Paper Reference(s)
6002/01

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Level

Unit 2: Corporate and Management Accounting

Thursday 24 January 2013 – Afternoon

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. Channel Oil plc drills for oil. Channel Oil plc had the following balances in the books at 31 December 2012, subject to some final adjustments.

	Debit £	**Credit** £
Buildings	974 000	
Bank	114 000	
Bank loan		500 000
Cash in hand	17 000	
Computer equipment	495 000	
8.5% Debenture (2017)		1 200 000
Debenture interest payable		51 000
Fittings	187 000	
Foreign exchange reserve		600 000
Furniture	64 000	
General reserve		75 000
Interest on bank loan payable		3 750
Investment property	750 000	
Non-oil inventories	116 000	
Land	3 150 000	
Patents purchased	45 000	
Machinery	685 000	
Oil drilling licence purchased	2 000 000	
Oil drilling plant	4 550 000	
Oil inventories	2 320 000	
Oil refining plant	1 930 000	
Ordinary £1 share capital		13 000 000
Other payables		16 500
Other receivables	7 000	
Retained earnings	929 250	
Share premium account		2 500 000
Taxation		460 000
Trade payables		24 000
Trade receivables	97 000	

Notes and final adjustments:

- The bank loan is due to be repaid in March 2015
- Buildings are to be revalued upwards by 5%
- Investment property is to be revalued upwards by 4%
- Oil inventories are to be revalued downwards by 7% to reflect a falling oil price
- Taxation due includes £198 000 to be paid within 30 days. The remainder is to be paid on 31 March 2014.

Required:

(a) Prepare the Statement of Financial Position for Channel Oil plc at 31 December 2012 in accordance with International Accounting Standard 1 (Revised).

(40)

At a board meeting at the end of the year, the Marketing Director stated "I am concerned about the liquidity position of the company".

Required:

(b) Evaluate the statement of the Marketing Director, concerning the liquidity position of Channel Oil plc, at 31 December 2012.

(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)	**Statement of Financial Position of Channel Oil Plc as at 31 December 2012** √	

ASSETS			
Non-current assets √			
Property, Plant & Equipment √			
Land	3 150 000		
Buildings	1 022 700	√	
Oil Drilling Plant	4 550 000		
Oil Refining Plant	1 930 000		
Fittings	187 000	√ Any 4	
Machinery	685 000		
Furniture	64 000		
Computer Equipment	<u>495 000</u>	√ Next 3	
		12 083 700	
Investment property √			
Investment property	<u>780 000</u>	√	
		780 000	
Intangible Assets √			
Oil drilling licence	2 000 000		
Patents	<u>45 000</u>	√ Both	
		2 045 000	
			14 908 700 √o/f
Current Assets			
Inventories √			
Oil inventories	2 157 600	√	
Non-oil inventories	<u>116 000</u>	√	
		2 273 600	
Trade and Other Receivables √			
Trade receivables	97 000		
Other receivables	<u>7 000</u>	√ Both	
		104000	
Cash and Cash Equivalents √			
Bank	114 000		
Cash	<u>17 000</u>	√ Both	
		131 000	
			<u>2 508 600</u>
Total Assets √			<u>**17 417300**</u> √o/f
EQUITY AND LIABILITIES √			
Equity			
Share Capital			
Ordinary shares of £1		13000000	√
Other Reserves			
Share Premium	2 500 000		
Revaluation Reserve √ (48700)√ +(30000) √	78 700	√	
General Reserve	75 000		
Foreign Exchange reserve	<u>600 000</u>	√ All 3	
		3 253 700	
Retained Earnings (-929 250) √ + (- 162 400) √		-1 091650	√√
			15 162 050√ o/f
Non-Current Liabilities √			
Long Term Borrowings			
Debenture 8.5% 2017	1 200 000		
Bank loan	500 000	√ Both	
Taxation	<u>262 000</u>	√	
			1 962 000

Question Number	Answer	Mark
	Current Liabilities Trade and other Payables √ Trade Payables 24 000 Other payables 16 500 Debenture Interest 51 000 Loan Interest 3 750 √ All 4 95 250 Current Tax Payable Income Tax Payable 198 000 √ 293 250 **17 417 300** √C√ o/f **Total Equity and Liabilities**	**(40)**

Question Number	Answer	Mark
1(b)	**FOR** statement Current ratio is 2 508 600 : 293 250 √ which is 8.56 : 1 √ O/F This is way above / too high √ ideal ratio of 1.5/2 : 1. √ Too much working capital √ is tied up in stocks of oil √ Acid ratio is (2 508 600 – 2 273 600) : 293 250 √ which is 0.80 : 1 √ O/F This is below/ too low √ the ideal ratio of 1:1 √ A tax bill of £198 000 must be paid in 30 days √ but there is only £131 000 Cash and cash equivalents √ **AGAINST** statement A current ratio of above 2:1 is better than below 2:1. √ If the business can sell stocks quickly, then liquidity problem can be avoided. √ The nature of the industry √ may mean that it is normal for large stocks of oil to be carried. √ Working capital is £2 215 350 √ which is a healthy figure. √ Bank balance is positive at £114 000 √ which can be used to pay debenture and loan interest √ and settle trade and other payables √ Conclusion (two √'s) Channel Oil plc has a liquidity problem √√ Maximum of 8 √'s for arguing one side.	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Khulnar Carpets Limited produces carpets. All carpets are produced to order, with no stocks held.

For the month of December 2012, the following information is available.

Budget:
- Each carpet is to use 16 sq m of material in production
- Material is to be purchased from suppliers at a rate of £7.50 per sq m
- Workers are to be paid £8.60 per hour, and are to produce 2 carpets per day
- 12 workers are to work 8 hours per day, five days per week, for four weeks.

Actual:
- 7 920 sq m of material were used for production at a total cost of £58 608
- Each carpet took 4.25 hours to produce
- Workers were paid £8.50 per hour.

The budgeted sales target of 480 carpets at £299 per carpet was achieved.

Required:

(a) Calculate the:

(i) budgeted cost of producing **one** carpet

(4)

(ii) actual cost of producing **one** carpet.

(4)

(b) Calculate, stating the formula used in each case, for the month ended 31 December 2012 the:

(i) labour efficiency, labour rate, and total labour variance for **one** carpet

(12)

(ii) materials usage, materials price, and total materials variance for **one** carpet.

(14)

Fixed costs for the month totalled £12 300.

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

(6)

The directors of Khulnar Carpets Limited expect higher costs to apply in January 2013, but have decided not to charge these extra costs to customers, i.e. they will **not** increase the price of each carpet sold.

Required:

(d) Evaluate the decision not to charge the extra production costs to the customer.

(12)

(Total 52 marks)

Answer space for question 2 is on pages 8 to 12 of the question paper.

Question Number	Answer	Mark
2(a)(i)	Budgeted cost of one carpet : Materials = (16 x £7.50) √ = £120 Labour = $\left(\frac{8}{2}\right.$ x £8.60) √ = £34.40 √ (both) £154.40 √ O/F	**(4)**

Question Number	Answer	Mark
2(a)(ii)	Actual cost of one carpet : Materials = $\frac{£58\ 608}{480}$ √ = £122.10 Labour = (4.25 x £8.50) √ = £36.125 √ (both) £158.225 √ O/F	**(4)**

Question Number	Answer	Mark
2(b)(i)	Labour Efficiency Variance = (Actual Hours - Standard Hours) x Standard Rate √ = (4.25 - 4) √ x £8.60 √ = £2.15 Adverse √ Labour Rate Variance = (Actual Rate - Standard Rate) x Actual Hours √ = (£8.50 - £8.60) √ x 4.25 √ = £0.425 Favourable √ Total Labour Variance = (Actual Hours x Actual Rate) - (Standard Hours x Standard Rate) √ = (4.25 x £8.50) √ - (4 x £8.60) √ = £36.125 - £34.40 = £1.725 Adverse √	**(12)**

Question Number	Answer	Mark
2(b)(ii)	Materials Price Variance = (Actual Price - Standard Price) x Actual Usage √ = ($\frac{58\ 608}{7\ 920}$ √ - £7.50 √) x $\frac{7\ 920}{480}$ √ √ = £1.65 Favourable √ Material Usage Variance = (Actual Usage - Standard Usage) x Standard Price √ = ($\frac{7\ 920}{480}$ - 16) √ x £7.50 √ = £3.75 Adverse √ Material Cost Variance = (Actual Usage x Actual Price) - (Standard Usage x Standard Price) √ = (16.5 x 7.40) √ - (16 x 7.50) √ = £122.10 - £120 = £2.10 Adverse √	**(14)**

Question Number	Answer	Mark
2(c)	Sales = £299 x 480 = £143 520 √ Variable costs = (£158.225 o/f x 480) = (£75 948) √√ Fixed costs = <u>(£12 300)</u> √ £55 272 √C √o/f	**(6)**

Question Number	Answer	Mark
2(d)	Answers may include : **<u>AGAINST</u>** Passing on the increase in production cost Could absorb rising costs √ by increasing efficiency. √ Customer could be unhappy and not buy √ and go to a rival supplier. √ New price could make firm's price higher than rivals. √ Present price of £299 is psychological √ and an increase will take them through the £300 barrier. √ **<u>FOR</u>** Passing on the increase in production cost Need to maintain profit margin, √ this (or mark up) could be fixed √ otherwise business makes losses / goes bankrupt √ Cannot keep same selling price for ever √ will have to increase price some day √ Customers may be quite willing to pay the higher price√ if they still think they get good value √ New price may still be below that of rival firms.√ **<u>CONCLUSION</u>** (√√) Should relate to above eg passing on increased costs is wrong/right √√ Maximum of 8 √ if only one side of argument.	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. Med Isle Travel plc sells holidays. The Statement of Changes in Equity of Med Isle Travel plc for the year ended 31 December 2012 is nearing completion and is shown below.

	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Redemption Reserve £m	Non-current Asset Replacement Reserve £m	Total Equity £m
Balance at 1 January 2012	800	200	11	75	40	50	1176
Issue of Share Capital (September)	100	150	--	--	--	--	250
Dividends	--	--	(69)	--	--	--	(69)
Comprehensive Income for the Year	--	--	37	--	--	--	37
Transfer	--	--	75	(75)	--	--	--
Transfer	--	--	(50)	--	--	50	--
Balance at 31 December 2012							

You are the accountant for Med Isle Travel plc.

Required:

(a) Complete the row in the Answer Booklet to show the figures for the Balance at 31 December 2012.

(6)

The published accounts were presented to the shareholders' meeting on 6 January 2013. You are required to answer the following points raised by shareholders.

(b) (i) "Could you explain **one** example for which the funds in the Non-current asset replacement reserve may be used?"

(2)

(ii) "Please explain the transfer of £75 million shown on line 6."

(2)

(iii) A new shareholder states "I know the Statement of Changes in Equity shows dividends paid only in the year. I did not receive an interim dividend of 3 pence per share in June, as I purchased my shares in the September issue. How much was the final dividend per share paid to ALL shareholders in December 2012?"

(6)

(iv) "How much did the shareholders pay for each share issued before 1 January 2012?"

(4)

"How much did the shareholders pay for each share issued in September 2012?"

(4)

"Can you explain the difference between the amount paid by shareholders to buy each share before 1 January 2012, and the amount to buy each share in September 2012?"

(4)

(v) "I am unhappy about the low level of dividend paid. I can see a large figure in the Total Equity column – could we use that to pay dividends?"

(12)

Another shareholder stated at the meeting. "I think that the company should have issued bonus shares in September instead of a rights issue. This would have been better for Med Isle Travel plc."

(c) Evaluate this statement on behalf of Med Isle Travel plc.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 13 to 17 of the question paper.

Question Number	Answer	Mark
3(a)	(see table below)	**(6)**

Figures are in £ millions	Ordinary Share £1 Capital	Share Premium	Retained Earnings	General Reserve	Capital Redemption Reserve	Non-current Asset Replacement Reserve	Total Equity
Balance at December 31st 2012	900 √	350 √	4 √	0 √	40	100 √	1394 √

Question Number	Answer	Mark
3(b)(i)	To replace worn out airplanes. √ which have a finite life √ OR To upgrade computer system √ to ensure compatibility etc √	**(2)**

Question Number	Answer	Mark
3(b)(ii)	An amount was transferred from General Reserve √ to Retained earnings √	**(2)**

Question Number	Answer	Mark
3(b)(iii)	Interim dividend is 800 x 3 pence = 24 √ so, Final dividend must be (69 – 24) √ = 45 √ Per share $\frac{45 \surd}{900 \surd}$ = £0.05 = 5 pence per share √	**(6)**

Question Number	Answer	Mark
3(b)(iv)	<u>Original issue</u> Premium was $\frac{200 \surd}{800 \surd}$ = £0.25 √ so issue price was £0.25 + £1 = £1.25 √ <u>September issue</u> Premium was $\frac{150 \surd}{100 \surd}$ = £1.50 √ so issue price was £1.50 + £1 = £2.50 √ The share issue price was higher in September √ because the market price of the shares was higher then, compared to when the original shares were issued. √√ The share premium reflects the market price. √	**(12)**

Question Number	Answer	Mark
3(b)(v)	Share Capital, Share Premium, and CRR √ are capital reserves √ and cannot be used to pay dividends. √ Total of 1290 cannot be used for dividends. √ Retained earnings, General, and Asset Replacement √ are revenue reserves √ and can be used to pay dividends. √ Total of 104 can be used for dividends. √ However, Retained earnings has very little left, √ and General reserve has nothing. √ It is only the fact that the General reserve has been transferred back, √ that has enabled the present dividend to be paid. √ Asset Replacement could be transferred back to Retained earnings and used for dividends. √ However, as more has been transferred into Asset Replacement, √ it is likely an asset needs replacing soon. √	**(12)**

Question Number	Answer	Mark
3(c)	For statement Company will not have pay cash dividends, √ which is beneficial if a liquidity problem √ Bonus shares makes the Statement of Financial Position look like that of a larger company √ which may help to raise finance etc √ Original shareholders would have been kept happy √ and therefore quiet √ as they would have received free shares√ and these shares are eligible for dividends. √ Quicker/cheaper to issue bonus shares √ Against statement Bonus shares bring in no cash for the company √√ but a rights issue does bring in cash √ which is used to run the business/ pay bills √ or expand the business √ or strengthen the company Statement of Financial Position √ Issue of bonus shares sees share price fall √ more than the possible fall if a rights issue √ Bonus shares will result in more shares eligible for dividends√ so dividend per share likely to fall. √ Maximum of 8 √ for arguing one side. Conclusion Bonus issue would <u>not</u> be better for company √√	**(12)**

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. Kim Seng plans to go into business opening a factory on 1 February 2013, to produce cartons of soft drink. These will be sold and delivered to retail customers.

Kim Seng has £15 000 of his own money to put into the business. He also has a loan of £15 000 from his mother. The loan is to be repaid at a later date, not yet agreed.

Additional information

1. In the first week of February, Kim Seng plans to pay for the following:
   - machinery £12 400
   - a delivery vehicle £9 500
   - three months rent on the factory at £1 199 per month.

2. Production will start in Week 2 of February. The factory can produce 1 400 cartons per day.

3. Kim Seng will purchase raw materials for the drinks, at the start of each week, at a cost of £0.04 per carton. All material purchases will be paid for in cash on the day of purchase.

4. The water charge for the factory will be £640 per month, paid on the last day of every month.

5. Cartons will be delivered to retail customers on the day of production. Delivery costs are expected to be £280 per week, payable at the end of each week.

6. All output is sold on the day of production. Retail customers will pay Kim Seng £0.22 per carton. All sales will be on credit. 70% of retail customers will pay one month after the sale. The other 30% will pay two months after the sale.

7. Kim Seng will take drawings of £400 per week, starting from 1 February 2013.

8. Assume that the factory will operate **five** days per week and **four** weeks per month.

Required :

(a) Prepare a monthly Cash Budget for each of the three months February to April 2013.
(24)

(b) Evaluate the level of drawings that Kim Seng is taking out of the business each month.
(8)

(Total 32 marks)

Answer space for question 4 is on pages 18 to 20 of the question paper.

Qst No	Answer	Mark
4(a)	**Cash Budget for 3 months February to April**	

	February		March		April	
INCOME						
Capital	15 000					
Loan	15 000	√ both				
Sales	0		3234	√√	5698	√√√
Total	30 000		3234		5698	
EXPENDITURE						
Machinery	12400					
Delivery Truck	9500	√ both				
Rent	3597	√				
Materials	840	√√	1120		1120	√ both
Water	640		640		640	√ all
Drawings	1600		1600		1600	√ all
Delivery Costs	840	√	1120		1120	√ both
Total Expenditure	29417	√ o/f	4480	√ o/f	4480	√ o/f
Monthly Balance	583	√ o/f	-1246	√ o/f	1218	√ o/f
Opening Balance	0		583		-663	
Closing Balance	583	√ o/f	-663	√ o/f	555	√ o/f

Workings
Sales
March = (3 weeks x 5 days x 1400 x 0.22p x 0.70%) = £3 234 (or √√)
Any 3 = first √

April = (3 weeks x 5 days x 1400 x 0.22p x 0.30%) = £1 386 √
(4 weeks x 5 days x 1400 x 0.22p x 0.70% = £4 312 √
£5 698 √ o/f

Materials
February = (3 weeks x 5 days x 1400 x 0.04p) = £840 (or √√)
(Any three items = first √)

(24)

Question Number	Answer	Mark
4(b)	O/F rule applies **FOR** correct drawings April balance is £1 218 but needs to have monthly rent of £1199 deducted, √ leaving a "balance" of £19, √ so Kim cannot draw out any more. √ May will be the first month of "normal" sales revenue √ of £6 160 √ which leaves a "balance" of £481. √ This will be needed for irregular payments eg truck service, √ as a precaution, √ and to pay back the loan eventually. √ **AGAINST** correct drawings £481 per month is not enough to meet irregular payments/bills√ as a precaution, √ and pay back the loan. √ The drawings should be smaller. √ With these drawings, March has a negative balance. √ Maximum for arguing only one side of the argument 4 marks **CONCLUSION** Should relate to points made above ie Drawings are at correct/incorrect level. √√	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. Metro Clean plc is considering bidding for a contract to dispose of household waste in the city of Valettori. The contract will last for five years, and the city authorities will pay the company to dispose of household waste.

The following information is available.

1. The initial cost of the contract to Metro Clean plc will be £1 900 000. This will include six specialist lorries costing £145 000 each. These lorries will last for five years when they will be sold for £5 000 each.

2. Running expenses, including depreciation of the lorries, for the first three years are forecast to be £850 000 per year. In year four running expenses, including depreciation, are forecast to rise by £50 000. In year five, running expenses are expected to stay at the same level as in year four.

3. The City of Valettori authorities will pay Metro Clean plc £1 200 000 for the first year. The payment for year two will rise by 5%. The payment for year three will be the same as year two. The payment for year four will increase by a further 5%. The payment for year five will be the same as year four.

4. It is Metro Clean plc policy to have a payback period of three years on investment projects.

5. It is Metro Clean plc policy only to invest in projects achieving an average rate of return of at least 10% per year.

Required:

(a) Calculate for the project the:

(i) payback period, showing your answer in years and months

(14)

(ii) average rate of return (accounting rate of return).

(10)

(b) Evaluate the project for Metro Clean plc, using the calculations made and considering any other relevant factors.

(8)

(Total 32 marks)

Answer space for question 5 is on pages 21 to 24 of the question paper.

Question Number	Answer	Mark
5(a)(i)	**Payback Period**	

Year	Cash Inflow		Cash Outflow		Net Cash Flow		Cumulative
0			-1,900,000	√	-1,900,000		
1	1,200,000		682,000	√√	518,000	√O/F	-1,382,000
2	1,260,000	√	682,000		578,000	√ O/F	-804,000
3	1,260,000		682,000		578,000		-226,000
4	1,323,000	√	732,000	√√	591,000	√ O/F	365,000
5	1,353,000		732,000		621,000		986,000

Pay back is after 3 and $\frac{226}{591}$ x 12 years = 3 years 4.59 months
√√ O/F √√ O/F

(14)

Question Number	Answer	Mark
5(a)(ii)	**Average Rate of Return**	

Total Surplus of Project = £ 6 396 000 √ o/f - £ 5 410 000 √ o/f = £ 986 000 √ o/f

Average Annual return = $\frac{\text{£ 986 000}}{\text{5 years}}$ o/f √ (5 years √) = £197 200 per year o/f √

Accounting rate of return = $\frac{\text{£ 197 200}}{\text{£ 1 900 000}}$ o/f √ (£ 1 900 000 √) x 100 = 10.38% √o/f √C

Other formulae are acceptable

(10)

Question Number	Answer	Mark
5(b)	**Evaluation – own figure rule applies.** Answers may include :	

Against Investment
Payback method says do not invest √ as project not within 3 year payback period √
May be better investment projects available? √

For Investment
ARR states invest √ as meets % return figure of 10% √
Project is profitable overall √ having total cash inflow £986 000 o/f √
It is possible to dispute 3 year payback period √, perhaps longer is better. √
What happens after 5 years? – renewal of contract?√ Any other/further business? √
Customer is in the public sector √ so little chance of bad debts. √

Other Relevant Points :
Accuracy of predictions? √
Objectives/strategy of company? √
Both methods ignore time value of money √ unlike NPV √
Could use other methods of appraisal √

Total of 4 marks for arguing one side only.

Conclusion : √√
Must relate to points made above

(8)

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. Shajah Music Limited owns two stores in the centre of Ashman. These are at the Higher End and the Lower End of the centre. The two stores are facing competition from supermarkets and the internet. Over the last few years, the financial performance of both stores has declined. The directors of Shajah Music Limited have decided to close one store.

Information and figures for the two stores for the year ended 31 December 2012 are shown below:

Higher End

- The store building is owned by Shajah Music Limited.
- The store has two staff members who are each paid a salary of £6 350 per year.
- Other fixed costs total £12 500 per year.
- Variable costs are purchasing CDs for £3 each.
- The store sells the CDs for a full price of £11 each.
- Last year the store sold 3 342 CDs.

Lower End

- This store is rented at a cost of £900 per month.
- The store employs three staff: a manager whose salary is £9 500 per year, a full time staff member whose salary is £6 500 per year, and a part time staff member whose salary is £2 500 per year.
- Other fixed costs total £11 800 per year.
- Variable costs are purchasing CDs for £3 each.
- The store heavily discounts the CDs and sells each CD for £6.
- Last year the store sold 14 784 CDs.

When making a decision as to which store will close, the directors consider the break even point, the margin of safety, and the profit or loss of each store.

Required:

Two fixed costs of the stores are given as rent and salaries.

(a) (i) State **four** other examples of fixed costs faced by the stores.

(2)

(ii) Define the term **semi-variable costs** and give **two** examples.

(4)

(b) Calculate for **each** store, for the year ended 31 December 2012, the:

(i) break-even point figure in the number of CDs sold

(8)

(ii) margin of safety in the number of CDs sold

(4)

(iii) profit or loss.

(6)

(c) Evaluate the information and figures calculated in (b) to decide which store should stay open, and which store should close.

(8)

(Total 32 marks)

Answer space for question 6 is on pages 25 to 28 of the question paper.

Question Number	Answer	Mark
6(a)(i)	Answers may include : Depreciation, business rates, √ loan interest, insurance, √	**(2)**

Question Number	Answer	Mark
6(a)(ii)	Semi variable costs are costs that may have a fixed element √ plus a variable element. √ OR For example there may be a standing charge √ and an element that varies with usage. √ OR A semi variable costs increases as output increases, √ but not in direct proportion to output. √ Possible examples gas, √ electricity, √ telephone √ water supply. √	**(4)**

Question Number	Answer	Mark
6(b)		

(i)	Higher		Lower		Mark
Fixed Costs	£25,200	√	£41,100	√	
Contribution	£8	√	£3	√	
Break even point	3150	√ o/f √ C	13700	√ o/f √ C	**(8)**
(ii) and (iii)					
Sales units	3342		14784		
Break even point	3150	√ o/f (both)	13700	√ o/f (both)	
Margin of safety	192	√ o/f	1084	√ o/f	**(4)**
Contribution	£8	√ o/f	£3	√ o/f	
Profit	£1,536	√ o/f √ C	£3,252	√ o/f √ C	**(6)**

Question Number	Answer	Mark
6(c)	Own figure rule applies **Case for Higher End staying open** Lower break even point √ by 10 550 units. √ Lower level of fixed costs √ by £15 900 √ if stays open, no need to pay rent on other store. √ Higher contribution per unit √ by £5 per unit √ **Case for Lower End staying open** Higher profit √ by £1 716 √ Greater margin of safety √ by 892 units. √ Higher level of sales √ by 11 442 units √ If other store closes, building could be sold, √ and maybe this stores building purchased. √ Maximum of 4 √ for arguing one side only. Conclusion √√ Should **CLOSE Higher end** store as lower profit made . √√	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. The directors of AED Engineering plc have agreed to purchase Machine Tools Limited, on 8 January 2013. The directors of AED Engineering plc agreed to take over all of the assets except the bank balance, and to settle all of the liabilities.

The balance sheet of Machine Tools Limited at 31 December 2012 showed:
All assets £22 200 000
All liabilities £14 800 000

The following revaluations took place in the books of Machine Tools Limited on 6 January 2013, before the takeover:

- Inventory was written down by £620 000 to its net realisable value
- Land was increased by 5% to a current market value of £4 410 000
- Motor vehicles with a carry over (net book value) of £310 000 were written down to a value of £185 000
- Equipment with a carry over (net book value) of £175 000 was written down by £125 000
- An exact figure for Current Taxation Payable was agreed at £40 500, down from £49 800.

Additional information concerning Machine Tools Limited:

- Bank balance £123 000
- Equity share capital £6 000 000, consisting of Ordinary shares of £1.20 each
- For every £1.20 share held in Machine Tools Limited, each shareholder should receive:
  - one £1 share in AED Engineering plc at a premium of £0.58 (the trading price is £1.58 a share)
  - £0.27 cash.

Required :

(a) Show the Journal entries to close the following accounts in the books of Machine Tools Limited, **before** any revaluations have taken place. Narratives are **not** required.
(i) Land
(ii) Current Taxation payable
(iii) Ordinary Shares of £1.20.

(8)

(b) Calculate the purchase price paid by AED Engineering plc for Machine Tools Limited.

(6)

(c) Calculate the goodwill paid by AED Engineering plc in the purchase of Machine Tools Limited.

(10)

(d) Evaluate the appropriateness of revaluing assets and liabilities before a takeover.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 29 to 32 of the question paper.

Question Number	Answer	Mark
7(a)(i) –(iii)		**(8)**

Jan 6	Realisation a/c √	4 200 000 √√		
	Land a/c √		4 200 000	
Jan 6	Current Taxation a/c	49 800		√
	Realisation a/c		49 800	√
Jan 6	Ordinary Shares of £1.20 a/c	6 000 000		√
	Sundry Shareholders a/c		6 000 000	√

Question Number	Answer	Mark
7(b)		**(6)**

Purchase Price			
No. of Ordinary shares in Machine Tools Limited	6 000 000√	5 000 000√	
	1.20√		
Shareholders receive/ Purchase Price	£1.00		
	£0.58		
	£0.27√ (all 3)		
5 000 000	£1.85√	£9 250 000	√

Question Number	Answer	Mark
7(c)		**(10)**

Calculation of Goodwill		
Purchase Price	9 250 000	√ o/f
Original Book value of Machine Tools Limited (22 2 √ - 14.8 √ = 7.4)	(7 400 000)	Or √√
Adjustments - Stock	620 000	√
- Land	(210 000)	√
- Motor vehicles	125 000	√
- Equipment	125 000	√
- Current taxation	(9 300)	√
Excluding Bank	123 000	√
Goodwill	2 623 700	√ o/f

Question Number	Answer	Mark
7(d)	AGAINST Revaluations The larger party may be in a position of strength and abuse this position √ to revalue assets to their own advantage √ ie lower value than true market value √ Revaluing assets and liabilities a pointless waste of time and money √ because the buyer can agree to pay whatever goodwill they feel is appropriate. √ Professional valuers may be required √ and these may charge considerable fees √ FOR Revaluations Even if one party is in a position of strength, the other party does not have to agree to a sale √ if they do not like the value put on assets. √ It is only fair √ that assets and liabilities are sold for their correct market value, √ not some historical book value √ that may not reflect market value. √ Maximum of 4 marks per side of argument. Conclusion 2 marks available It is appropriate for revaluations. √√	**(8)**