre. Should continue in the short term but probably not in the long term. √
Makes a loss of £11 035 next year. √

Woodgate
Not making a positive or negative contribution.√ Maybe continue in the short term but stop in the long term. √
Makes a loss of £22 000 next year. √

Maximum of 3 marks per farm

Other points
Is it possible to find another customer, √ who is willing to pay a higher price for milk. √ Given the large volumes of production, √ it is likely to have to be a supermarket, √ who may already have contracts in place, √ or who are likely to want to drive down prices. √

Is it possible to negotiate with the supermarket √ to achieve a higher price for the milk. √ Perhaps Westdownes Farm Limited can argue that some farms will have to close at these prices, √ so the supermarket will not achieve the required level of supply. √ Is it possible to publicly highlight the plight of farmers, √ to persuade the supermarkets to offer a higher price. √

Some of the Head Office costs will probably have to be reapportioned at a higher level √ to the farms that are remaining open. √ This could result in these farms having to close. √

Is it possible for the farms to reduce their costs, √ in order to remain in business. √

(12)

Total for Question 1 = 52 Marks

SOURCE MATERIAL FOR USE WITH QUESTION 2

2 You are the new Finance Director at Bangla National Brick plc, and you have decided to introduce a standard costing system for production. You must explain how this is to be introduced at a board meeting.

Required:

(a) Explain the stages in establishing a **standard cost** for a unit of production.

(4)

You decide to start by looking at the production of red bricks in the month of December 2016. First, you meet with the Production Manager, who provides some information that he uses as a basis for production for each month. You decide to use this information for the budget for December 2016.

Budget for December 2016

- production of red bricks 135 000 per month
- each red brick uses 2.8 kilos of clay
- cost of clay 2.6 pence (£0.026) per kilo
- a team of 3 direct labour workers can produce 75 red bricks per hour
- there are 9 teams of 3 direct labour workers
- direct labour workers work for 10 hours a day, 5 days a week
- there are 4 weeks in a month
- direct labour workers are paid £4.90 per hour

On 2 January 2017 you meet with the Finance Manager, who provides you with the actual figures for December 2016.

Actual for December 2016

- production of red bricks 135 000
- cost of clay purchased for production £9 396
- there is no opening or closing inventory of clay
- actual direct labour cost £28 350

On 3 January 2017 you meet with the Purchasing Manager, who informs you that she purchased the clay used in December for 2.4 pence (£0.024) per kilo.

On 4 January 2017 you meet with the Human Resources (HR) Manager, who informs you that he agreed to pay a labour rate of £5.00 per hour for December.

Required:

(b) Calculate for December 2016 the:

(i) budgeted total quantity of clay to be used
(2)

(ii) budgeted total cost of clay to be used
(2)

(iii) actual total quantity of clay used
(3)

(iv) material price variance
(4)

(v) material usage variance
(4)

(vi) total material cost variance.
(3)

(c) Calculate for December 2016 the:

(i) budgeted total labour hours
(3)

(ii) budgeted total labour cost
(2)

(iii) actual hours worked
(2)

(iv) labour rate variance
(4)

(v) labour efficiency variance
(4)

(vi) total labour rate variance.
(3)

At the next board meeting, the Chair has asked you to inform the board of the performance of the four managers: Purchasing Manager, Human Resources (HR) Manager, Production Manager, and Finance Manager. The Chair requires your thoughts as to whether each manager should receive their bonus for December 2016. The bonus would be awarded if the performance of the individual manager in December was good.

(d) Evaluate the performance of **each** of the four individual managers for the month of December 2016. Your evaluation should include recommendations to the board concerning the awarding of the bonus for **each** manager for the month of December 2016.
(12)

(Total for Question 2 = 52 marks)

Answer space for Question 2 is on pages 9 to 15 of the question paper.

2(a) Answers may include:
For product, obtain a product specification√ giving standard quantities for materials and labour√
Look at figures for past cost of sales √
Standard prices for materials obtained √ by consulting buyers and suppliers √
Standard labour rates obtained √ by consulting human resources department and/or unions.√
Standard overheads obtained √ by consulting management / finance department. √
Standard cost calculated may be regarded as provisional √ and may be tested to see if realistic √
Standard cost may be revalued if appropriate. √

(4)

2(b)(i) Budgeted total quantity of clay = (135 000 x 2.8 kilos) √
= 378 000 kilos √

(2)

2(b)(ii) Budgeted total cost of clay = (378 000 kilos of x 2.6 p)√
= £9 828 √of

(2)

2(b)(iii) Actual total quantity of clay = $\frac{£9\ 396\ √}{£0.024\ √}$ = 391 500 kilos √

(3)

2(b)(iv) Material price variance = (2.6 p √ - 2.4 p √) x 391 500 √of
= £783 Favourable √of

(4)

2(b)(v) Material usage variance = (378 000 √of – 391 500 √of) x 2.6 p √
= £351 Adverse √of

(4)

2(b)(vi) Total material cost variance = (£9 396 √ - £9 828 √of)
= £432 Favourable √of

OR

783 Favourable √of + 351 Adverse √of = 432 Favourable √of

(3)

2(c)(i) Budgeted labour hours **=** (10 x 5 x 4) √ x (3 x 9) √
= 5 400 hours √

(3)

2(c)(ii) Budgeted total labour cost = (5 400 of x £4.90) √ = £26 460 √of

(2)

2(c)(iii) Actual Hours worked = $\dfrac{(\underline{£28\ 350})}{(£5.00)}$ √ = 5 670 hours √

(2)

2(c)(iv) Labour rate variance = (£4.90 √ - £5.00 √) x 5 670 √of
= £567 Adverse √of

(4)

2(c)(v) Labour efficiency variance = (5 400 √of – 5 670 √of) x £4.90 √
= £1 323 Adverse √of

(4)

2(c)(vi) Total labour rate variance = (£26 460 √of - £28 350 √)
= £1 890 Adverse √of

OR

567 Adverse √of + 1 323 Adverse √of = 1 890 Adverse √of

(3)

2(d)

All own figure

<u>Purchasing Manager</u>
<u>For bonus</u>: purchased clay at a price below budget. √
<u>Against bonus</u>: there seems to have been much wastage √ was the clay poor quality? √
Conclusion probably gets bonus √
Maximum 3 marks

<u>Human Resources Manager</u>
<u>For bonus</u>: Did the pay rise keep workers happy, √ maybe preventing a strike etc √
<u>Against bonus</u>: Budget was £4.90 per hour, but £5.00 per hour was paid √
Labour efficiency variance adverse so workers may not be motivated √ do the workers need training? √
<u>But</u>: how does this compare with the industry average? √ what is the inflation rate? √ when was the last time workers had a pay rise? √
Conclusion probably does/does not get bonus √
Maximum 3 marks

<u>Production Manager</u>
<u>For bonus</u>: met production target √
<u>Against bonus</u>: not efficient √ is this due to workers having to work a 10 hour shift? √ extra 270 hours worked over budget, √ extra 13 500 kilos of clay used. √
<u>But</u>: was the clay poor quality? √ Is the company using poor machinery? √
Conclusion probably does/does not get bonus √
Maximum 3 marks

<u>Finance Manager</u>
<u>For bonus</u>: does the Finance Manager merely act as a recorder of the figures? √
<u>Against bonus</u>: 3 out of 4 variances are adverse/ the overall variance is adverse √ could the Finance Manager take action to help? √ <u>But</u>: Are the budgets realistic? √
Conclusion probably does not get bonus √
Maximum 3 marks

(12)

Total for Question 2 = 52 marks

SOURCE MATERIAL FOR USE WITH QUESTION 3

3 Angel plc produces computer games, but has been making losses in a very competitive market. The directors have looked around to find a larger company to take over Angel plc.

United Games plc agreed to purchase the smaller company, Angel plc, on 2 January 2017. The directors of United Games plc agreed to take over all the assets and to settle all the liabilities.

The Statement of Financial Position of Angel plc at 31 December 2016 showed:

- all assets £22 600 000
- all liabilities £14 800 000
- ordinary shares and share premium – £12 500 000, consisting of £0.60 shares issued at a premium of £0.20 per share
- retained earnings £4 700 000 debit balance.

Angel plc and United Games plc agreed the following revaluations of some of the assets and liabilities:

- property was increased by 15 % to a current market value of £12 650 000
- plant with a value of £500 000 was written down to a value of £380 000
- equipment with a book value of £600 000 was written down by £150 000
- a tax bill payable of £320 000 was agreed at £280 000

Purchase price information

- For every one share held in Angel plc, each shareholder received:
  - one £0.25 share in United Games plc, at a premium of £0.27
  - and £0.11 cash.

Required:

(a) Calculate the purchase price paid by United Games plc for Angel plc.
(8)

(b) Calculate the goodwill paid by United Games plc when Angel plc was purchased.
(9)

(c) Show the Journal entries to close the following accounts in the books of Angel plc, **before** any revaluations took place. Narratives are **not** required.

- Property
- Taxation payable
- Ordinary shares of £0.60
- Share premium
- Retained earnings

(14)

(d) Prepare the Sundry Shareholders Account in the books of Angel plc.
(7)

(e) Explain why holders of a £0.60 share in Angel plc accepted a £0.25 share in United Games plc and £0.11 pence per share.
(2)

Angel plc has made losses in the past few years. United Games plc paid goodwill to acquire Angel plc.

(f) Evaluate United Games plc paying goodwill to acquire Angel plc.

(12)

(Total for Question 3 = 52 marks)

Answer space for Question 3 is on pages 16 to 20 of the question paper.

3(a) Purchase Price			
No. of Ordinary shares in Angel plc	12 500 000√	15 625 000√	
	0.60√ + 0.20√		
Shareholders receive/ Purchase Price	£0.25		
	£0.27		
	£0.11√		
15 625 000 √ o/f	£0.63√	£9 843 750	√ o/f
			(8)

3(b) Calculation of Goodwill		£	
Purchase Price		9 843 750	√ o/f
Original Book value of Angel plc	22 600 000	OR 12 500 000	√
	(14 800 000)	(4 700 000)	√
		7 800 000	
Adjustments - Property		(1 650 000)	√ √
- Plant		120 000	√
- Equipment		150 000	√
- Tax payable		(40 000)	√
Goodwill		623 750	√ o/f
			(9)

3(c)		Debit	Credit	
	Realisation a/c√	11 000 000 √√		
	Property a/c		11 000 000	√
	Tax Payables a/c	320 000		√
	Realisation a/c		320 000	√
	Ordinary Shares (of £0.60) a/c√	9 375 000 √		
	Sundry Shareholders a/c		9 375 000	√
	Share Premium a/c√	3 125 000 √		
	Sundry Shareholders a/c		3 125 000	√
	Sundry Shareholders a/c	4 700 000		√
	Retained Earnings		4 700 000	√
				(14)

3 (d) **Angel plc Sundry Shareholders Account**

	£		£
United Games plc	9 843 750 √of	Share capital	9 375 000 √
(Purchase Consideration)		Share premium	3 125 000 √
Retained Earnings	4 700 000 √	(Profit on) Realisation√	2 043 750 √of√C
	14 543 750		14 543 750
			(7)

3(e) Answers may include:
Because the £0.25 share in United Games plc is probably trading √ at a value of £0.52 √ OR
Because the £0.60 share in Angel plc is probably trading √ at a value below face value √

(2)

3(f) Answers may include:

Case FOR paying goodwill:
Angel plc has an existing customer base √ and brand value √
Angel plc has existing links with suppliers √ and a trained workforce √
What was Angel plc may improve in the future/ make future profits √
United Games plc may benefit from economies of scale √
United Games plc should increase its market share √
United Games plc may benefit from trading in a different segment of the computer games market √
Good chance that the value of the property will rise in the future √, as it has already had to be revalued upwards once. √
Angel plc may have best-selling games in its portfolio √ and may have patents √ which will not be shown on the statement of financial position. √
The staff of Angel plc may be skilled, creative etc √ but this value will not be found on the statement of financial position. √
Goodwill paid is not very high, √ being 6.34% of the purchase price √

Case AGAINST paying goodwill:
Angel plc has been making losses recently, buyers should question - "Why?" √ Is this because they are inefficient/ badly managed √ or the games are not very good √ or the design team are not very creative. √
United Games plc may suffer from diseconomies of scale √ and see profits reduced. √
Staff of Angel plc may have outdated skills √ and may need training. √
If professionals are hired calculating goodwill this may be expensive √
Maximum of 8 marks per side of argument.

Conclusion - 2 marks available
Should relate to points made above.
United Gaming should / should not pay goodwill to acquire Angel plc.

(12)

Total for Question 3 = 52 marks

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4 You work for a firm of stockbrokers and have been asked to prepare a report on Muscat Technologies plc, who has just released its Annual Report and Financial Statements for the year ended 31 December 2016.

Extracts from the Financial Statements are shown below.

Non-current liabilities

10 year 7% Debenture 2020	£50 000 000
8% Bank loan	£30 000 000

Statement of Changes in Equity

Figures are in £ millions	Ordinary £1 share capital £m	Share premium £m	Retained earnings £m	General reserve £m	Foreign exchange reserve £m	Total equity £m
Balance at 1 January 2016	80	12	11.8	4	9	116.8
Comprehensive income for the year			12			128.8
Transfer to general reserve			(4)	4		128.8
Interim dividend paid June 2016			(0.8)			128
Final dividend paid December 2016			(2)			126
Balance at 31 December 2016	80	12	17	8	9	126

Additional information

- Corporation tax paid on profits: £3 000 000
- Share price at 31 December 2016: £1.40

Required:

(a) Calculate the following ratios, using the **year end** balances where relevant:

(i) dividend paid per share

(3)

(ii) dividend cover

(3)

(iii) dividend yield

(3)

(iv) earnings per ordinary share

(3)

(v) price/earnings ratio

(3)

(vi) return on capital employed.

(5)

(b) Calculate the gearing ratio, stating the formula used, using the **year end** balances where relevant.

(4)

The report you are preparing will be used to give investment advice to clients.

(c) Evaluate the performance of Muscat Technologies plc, and make a recommendation to clients advising whether to invest in the company or not.

(8)

(Total for Question 4 = 32 marks)

Answer space for Question 4 is on pages 21 to 24 of the question paper.

Section B

4a(i) Dividend paid per share $= \dfrac{\text{Total ordinary dividend}}{\text{Issued ordinary shares}}$

$= \dfrac{£2\,800\,000\ \checkmark}{80\,000\,000\ \checkmark} = 3.5\text{p per share}\ \checkmark$

(3)

4a(ii) Dividend cover $= \dfrac{\text{Net profit after interest and tax}}{\text{Total ordinary dividend}}$

$= \dfrac{£12\,000\,000\ \checkmark}{£2\,800\,000\ \checkmark} = 4.29\text{ times}\ \checkmark$

(3)

4a(iii) Dividend yield $= \dfrac{\text{Dividend per share}}{\text{Market price of share}} \times 100$

$= \dfrac{3.5\text{p}}{140\text{p}\ \checkmark}\ \text{o/f} \times 100\ \checkmark = 2.5\ \%\ \text{o/f}\ \checkmark$

(3)

4a(iv) Earnings per ordinary share $= \dfrac{\text{Net profit after interest and tax}}{\text{Issued ordinary shares}}$

$= \dfrac{£12\,000\,000\checkmark}{80\,000\,000\ \checkmark} = 15\text{p per share}\ \checkmark$

(3)

4a(v) Price/earnings ratio $= \dfrac{\text{Market price of share at year end}}{\text{Earnings per share}}$

$= \dfrac{140\text{p}\ \checkmark}{15\text{p o/f}\ \checkmark} = 9.33\text{ times o/f}\ \checkmark$

(3)

4a(vi) Return on Capital employed $= \dfrac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100$

$= \dfrac{(12 + 3)\ \checkmark\ + 3.5 + 2.4}{£(126\ \checkmark + 80\ \checkmark)} \times 100\ \checkmark = 10.15\%\ \checkmark$

(5)

4(b) Gearing ratio $= \dfrac{\text{Debt}}{\text{Debt + Equity}} \times 100$ √

$= \dfrac{80 \text{ √}}{80 + 126 \text{ √}} \times 100 = 38.83\%$ √

OR

Gearing ratio $= \dfrac{\text{Debt}}{\text{Equity}} \times 100 = \dfrac{80}{126} \times 100 = 63.49\%$

(4)

4(c) All own figure

For Investment

Dividend yield at 2.5% may be above what could be obtained by investing elsewhere √ eg banks, √ in times of low interest rates. √
Earnings per share at 15p per share is good √
Price/Earnings ratio is reasonably good, √ so the market has confidence in the company. √
Dividend cover may be cautious, √ which ensures company does not pay out all liquid funds/profits as dividends. √
ROCE at 10.15% is higher than could be obtained by many other businesses, √ especially if there is a recession. √ but knowing the industry averages would be worthwhile. √
Gearing is fairly safe at 38.83% √
Share price must have risen from probably £1 to £1.40 over time. √

Against Investment

Dividend yield is low at 2.5% √
Dividend cover may be cautious, √ which may mean only a small percentage of profits paid out in dividends. √

Maximum for arguing one side only – 4 marks

Conclusion – 2 marks
Muscat Technologies would /would not be a good investment. √√

(8)

Total for Question 4 = 32 marks

SOURCE MATERIAL FOR USE WITH QUESTION 5

5 Maria Andreou will commence business selling sandals. The sandals will be produced in a workshop at the back of her shop, by staff who will be paid for each pair of sandals produced. Maria will work in the shop, selling the sandals to customers.

She estimates the following figures for the first year of trading:

- material cost £3.25 per pair of sandals
- labour cost £8.50 per pair of sandals
- rent of shop premises £310 per month
- insurance and accountancy fees £396 per year
- other fixed costs £5 a week
- selling price per pair of sandals £20
- number of pairs of sandals to be produced and sold per year 960
- the business will be open for 48 weeks in the year
- assume 4 weeks in a month
- assume 12 months in a year.

You are Maria's accountant. Maria requires further information before starting the business.

Required:

(a) Calculate the:

(i) number of pairs of sandals that need to be sold in the year to break-even
(8)

(ii) number of pairs of sandals that need to be sold **per week** to break-even
(2)

(iii) forecast profit for the year.
(4)

The first year of trading was good, and sales were higher than expected. For the second year of trading, Maria has decided to look for larger premises in a better location for sales.

The following information applies to the second year of trading:

- number of pairs of sandals to be produced and sold per year 1 500
- labour cost per pair of sandals, £8.75
- selling price per pair of sandals, £22
- target annual profit £8 000
- all other costs, except rent, to stay the same.

(b) Calculate the maximum amount of rent per month that Maria could pay if she is to reach her target annual profit figure of £8 000.
(10)

Maria has informed you that for the second year of trading she is considering making the sandals herself, instead of paying labour to produce the sandals.

(c) Evaluate the proposal by Maria to produce the sandals herself.

(8)

(Total for Question 5 = 32 marks)

Answer space for Question 5 is on pages 25 to 28 of the question paper.

5(a)	
Fixed Costs	£(310 x 12) + 396 + (5 x 4 x 12)√ = £4 356√
Variable Costs	£3.25 + 8.50 = £11.75 √
Contribution	(£20 - £11.75) √ = £8.25 √ o/f
Break even point	= 4 356 √ o/f / 8.25 √ o/f
	= 528 √ o/f
	(8)
5a(ii) Number of sales per week	528 √ o/f / 48 = 11 units √
	(2)
5a(iii) Sales	960 x £20 = £19 200 √
Less Fixed Costs	= (£4 356) √ o/f
Less Variable Costs	(960 x £11.75) = (£11 280) √ o/f
= Profit	= £3 564 √ o/f
OR	
Contribution x Sales	(£8.25 o/f x 960) √ = £7 920 √ o/f
Less fixed Costs	(£4 356) √ o/f
= Profit	£3 564 √ o/f
	(4)

5 (b)	£	
Revenue 1 500 X £22	33 000	√
Less variable costs : materials 1 500 X £3.25	(4 875)	
Labour 1 500 X £8.75	(13 125)	√ both
= Contribution	15 000	√
Less Profit	(8 000)	√
= Maximum for fixed costs	7 000	√
Less fixed costs : Insurance	(396)	
Other	(240)	√ both
= Annual Rent	(6 364)	√
Monthly Rent	6364 / 12	√ √
Monthly rent	503.33	√
		(10)

5(c)

For proposal
Will reduce labour costs √ and increase profits. √
Increased contribution per pair of sandals √ and lower break even point √
Less supervision required √

Against proposal
Does Maria have the required skills to produce the sandals? √ If not, will poor quality products effect the level of sales? √
Possible reduction in consumer confidence in product √ which may lead to decrease in demand √
Will this reduce the effectiveness of Maria serving in the shop, √ maybe persuading customers to buy? √
Will Maria have to hire somebody to run the shop? √
Will Maria be able to produce 1500 pairs of sandals herself in a year? √
Will Maria be tired / stressed etc producing all these sandals? √

Conclusion – 2 marks
Unless Maria has the required skills, she should not make the sandals herself.

(8)

Total for Question 5 = 32 marks

SOURCE MATERIAL FOR USE WITH QUESTION 6

6 You are the Financial Accountant for Panadura Spice Traders plc.

Extracts from the Statements of Financial Position for the last two years are shown below.

	31 December 2015 £	31 December 2016 £
Non-current assets		
Property, plant and equipment	8 542 000	5 869 000
Provision for depreciation	(3 679 000)	(3 137 000)
Property, plant and equipment carrying value	4 863 000	2 732 000
Intangible assets	2 800 000	2 600 000
	7 663 000	5 332 000
Current assets		
Inventories	4 387 000	4 653 000
Trade receivables	321 000	375 000
Other receivables	23 000	17 000
Cash and cash equivalents	143 000	------------
	4 874 000	5 045 000
Total assets	12 537 000	10 377 000
Current liabilities		
Bank overdraft	------------	72 000
Trade payables	2 793 000	3 018 000
Other payables	57 000	51 000
Current tax payable	315 000	217 000
	3 165 000	3 358 000

Additional information

(1) On 3 March 2016 property that cost £2 450 000 with depreciation to date of £645 000 was sold for £1 925 000

(2) On 4 September 2016 plant that cost £387 000 with a carrying value of £193 000 was sold for £167 000

(3) All plant, property and equipment are kept in the Plant, Property and Equipment Account at cost. All sales of non-current assets are recorded in a Disposals of Non-Current Assets Account.

(4) On 5 November 2016 equipment was bought for £164 000

(5) No intangible assets were bought or sold in 2016.

(6) Interest on the bank overdraft was £5 000 for the year.

(7) On 1 July 2011 a 10-year debenture for £5 000 000, at a fixed interest rate of 9%, was issued.

(8) Profit after interest for the year ended 31 December 2016 was £2 038 000

Required:

(a) Prepare, for the year ended 31 December 2016, the:

(i) Property, Plant and Equipment Account
(4)

(ii) Cash Flows from Operating Activities section of the Statement of Cash Flows, in accordance with International Accounting Standard (IAS) 7.
(20)

The Managing Director stated, 'We had to sell the property we owned, to improve cash flow.'

(b) Evaluate whether a company should sell non-current assets to improve cash flow.
(8)

(Total for Question 6 = 32 marks)

Answer space for Question 6 is on pages 29 to 31 of the question paper.

6(a)(i)

Property, plant and equipment Account

Date	Details	£		Date	Details	£	
Jan 1	Bal b/d	8 542	√	March 3	Disposals	2 450	
Nov 5	Bank	164	√	Sept 4	Disposals	387	√ both
				Dec 31	Bal c/d	5 869	√
		8 706				8 706	
Jan 1	Bal b/d	5 869					

(4)

6(a)(ii)

Statement of Cash Flows for year ending 31 December 2016		
Cash Flows from operating activities		
Profit from operations (2 038 √ + 5 √ + 450 √)	2 493 000	√√√
Add Depreciation	297 000	√√√√√
Add amortisation of intangible assets	200 000	√
Less Profit on Sale of non-current Asset	(120 000)	√√
Add Loss on Sale of non-current Asset	26 000	√
Operating cash flow before working capital changes	2 896 000	√ o/f
Less increase in Inventories	(266 000)	
Less increase in Trade receivables	(54 000)	√ both
Add decrease in Other receivables	6 000	√
Add increase in Trade payables	225 000	
Less decrease in Other payables	(6 000)	√ both
Cash generated from operations	2 801 000	√ o/f
Less Interest Paid (5 + 450)	(455 000)	√
Less Tax Paid	(315 000)	√
Net Cash from Operating Activities	2 031 000	√ o/f

(20)

Working for depreciation:

Depreciation Account

Date	Details	£		Date	Details	£	
Mar 3	Disposals	645	√	Jan 1	Balance b/d	3 679	√
Sept 4	Disposals	194	√	Dec31	Statement of Comprehensive Income	297	√
Dec31	Balance c/d	3 137	√				
		3 976				3 976	
				Jan1	Balance b/d	3 137	

6(b)

For statement

The company may be experiencing cash flow problems. √
Company may be able to find premises to rent √ or company may be able to lease back the same building √
Property prices may be falling, √ so now is the time to sell. √
Company may not need property of this size to function/surplus asset. √
Company may be able to buy another property for a lower price. √
No alternative funding is available √
Sale may reduce interest payments on mortgage/loan √

Against statement

It is taking a short term view. √
Property prices may be rising, √ so good business would be to hold onto the asset. √
Years of rental may eventually be greater √ than the price for which the property was sold. √
There will be other costs associated with finding another location √ eg staff time, legal fees √
Alternative funding may be available eg bank loan √
Sale may reduce collateral available √ if requesting to take out a new loan. √

Maximum for arguing for one side - 4 marks

Conclusion

Company may be better not selling off the property to improve cash flow – 2 marks

(8)

Total for Question 6 = 32 marks

SOURCE MATERIAL FOR USE WITH QUESTION 7

7 ZimbaPower Electrical Limited buys and sells electrical goods. The company has many stores throughout the country, and is to open its first store in the city of Naniuke on 1 February 2017.

The following information is available concerning purchases for the Naniuke store:

- In the period February to July, monthly purchases are expected to be 1 200 units each month.
- The average cost of a purchase is £60 per unit.
- The credit terms given by suppliers are:
  - 10% sell only for cash
  - 60% give one month's credit
  - 25% give two months' credit
  - 5% give three months' credit.
- Full advantage is taken of credit terms offered by suppliers.

You are the Cost Accountant for ZimbaPower Electrical Ltd, and have to prepare the budgets in columnar format.

Required:

(a) Prepare for **each** of the months from February to July for the Naniuke store the:

(i) purchases budget, in pounds (£)

(2)

(ii) trade payables budget, showing the amount owed to suppliers at the end of **each** month.

(10)

The following information is available for forecasted sales at the Naniuke store:

- The mark up on all units will be 100%.
- All units are to be sold in the same month as purchase.
- Sales are made on the following terms:
  - 80% are for cash
  - 20% will spread payments equally over a 6-month period, with the first payment due one month after the sale.

Required:

(b) Prepare for **each** of the months from February to July the:

(i) sales budget, in pounds (£)

(2)

(ii) trade receivables budget, showing the amount owed by customers at the end of **each** month.

(6)

The company is considering adding interest on to sales on credit.

(c) State:

(i) **two** advantages of adding interest on to sales on credit
(ii) **two** disadvantages of adding interest on to sales on credit.

(4)

ZimbaPower Electrical Limited has estimated the figures that will be entered into the budgets for the store at Naniuke.

(d) Evaluate the possible accuracy of the estimates ZimbaPower Electrical Limited has entered into the budgets for February to July.

(8)

(Total for Question 7 = 32 marks)

Answer space for Question 7 is on pages 32 to 36 of the question paper.

7(a)(i) Purchases	February		March		April		May		June		July	
	72 000		72 000		72 000	√	72 000		72 000		72 000	√
											(2)	
7(a)(ii) Trade Payables	February		March		April		May		June		July	
One month credit	43 200		43 200		43 200		43 200		43 200		43 200	√
Two months credit	18 000	√	36 000	√	36 000		36 000		36 000		36 000	√
Three months credit	3 600	√	7 200	√	10 800	√	10 800		10 800		10 800	√
Total	64 800		86 400		90 000	√of	90 000		90 000		90 000	√of
											(10)	
7(b)(i) Sales	February		March		April		May		June		July	
	144 000		144 000		144 000	√	144 000		144 000		144 000	√
											(2)	
7(b)(ii) Trade Receivables	February		March		April		May		June		July	
Six months	28 800	√	52 800	√	72 000	√	86 400	√	96 000	√	100 800	√
											(6)	

7(c)(i) Two advantages of adding interest:
- income earned from interest √
- helps cash flow as more customers may pay by cash √
- makes customers pay more quickly √

7(c)(ii) Two disadvantages of adding interest:
- credit customers may buy from other suppliers who do not charge interest√
- administration costs √
- item is now more expensive so sales may reduce √
- may increase bad debts √

(4)

7 (d)

<u>For accuracy</u>

Simba have other stores around the country.√ They can look at the figures of similar sized stores. √
If they have many stores and are opening another store, they are probably a successful company, √ so are probably good at predicting figures. √

Against accuracy

They have not had a store in Naniuke before, so do not know what to expect. √
They may not have accurately factored in local competition √ and the reaction of local competition to a new store. √
They may not have predicted accurately changes in the economic cycle √, having sales the same in each month. √
Simba may not have taken into account customer loyalty to existing stores, √ and it may take some months to build up their own customer loyalty. √
This may have to be done by offering discounts, special offers etc which will alter sales figures. √
Estimates ignore the falling value of money over time √
Sales may be affected by seasonal factors √
There may be changes in technology that result in a different sales level √

Maximum for arguing one side 4 marks

Conclusion – 2 marks
Should relate to points made above

Simba have predicted /not predicted figures accurately.

(8)

Total for Question 7 = 32 marks