

Paper Reference(s)

6002/01

London Examinations GCE
Accounting (Modular Syllabus)
Advanced

Unit 2 – Corporate and
Management Accounting

Wednesday 12 June 2013 – Morning

Source booklet for use with
Questions 1 to 7.

Do not return the insert with the
question paper.

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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1. Hong Kong Cameras plc produces cameras at its factory. The cameras are then delivered to Hong Kong Cameras plc shops, where they are sold to customers.

At 31 March 2013, the following balances were in the books:

	Debit £	Credit £
Bad debts written off	1 850	
Bank	38 762	
Commission on sales	52 750	
Corporation tax provision		90 000
7% Debentures 2018		500 000
Direct materials	320 855	
Directors' salaries	290 000	
Discount allowed	45 997	
Discount received on materials		7 150
Factory buildings (at cost)	3 840 000	
Factory machinery (at cost)	365 000	
Factory power	48 950	
Fuel for lorries	35 460	
Interest on bank balance		2 836
Inventory of finished goods at 1 April 2012	134 800	
Maintenance of machinery	44 780	
Motor lorries (at cost)	172 000	
Office stationery	3 865	
Ordinary shares of £1 each		1 500 000
Promotions and advertising	65 000	
Rent on shop premises	298 000	
Retained earnings		369 629
Revenue (sales)		4 183 693
Running costs of motor lorries	36 880	
Trade payables		21 100
Trade receivables	17 459	
Wages	<u>862 000</u>	
	<u>6 674 408</u>	<u>6 674 408</u>

Adjustments and additional information at 31 March 2013:

- Inventory of finished goods £138 400
- Inventory of office stationery £571
- Interest on bank balance has £242 outstanding
- Directors' salaries include:

Finance director	£95 000
Production director	£95 000
Sales director	£100 000

- Factory power includes £4 000 paid in advance
- Wages include

Accountancy staff	£71 800
Production staff	£339 100
Office staff	£141 200
Shop staff	£197 500
Transport staff	£112 400

- 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
 - factory machinery is to be depreciated over an eight year life
 - motor lorries are to be depreciated over a four year life.

Required:

- (a) Using **only** the appropriate balances and adjustments, prepare the Statement of Comprehensive Income for Hong Kong Cameras plc for the year ended 31 March 2013, using International Accounting Standard (IAS) 1.

You must show all workings **clearly labelled** in arriving at your figures to be entered in the Statement of Comprehensive Income.

(40)

- (b) Evaluate the usefulness of the Auditors' Report to the users of the published accounts of Hong Kong Cameras plc.

(12)

(Total 52 marks)

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

Question Number	Answer	Mark
1(a)	Q1a Mark Scheme	
	Statement of Comprehensive Income for Hong Kong Cameras plc for Y/e 31st March 2013 ✓	
	Revenue	4 183 693 ✓
	Cost of sales	(956 360) ✓ o/f
	Gross profit	3 227 333 ✓ o/f
	Other Income	3 078 ✓ o/f
	Distribution costs	(940 990) ✓ o/f
	Administrative expenses	(359 141) ✓ o/f
	Financial cost	(35 000) ✓ o/f
	Profit on ordinary activities before tax	1 895 280 ✓ o/f
	Corporation tax	(90 000) ✓
	Profit on ordinary activities after tax	1 805 280 ✓o/f✓C
		W1 Cost of Sales
		Direct Materials 320 855 ✓
		Less Discount Received -7 150 ✓
		Factory Depreciation 76 800 ✓
		Machinery Depreciation 45 625 ✓
		Factory Power 44 950 ✓ 10 x ✓
		Machinery maintenance 44 780 ✓
		Production staff 339 100 ✓
		Production Director 9 5000 ✓
		Inventory Adjustment Finished Goods -3 600 ✓✓
		956 360
		W2 Distribution Costs
		Commission on sales 52 750 ✓
	Sales director 100 000 ✓	
	Fuel 35 460 ✓	
	Motor lorries depreciation 43 000 ✓	
	Promotions and advertising 65 000 ✓	
	Rent on shop premises 298 000 ✓ 9 x ✓	
	Running cost of lorries 368 80 ✓	
	Shop staff wages 197 500 ✓	
	Transport staff wages 112 400 ✓	
	940 990	
	W3 Administrative Expenses	
	Bad Debts Written Off 1 850 ✓	
	Finance director 95 000 ✓	
	Discount allowed 45 997 ✓	
	Office stationery 3 294 ✓	
	Accountancy staff wages 71 800 ✓ 6 x ✓	
	Office staff wages 14 1200 ✓	
	359 141	
	W4 Other Income	
	Interest on bank balance 3 078 ✓ 1 x ✓	
	W5 Financial cost	
	Interest on debenture 35 000 ✓✓ 2 x ✓	
	TOTAL 40 marks	
	Note: Discount allowed accepted as a Distribution cost	

(40)

Question Number	Answer	Mark
1(b)	<p>FOR Importance</p> <p>Auditors are independent ✓ scrutineers of the accounts. ✓ who report that the accounts have been prepared “correctly” ✓ in accordance with International Accounting Standards ✓ or rather, give a True and Fair view. ✓ or do not ✓ .</p> <p>Auditors are reporting on how Directors have used the funds ✓ invested by shareholders. ✓. The auditors duty is to the shareholders. ✓</p> <p>Auditors may give tax authorities ✓ more confidence that the tax computation is correct. ✓</p>	

	<p>Professional supervisory bodies ✓ exist to give guidelines to auditors ✓ , eg Audit and Assurances Council. ✓ Auditors should be professionally qualified ✓ eg Chartered Accountants.✓ Report is required by the Companies Act/legislation ✓ If Auditors are unhappy with the accounts ✓ the Auditors Report will be qualified ✓ The report may help users make a decision ✓ eg buy or sell shares in the company ✓</p> <p>AGAINST Importance Auditors may not be very independent, ✓ going along with the wishes of clients, ✓ i.e. conflict of interest ✓ in order to keep their custom/earn fee/ which may include non-audit work. ✓ Auditors could be misled ✓ by the directors ✓ and provide an inaccurate report. ✓ Auditors do not guarantee ✓ that material fraud has not occurred. ✓</p> <p>Maximum of 8 marks for argument on one side</p> <p>CONCLUSION - 2 marks Should relate to points made above. Eg Auditors' Report is important and of value. ✓✓</p>	<p>(12)</p>
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SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Chandpur Sounds Limited produces speakers for home music systems. It has been normal practice by senior management to ask the accountant to value inventory using both the marginal costing method and the absorption costing method.

The following information is available for the year ended 31 March 2013:

Opening inventory	2 100 units
Opening inventory value:	Marginal costing £25 200
	Absorption costing £33 600
Production	84 000 units per year
Semi-Variable costs	£202 800 fixed element per year plus £0.70 per unit of production
Fixed overheads	£12 500 per month
Direct materials	£6.90 per unit
Direct labour	40 minutes work per unit at a wage rate of £6.90 per hour
Selling price	£25 per unit
Closing inventory	2 450 units

Required:

- (a) Prepare for management, in columnar format, a Statement of Comprehensive Income for the year ended 31 March 2013, showing:
- (i) marginal costing inventory valuation
 - (ii) absorption costing inventory valuation

(20)

In March 2013, a possible customer is interested in buying the product, but is only prepared to offer £15 per unit.

Required:

- (b) Advise the management of Chandpur Sounds Limited whether this offer should be accepted.

(8)

The semi-variable costs above are charged by a power company. The power company has informed Chandpur Sounds Limited that, from 1 April 2013, the charges for power will change. They have offered Chandpur Sounds Limited the choice of three options.

The three options are:

Option 1 A fixed rate of £23 000 per month

Option 2 An increase in the fixed element of £202 800 per year by 5%, with the variable charge to remain at £0.70 per unit of production.

Option 3 A monthly charge of £16 200, plus a variable charge of £0.90 per unit of production.

Required:

- (c) (i) Advise the management of Chandpur Sounds Limited which Option they should accept, if output is expected to be 84 000 units for the year starting 1 April 2013. (7)
- (ii) Which Option would be the best option for Chandpur Sounds Limited, if output were greater or less than 84 000 units for the year starting 1 April 2013? (5)
- (d) Evaluate whether Chandpur Sounds Limited should use marginal costing or absorption costing to value inventory. (12)

(Total 52 marks)

Answer space for question 2 is on pages 8 to 13 of the question paper.

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2(b)	<p>Answers could include</p> <p>Marginal costing says the order should be accepted ✓ on the grounds that £15 is greater ✓ than the marginal cost ✓ of £12.20 o/f ✓ ie a positive contribution ✓ of £2.80 o/f ✓ (Maximum of 4 ticks)</p> <p>New customer may result in more orders in the future, ✓ perhaps at a higher price. ✓</p> <p>However in the long term, ✓ selling at £15 would result in a Net Loss / not all costs are covered. ✓ (loss of £1.40 ✓o/f) Absorption costing says do not accept offer ✓</p> <p>Existing customers would be unhappy ✓ to hear of this low price on offer / will ask for lower prices. ✓</p>	(8)

Question Number	Answer	Mark
2(c)(i)	<p>Option (i) - £23 000 x 12 = £276 000 ✓</p> <p>Option (ii) - £202 800 x 1.05 = £212 940 ✓ + (£0.70 x 84 000)</p> <p style="padding-left: 40px;">= £212 940 + £58 800 ✓</p> <p style="padding-left: 40px;">= £271 740 ✓</p> <p>Option (iii) - £16 200 x 12 = £194 400 + (£0.90 x 84 000)</p> <p style="padding-left: 40px;">= £194 400 + £75 600 ✓</p> <p style="padding-left: 40px;">= £270 000 ✓</p> <p>Option (iii) is the best, ✓ if output remains at 84 000 units per year.</p>	(7)

Question Number	Answer	Mark
2(c)(ii)	<p>Development of answers could include :</p> <p>If output increases, other options may be the best. ✓</p> <p>For example, if output rises by 6667, ✓ option (iii) is more expensive than option (i) ✓</p> <p>If output rises by 6086 units, ✓ option (ii) is more expensive than option (i) ✓</p> <p>If output is less than 84 000, option (iii) remains the best. ✓✓</p>	(5)

Question Number	Answer	Mark
2(d)	<p>Answers could include:</p> <p>Maximum of 8 marks for argument of one side.</p> <p>Case for Marginal Costing</p> <p>Could be said to help decision making ✓ in the short term ✓ when deciding whether to accept an offer price ✓ or make or buy ✓ or discontinue a product/profit centre. ✓ or a limiting factor problem ✓</p> <p>Sees costs allocated to a time period, ✓ so it may be argued that profit for that time period is more accurate. ✓ External accounts ✓ are drawn up on the basis of a time period. ✓</p> <p>Follows prudence concept ✓ as closing stock and profit figures are lower.</p>	

	<p>Case for Absorption Costing Sees costs allocated to products. ✓ Could be useful for management ✓ when fixing prices ✓ or reviewing if a product/project has been profitable. ✓ in the long term ✓ Recommended ✓ by SSAP 9. ✓ Gives a realistic figure for profit ✓ Follows matching concept ✓ as revenues for the product are matched against costs. ✓</p> <p>Other Points If figures in the future are similar, choice of stock valuation will not have very much effect on the profit. ✓✓</p> <p>Conclusion Max 2 marks available. Should use absorption costing as per accounting standards.</p>	<p>(12)</p>
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Question Number	Answer	Mark	
3(a)	Statement of Cash Flow for Larnaca plc for y/e 31 March 2013✓	1	
	Cash Flows from operating activities✓		
	Profit from operations (8000✓ + 6400✓)	14400 ✓✓	
	Add Depreciation (66000✓✓✓✓ + 20000✓✓)	86000 ✓✓✓✓✓	
	Add Loss on Sale of Fixed Asset	6000 ✓	
	Operating cash flow before working capital changes✓	106400 ✓	
	Increase in inventories	-23000 ✓	
	Increase in trade receivables	-15000 ✓	19
	Increase in trade payables	51000 ✓	
	Cash generated from operations	119400 ✓ o/f	
	Less Interest Paid: Debenture	-6400 ✓	
	Less Tax Paid	-18000 ✓	
	Net Cash from Operating Activities	95000 ✓ o/f	
	Cash Flow from Investing Activities✓		
	Payments to acquire tangible fixed assets	-60000 ✓	
	Proceeds from sale of tangible fixed assets	36000 ✓	5
	Net Cash Used in Investing Activities✓	-24000 ✓ o/f	
	Cash Flow from Financing Activities✓		
	Issue of Ordinary shares	50000 ✓	
	Repayment of Debenture	-80000 ✓	
	Dividends Paid : Final 2012	-25000 ✓✓	9
	Interim 2013	-22000 ✓✓	
	Net Cash Used in Financing Activities✓	-77000 ✓ o/f	
Net decrease in cash and cash equivalents✓	-6000 ✓o/f✓C	3	

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. The Statements of Financial Position of Larnaca Distributors plc at 31 March 2012 and 31 March 2013 were as follows:

	<u>31 March 2012</u>	<u>31 March 2013</u>
ASSETS	£	£
Non-current assets		
Non-current assets at cost	800 000	720 000
Provision for depreciation	(400 000)	(388 000)
	400 000	332 000
Current assets		
Inventories	323 000	346 000
Trade and Other receivables	197 000	212 000
Cash and cash equivalents	77 000	71 000
	597 000	629 000
Total Assets	<u>997 000</u>	<u>961 000</u>
EQUITY AND LIABILITIES		
Equity		
Share capital – £1 Ordinary shares	500 000	550 000
Retained earnings	180 000	139 000
Total capital and reserves	680 000	689 000
Non-current liabilities		
8% Debenture 2013	80 000	-----
Current liabilities		
Trade and Other payables	219 000	270 000
Tax payable	18 000	2 000
	237 000	272 000
Total Equity and Liabilities	<u>997 000</u>	<u>961 000</u>

Additional information:

1. Motor vans bought for £140 000 were sold for £36 000 on 1 April 2012. The carry over (net book) value of these motor vans was £42 000.
2. Computers were bought for £60 000 on 1 April 2012 and are expected to last for three years, with no residual value.
3. At 15 May 2012 a final dividend of 5 pence per share was paid to shareholders.
4. An issue of 50 000 £1 Ordinary shares at par was made on 1 October 2012. All shares were purchased and have been fully paid.
5. At 30 March 2013, an interim dividend of 4 pence per share was paid to all Ordinary shareholders.
6. The £80 000 8% Debenture was repaid on 31 March 2013.
7. Operating profit before tax for the year ended 31 March 2013 was £8 000

Required:

- (a) Prepare the Statement of Cash Flows for the year ended 31 March 2013 for Larnaca Distributors plc in accordance with International Accounting Standard (IAS) 7 Statements of Cash Flows. (40)
- (b) Evaluate the current liquidity position of Larnaca Distributors plc. (12)

(Total 52 marks)

Answer space for question 3 is on pages 14 to 18 of the question paper.

	<p>Case for Absorption Costing Sees costs allocated to products. ✓ Could be useful for management ✓ when fixing prices ✓ or reviewing if a product/project has been profitable. ✓ in the long term ✓ Recommended ✓ by SSAP 9. ✓ Gives a realistic figure for profit ✓ Follows matching concept ✓ as revenues for the product are matched against costs. ✓</p> <p>Other Points If figures in the future are similar, choice of stock valuation will not have very much effect on the profit. ✓✓</p> <p>Conclusion Max 2 marks available. Should use absorption costing as per accounting standards.</p>	<p>(12)</p>
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Question Number	Answer	Mark	
3(a)	Statement of Cash Flow for Larnaca plc for y/e 31 March 2013✓	1	
	Cash Flows from operating activities✓		
	Profit from operations (8000✓ + 6400✓)	14400 ✓✓	
	Add Depreciation (66000✓✓✓✓ + 20000✓✓)	86000 ✓✓✓✓✓	
	Add Loss on Sale of Fixed Asset	6000 ✓	
	Operating cash flow before working capital changes✓	106400 ✓	
	Increase in inventories	-23000 ✓	
	Increase in trade receivables	-15000 ✓	19
	Increase in trade payables	51000 ✓	
	Cash generated from operations	119400 ✓ o/f	
	Less Interest Paid: Debenture	-6400 ✓	
	Less Tax Paid	-18000 ✓	
	Net Cash from Operating Activities	95000 ✓ o/f	
	Cash Flow from Investing Activities✓		
	Payments to acquire tangible fixed assets	-60000 ✓	
	Proceeds from sale of tangible fixed assets	36000 ✓	5
	Net Cash Used in Investing Activities✓	-24000 ✓ o/f	
	Cash Flow from Financing Activities✓		
	Issue of Ordinary shares	50000 ✓	
	Repayment of Debenture	-80000 ✓	
	Dividends Paid : Final 2012	-25000 ✓✓	9
	Interim 2013	-22000 ✓✓	
	Net Cash Used in Financing Activities✓	-77000 ✓ o/f	
Net decrease in cash and cash equivalents✓	-6000 ✓o/f/✓C	3	

	Cash and cash equivalents at the beginning of the year	77000	✓	
	Cash and cash equivalents at the end of the year	71000	✓	3
	Net decrease in cash and cash equivalents	-6000	✓	
		TOTAL	✓ x 40	40 Marks
	(40)			

Question Number	Answer	Mark
3(b)	<p>Answers could include:</p> <p>Liquidity position good Firm has healthy level of cash and cash equivalents ✓ Current Ratio now stands at 2.31: 1 ✓✓ which is good. ✓ Acid ratio now stands at 1.04 :1 ✓✓ which is ideal ✓ Liquidity has been improved by issue of ordinary shares ✓ Working capital is £629 000 - £272 000 = £357 000 ✓ which is healthy/ means current liabilities can be paid. ✓</p> <p>Liquidity position worsening/problems Net cash outflow of £6 000 ✓ Inventories are a large figure and rising ✓ is there a problem with unsold inventories/ is it perishable? ✓ Trade Receivables rose by 15 000 ✓ Credit control/ chasing up debtors needs to be carried out immediately as figure is very high. ✓ Big increase in Trade Payables to very large sum ✓ Is firm paying on time and obtaining cash discounts etc ✓ Cash and Cash Equivalents of £71 000 are unable to pay ✓ Current Liabilities of £272 000 ✓ Dividend policy needs to be reviewed. ✓ Ordinary shareholders have been paid an interim dividend for 2013 of £22 000 on a profit before tax of £8000 ✓ which is very high. ✓ Debenture has been redeemed which uses liquid funds ✓ but helps future liquidity as no more interest has to be paid. ✓</p> <p>Maximum 8 marks for arguing one side. Conclusion on current liquidity position max 2 marks ie Liquidity position is good ✓✓</p>	(12)

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. You are in practice as an accountant and have a meeting with a client, Sunny Kipwat, who owns a fruit-growing business.

The accounts of Sunny Kipwat show:

1. Rent of land is £1 560 per quarter (3 months)
2. Direct labour is £1.05 per tray of fruit
3. Water bill is £250 a month plus £0.06 per tray of fruit
4. Insurance for the year is £1 080
5. A motor van was purchased at a cost of £13 160. The motor van has a life of 8 years and a residual value of £200. Depreciation is to be charged on a straight-line basis.
6. Delivery costs per tray are £0.27
7. Loan interest and repayment is £270 per month
8. Selling price of a tray of fruit is £4.15
9. Sales are 283 trays per week. All production is sold.

Assume there are four weeks in a month.

Required:

- (a) How many trays of fruit a month must Sunny Kipwat sell, in order to break even? **(12)**
- (b) How much profit will Sunny Kipwat make in one month? **(4)**

Sunny Kipwat stated “I would like to make a profit of £2 000 a month. If all other costs and my selling price remain the same, how much must I pay my workers per tray of fruit, in order to make a profit of £2 000 a month?”

Required:

- (c) Calculate how much Sunny Kipwat would need to pay his workers per tray of fruit, to make a profit of £2 000 per month. (8)
- (d) Evaluate whether it would be advisable to pay direct labour a lower rate per tray, for Sunny Kipwat to achieve a profit of £2 000 per month. (8)

(Total 32 marks)

Answer space for question 4 is on pages 19 to 22 of the question paper.

Question Number	Answer	Mark
4(a)	<p>Fixed Costs</p> <p>Rent £520 per month</p> <p>Water £250 per month ✓ both</p> <p>Depreciation £135 per month ✓✓</p> <p>Insurance £90 per month</p> <p>Loan £270 per month ✓ both</p> <p>Total FC £1 265 per month ✓</p> <p>Variable costs per unit (1.05 + 0.06 + 0.27) ✓ Total £ 1.38 per unit ✓</p> <p>Contribution per unit (£ 4.15 - £ 1.38) ✓ = £2.77 ✓</p> <p>Break Even Point = $\frac{£1\ 265 \text{ o/f } ✓}{£2.77 \text{ o/f } ✓} = 456.67 / 457 \text{ trays o/f } ✓$</p>	(12)

Question Number	Answer	Mark
4(b)	<p>Profit for month Contribution (2.77 x 1132) = £3 135.64 o/f ✓ Less FC = £1 265 ✓ o/f Profit = £1 870.64 ✓ o/f ✓C</p>	(4)

Question Number	Answer	Mark
4(c)	<p>Contribution for month = (£2 000 + £1 265 o/f) ✓ = £3 265 ✓ o/f</p> <p>If 1132 trays produced, contribution for one tray = $\frac{£3\ 265 \text{ o/f } ✓}{1132} = £2.88 ✓ \text{ o/f}$</p> <p>So variable costs for one tray must be (£4.15 - £2.88 o/f) ✓ = £1.27 ✓ o/f</p> <p>So labour costs must be = £1.27 o/f - (£0.06 + 0.27) ✓ = £0.94 ✓ o/f</p>	(8)

Question Number	Answer	Mark
4(d)	<p>Case for lower labour rate. Business has profit target ✓ and has to take action to achieve these targets. ✓ May not possible to decrease other costs, ✓ especially if fixed eg loan repayment, rent etc ✓ May not be possible to increase selling price to increase profit, ✓ as will result in reduced sales ✓</p> <p>Case against lower labour rate. Workers will be demotivated ✓ and workforce morale will be low. ✓ It may not be possible for workers to pick extra fruit, ✓ to maintain overall wage level. ✓ Could try to reduce other costs instead ✓ eg shop around for lower insurance. ✓</p> <p>Maximum of 4 ticks for arguing one side</p> <p>Conclusion - Two ✓✓ It is a good/bad idea to lower labour rate.</p>	(8)

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. Imran Mohammad studies reports and company accounts on the internet, to decide whether to invest in shares in a company. He is considering investing in Bengal Life plc, a life assurance company. Imran has managed to find the following information from the reports and company accounts:

Authorised share capital:

£80 000 000 in Ordinary shares of £2.50 each

£20 000 000 in 4% Redeemable Preference shares of £1 each

Issued share capital:

£60 000 000 in Ordinary shares of £2.50 each

£20 000 000 in 4% Redeemable Preference shares of £1 each

Profit for the year after tax £3 104 000

Total ordinary dividend paid £960 000

Redeemable Preference share dividend was paid in full.

Market price of Ordinary shares £2.00

Imran would like further information to decide whether to invest in this company.

Required:

- (a) Calculate the following ratios, stating the formula used in each case:

- | | |
|--------------------------|------------|
| (i) Dividend per share | (4) |
| (ii) Dividend yield | (4) |
| (iii) Dividend cover | (4) |
| (iv) Earnings per share | (4) |
| (v) Price/Earnings ratio | (4) |

Jahingar, the uncle of Imran, is also interested in investing in shares and has given Imran the following advice.

“Do not buy the shares in Bengal Life plc at a market price of £2.00. You should buy the shares in Oceanic Assurance at £2.25. They have a higher share price, so they must be a better share.”

Required:

(b) Advise Imran as to the value of this statement.

(4)

Jahingar also states “There is only one ratio that is important and worth knowing about, and that is the dividend per share”.

(c) Evaluate this statement on behalf of Imran.

(8)

(Total 32 marks)

Answer space for question 5 is on pages 23 to 26 of the question paper.

Question Number	Answer	Mark
5(a)(i)	$\text{Dividend paid per share} = \frac{\text{Total ordinary dividend } \pounds}{\text{Issued ordinary shares}}$ $= \frac{\pounds 960\,000}{24\,000\,000} = 4 \text{ pence per share}$	(4)

Question Number	Answer	Mark
5(a)(ii)	$\text{Dividend yield} = \frac{\text{Dividend per share}}{\text{Market price of share}} \times 100$ $= \frac{4 \text{ p o/f}}{200 \text{ p}} \times 100 = 2 \% \text{ o/f}$	(4)

Question Number	Answer	Mark
5(a)(iii)	$\text{Dividend cover} = \frac{\text{Net profit after interest and tax and preference dividend}}{\text{Total ordinary dividend}}$ $= \frac{\pounds 2\,304\,000}{\pounds 960\,000} = 2.4 \text{ times}$	(4)

Question Number	Answer	Mark
5(a)(iv)	$\text{Earnings per ordinary share} = \frac{\text{Net profit after interest and tax and preference dividend}}{\text{Issued ordinary shares}}$ $= \frac{\pounds 2\,304\,000}{24\,000\,000} = 9.6 \text{ pence per share}$	(4)

Question Number	Answer	Mark
5(a)(v)	$\text{Price/earnings ratio} = \frac{\text{Market price of share}}{\text{Earnings per share}}$ $= \frac{200 \text{ p}}{9.6 \text{ p o/f}} = 20.83 \text{ times o/f}$	(4)

Question Number	Answer	Mark
5(b)	<p>Answers could include:</p> <p>A higher share price does not mean a “better” share. The nominal or face value of the share needs to be considered. Also the total number of shares in the company.</p> <p>Also important is the movement in the value of the share - is it moving up or down?</p> <p>Very important is the demand and/or future/confidence of the market in the share - if Imran buys now, will he make a profit or a loss on the share. Many factors both inside the company and outside the company can affect the price of a share.</p>	(4)

Question Number	Answer	Mark
5(c)	<p>Answers could include</p> <p>For the statement Investors are usually interested only in the return on their investment, £ which is shown in the dividend per share, which is used to calculate how much the investor receives. £ Investors are more concerned with what they actually receive, £ than how easily the company can afford to pay the dividend, £ as shown by the dividend cover. £</p> <p>Against the statement Investors also have a capital gain when the share price rises, £ which is partly shown in the Price/Earnings ratio. £ Dividend yield shows the return for every pound invested, £ which is more important than dividend per share. £ Earnings per share is an important ratio, as it shows how much profit is being generated for each share invested. £ These profits are then used to pay dividends. £ Other ratios concerning profitability and liquidity etc are important, £ as they show how well the firm is doing. £</p> <p>Maximum of 4 marks for arguing one side</p> <p>Conclusion 2 marks Dividend per share is not the only important ratio worth knowing about. ££</p>	(8)

Question Number	Answer	Mark						
6(a)(i)	<p>Sales Budget - Units</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>10 £</td> <td>32 £</td> <td>48 £</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	10 £	32 £	48 £	(3)
MONTH 1	MONTH 2	MONTH 3						
10 £	32 £	48 £						

Question Number	Answer	Mark						
6(a)(ii)	<p>Production Budget - Units</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>21 £</td> <td>40 £</td> <td>48 £</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	21 £	40 £	48 £	(3)
MONTH 1	MONTH 2	MONTH 3						
21 £	40 £	48 £						

Question Number	Answer	Mark												
6(a)(iii)	<p>Inventory Budget - Units</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>To Inventory each month</td> <td>11 £</td> <td>8 £</td> <td>0 £</td> </tr> <tr> <td>Total in Inventory</td> <td>11 £</td> <td>19 £</td> <td>19 £</td> </tr> </tbody> </table>		MONTH 1	MONTH 2	MONTH 3	To Inventory each month	11 £	8 £	0 £	Total in Inventory	11 £	19 £	19 £	(6)
	MONTH 1	MONTH 2	MONTH 3											
To Inventory each month	11 £	8 £	0 £											
Total in Inventory	11 £	19 £	19 £											

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. Venture Vending Limited is to start a business producing vending machines. The following information is available:
- Sales are budgeted to be 5 vending machines a week, starting Week 3 in Month 1. In Month 2, sales are budgeted to be 8 machines a week. In Month 3, sales are expected to rise to 12 machines a week. Sales are expected to stay at this level in future months. Each vending machine sells for £2 450.
 - Production will start in Week 2 in Month 1. For Month 1, production will be 7 vending machines per week. In Month 2, production will be 10 machines a week. In Month 3, the number of vending machines produced each week will be equal to sales in the following week. Any vending machines produced but not sold each week will be put into inventory in the warehouse.
 - Materials for production will be delivered from Week 1 in Month 1. Each week, the materials delivered are the materials needed for production in the following week. Each vending machine requires £675 of materials.
 - Materials are budgeted to be paid for 2 weeks after delivery. For example, materials delivered in Week 1 in Month 1, will be paid for in Week 3 Month 1.
 - Customers are budgeted to pay 3 weeks after a sale. For example, a vending machine sold in Week 3 Month 1, will be paid for in Week 2 Month 2.
 - Assume 4 weeks in each month.

Required:

- (a) Prepare, for the first three months of trading for Venture Vending Limited, the following budgets:

For each of the three months, the budgets should show total figures for EACH month, NOT weekly figures.

- (i) A sales budget in units of vending machines sold. (3)
- (ii) A production budget in units of vending machines produced. (3)
- (iii) An inventory budget in units of vending machines. The budget is to show the number of units going to inventory each month, and the total number of units in inventory at the end of each month. (6)
- (iv) A purchases budget in units. (3)
- (v) A purchases budget in pounds (£s). (3)

(vi) A trade payables budget in pounds (£s) showing the trade payables figure at the end of each month. (3)

(vii) A trade receivables budget in pounds (£s) showing the trade receivables figure at the end of each month. (3)

At the end of Month 1, actual sales of vending machines have only been half (50%) of budgeted sales.

Required:

(b) Evaluate whether Venture Vending Limited should draw up a new set of budgets to replace the existing budgets for Months 2 and 3. (8)

(Total 32 marks)

Answer space for question 6 is on pages 27 to 29 of the question paper.

Question Number	Answer	Mark
5(c)	<p>Answers could include</p> <p>For the statement Investors are usually interested only in the return on their investment, £ which is shown in the dividend per share, which is used to calculate how much the investor receives. £ Investors are more concerned with what they actually receive, £ than how easily the company can afford to pay the dividend, £ as shown by the dividend cover. £</p> <p>Against the statement Investors also have a capital gain when the share price rises, £ which is partly shown in the Price/Earnings ratio. £ Dividend yield shows the return for every pound invested, £ which is more important than dividend per share. £ Earnings per share is an important ratio, as it shows how much profit is being generated for each share invested. £ These profits are then used to pay dividends. £ Other ratios concerning profitability and liquidity etc are important, £ as they show how well the firm is doing. £</p> <p>Maximum of 4 marks for arguing one side</p> <p>Conclusion 2 marks Dividend per share is not the only important ratio worth knowing about. ££</p>	(8)

Question Number	Answer	Mark						
6(a)(i)	<p>Sales Budget - Units</p> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>10 £</td> <td>32 £</td> <td>48 £</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	10 £	32 £	48 £	(3)
MONTH 1	MONTH 2	MONTH 3						
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Question Number	Answer	Mark						
6(a)(ii)	<p>Production Budget - Units</p> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>21 £</td> <td>40 £</td> <td>48 £</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	21 £	40 £	48 £	(3)
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Question Number	Answer	Mark												
6(a)(iii)	<p>Inventory Budget - Units</p> <table border="1" style="margin-left: 40px;"> <thead> <tr> <th></th> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>To Inventory each month</td> <td>11 £</td> <td>8 £</td> <td>0 £</td> </tr> <tr> <td>Total in Inventory</td> <td>11 £</td> <td>19 £</td> <td>19 £</td> </tr> </tbody> </table>		MONTH 1	MONTH 2	MONTH 3	To Inventory each month	11 £	8 £	0 £	Total in Inventory	11 £	19 £	19 £	(6)
	MONTH 1	MONTH 2	MONTH 3											
To Inventory each month	11 £	8 £	0 £											
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Question Number	Answer	Mark						
6(a)(iv)	Purchases Budget - Units <table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>31 ✓</td> <td>42 ✓</td> <td>48 ✓</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	31 ✓	42 ✓	48 ✓	(3)
MONTH 1	MONTH 2	MONTH 3						
31 ✓	42 ✓	48 ✓						

Question Number	Answer	Mark						
6(a)(v)	Purchases Budget (£) <table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>£20 925 ✓</td> <td>£28 350 ✓</td> <td>£32 400 ✓</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	£20 925 ✓	£28 350 ✓	£32 400 ✓	(3)
MONTH 1	MONTH 2	MONTH 3						
£20 925 ✓	£28 350 ✓	£32 400 ✓						

Question Number	Answer	Mark						
6(a)(vi)	Creditors Budget (£) <table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>£11 475 ✓</td> <td>£14 850 ✓</td> <td>£16 200 ✓</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	£11 475 ✓	£14 850 ✓	£16 200 ✓	(3)
MONTH 1	MONTH 2	MONTH 3						
£11 475 ✓	£14 850 ✓	£16 200 ✓						

Question Number	Answer	Mark						
6(a)(vii)	Debtors Budget <table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th>MONTH 1</th> <th>MONTH 2</th> <th>MONTH 3</th> </tr> </thead> <tbody> <tr> <td>£24 500 ✓</td> <td>£58 800 ✓</td> <td>£88 200 ✓</td> </tr> </tbody> </table>	MONTH 1	MONTH 2	MONTH 3	£24 500 ✓	£58 800 ✓	£88 200 ✓	(3)
MONTH 1	MONTH 2	MONTH 3						
£24 500 ✓	£58 800 ✓	£88 200 ✓						

Question Number	Answer	Mark
6(b)	<p>For Decision to draw up new budgets. Existing budgets are not likely to be accurate ✓ so there is little point in sticking with them. ✓ Good budgeting should be flexible, ✓ so changes should be made to this ongoing process ✓ with regular reviews taking place. ✓ A new business should not draw up a three month budget, ✓ as it is likely to be unsure of the predicted figures, ✓ not having any past figures to rely on ✓ A new budget would help planning / changes ✓ eg reduce the purchases for each month ✓ New budgets may have targets staff can reach ✓ which will increase motivation ✓</p> <p>Against Decision to draw up new budgets Will take time ✓ and money to draw up new budgets. ✓ Variance analysis could be carried out ✓ and actions taken to meet original budgeted figures. ✓ The new budget will only be estimates anyway, so may not be accurate ✓ The only budget directly affected by a lower sales level is trade receivables ✓ so there maybe a need just to draw up trade receivables ✓ This is a new business, and sales may pick up ✓ to meet month 2 an3 figures in the original budget, making it accurate. ✓</p>	(8)

	<p>Maximum of 4 marks for arguing one side only</p> <p>Evaluation 2 marks available for overall conclusion, should relate to points made above.</p>	
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Question Number	Answer	Mark
7(a)	Actual Direct Materials	1265 x 8.14 £ x 0.51 £ = £5 251.52 £
		1 st tick any two
	Actual Direct Labour	11 x 43.5£ x 4 x £4.80£ = £9 187.20 £
		1 st tick any two
		(6)

Question Number	Answer	Mark
7(b)	Material Usage Variance	(8.14 - 8.00) £ x (0.45 £ x 1265 £) = £79.70 Adv£
	Material Price Variance	(0.51 - 0.45) £ x (8.14 £ x 1265 £) = £617.83 Adv £
		or add downwards
	Total Material Cost Variance	£5 251.52 - £4 554 £ = £697.52 Adv £ o/f
		(10)

Question Number	Answer	Mark
7(c)	<p>One mark for reason given, up to three marks maximum for actions taken.</p> <p>Material Usage variance Could be caused by poor quality materials resulting in a lot of wastage. £ Action to solve the problem could be to change supplier £ or insist on a certain level of quality. £ Perhaps insert penalty clauses £ into supplier's contracts for quality. £ Or wastage caused by poor quality labour. £ So train labour better, £ or hire better quality labour, £ or raise wage rates to attract better quality labour £ or improve quality control £</p> <p>Material Price variance Could be caused by suppliers charging a high price. £ Action could be Purchasing department must negotiate a lower price. £ Or change to supplier with lower price. £ or buy lower quality materials £ Or achieve discount by bulk buying £ or prompt payment. £</p>	(8)

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. Vandeloos Fencing Limited produces wooden fence panels. Vandeloos Fencing Limited uses a standard costing system and management by exception.

The budget and some actual figures for production for April 2013 were:

	Budget	Actual
Production (units)	1 265	1 265
Direct Materials	£4 554	?
Direct Labour	£8 870	?

- Each fence panel was budgeted to use 8 square metres of material in production but the actual usage was 8.14 square metres
- The budgeted price of material was £0.45 per square metre, but the actual price paid was £0.51 per square metre
- 11 workers were employed and each worker produced the budgeted figure of 115 fence panels per month
- To produce the output, each worker was budgeted to work 42 hours per week for each of the 4 weeks in the month. Actual hours worked were 43.5 hours for each of the 4 weeks
- The budgeted labour wage rate was £4.80 per hour, and this was achieved.

Required:

- (a) Calculate for the month of April 2013, total expenditure on:

- (i) direct material
- (ii) direct labour.

(6)

- (b) Calculate for the month of April 2013 the:

- (i) material usage variance
- (ii) material price variance
- (iii) total material cost variance.

(10)

- (c) Suggest **one** reason for each of the following variances and explain the actions Vandeloos Fencing Limited could take on the:

- (i) material usage variance
- (ii) material price variance.

(8)

Vandeloos Fencing Limited applied management by exception to the figures for April 2013. The cost accountant decided to ignore the labour variance, but to investigate the material variance.

- (d) Evaluate the decision of the cost accountant to ignore the labour variance, but to investigate the material variance.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 30 to 33 of the question paper.

	<p>Maximum of 4 marks for arguing one side only</p> <p>Evaluation 2 marks available for overall conclusion, should relate to points made above.</p>	
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Question Number	Answer	Mark			
7(a)	Actual Direct Materials	$1265 \times 8.14 \text{ £} \times 0.51 \text{ £}$	=	$£5\,251.52 \text{ £}$	(6)
		1 st tick any two			
	Actual Direct Labour	$11 \times 43.5 \text{ £} \times 4 \times £4.80 \text{ £}$	=	$£9\,187.20 \text{ £}$	
		1 st tick any two			

Question Number	Answer	Mark			
7(b)	Material Usage Variance				(10)
		$(8.14 - 8.00) \text{ £} \times$	$(0.45 \text{ £} \times 1265 \text{ £})$	= $£79.70 \text{ Adv £}$	
	Material Price Variance				
		$(0.51 - 0.45) \text{ £} \times$	$(8.14 \text{ £} \times 1265 \text{ £})$	= $£617.83 \text{ Adv £}$	
				or add downwards	
	Total Material Cost Variance	$£5\,251.52$	$- £4\,554 \text{ £}$	= $£697.52 \text{ Adv £ o/f}$	

Question Number	Answer	Mark
7(c)	<p>One mark for reason given, up to three marks maximum for actions taken.</p> <p>Material Usage variance Could be caused by poor quality materials resulting in a lot of wastage. ✓ Action to solve the problem could be to change supplier ✓ or insist on a certain level of quality. ✓ Perhaps insert penalty clauses ✓ into supplier's contracts for quality. ✓ Or wastage caused by poor quality labour. ✓ So train labour better, ✓ or hire better quality labour, ✓ or raise wage rates to attract better quality labour ✓ or improve quality control ✓</p> <p>Material Price variance Could be caused by suppliers charging a high price. ✓ Action could be Purchasing department must negotiate a lower price. ✓ Or change to supplier with lower price. ✓ or buy lower quality materials ✓ Or achieve discount by bulk buying ✓ or prompt payment. ✓</p>	(8)

Question Number	Answer	Mark
7(d)	<p>For the decision Material variance is larger / labour variance is smaller ✓ Labour variance is £317.20 adverse, ✓ which is £380.32 less than the adverse material variance ✓ of £697. Maybe the policy is to investigate variances over a particular limit ✓ eg £500. ✓ The labour variance is only 3.56%, ✓ whereas the materials variance is 15.3%✓ which is much bigger. ✓ Management by exception tries to make the management time cost effective, ✓ so no time is wasted investigating small variances. ✓</p> <p>Against the decision It is possible that all costs, including labour could be reduced ✓ so the adverse variance should be investigated. ✓ If you ignore an adverse variance below a certain limit, ✓ the cost could “creep up” each year without any action being taken. ✓ It is possible that any reduction in costs after investigation is cost effective✓ ie could be greater than management time spent investigating. ✓</p> <p>Maximum of 4 marks for argument of one side. Conclusion Should relate to above points eg decision was correct/incorrect ✓✓</p>	(8)