Paper Reference(s)

6002/01

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary/Advanced Level

Unit 2: Corporate and Management Accounting

Thursday 26 January 2012 – 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 Home Gaming plc had the following balances in the books at December 31 2011, before making some final adjustments.

	Debit £	Credit £
Accruals		3 300
Buildings	1 754 000	
Bank loan		100 000
Cash in hand	3 000	
Computer equipment	649 000	
Copyright purchased	125 000	
Debenture 13% (2016)		800 000
Debenture Interest		52 000
Fittings	117 000	
Furniture	83 000	
General reserve		110 000
Goodwill purchased	85 000	
Interest on bank loan		10 000
Inventories (stocks)	132 000	
Machinery	380 000	
Ordinary £1 share capital		2 000 000
Overdraft		41 000
Patents purchased	165 000	
Prepayments	5 400	
Retained earnings at 1 Jan 2011	214 000	
Rent received	2 000	
Revaluation reserve		15 000
Share premium account		125 000
Trade payables (creditors)		11 000
Trade receivables (debtors)	27 900	

Notes and final adjustments:

- Profit before tax for the year ended December 31 2011, not yet entered above, is £475 000.
- The directors have decided to make a provision for likely Income Tax of £124 000, to be paid on the profit above. The tax authorities require all taxation to be paid by 30 September 2012.

  The directors decided to pay a dividend of 2.2 pence per share, which will be paid in February 2012.
- The bank requires the loan to be repaid in full by 30 April 2013.

Required:

(a) Prepare for Home Gaming plc as at 31 December 2011 **EITHER:**

- the appropriation account as required by the Companies Act 1985 **OR**
- the Statement of Changes in Equity in accordance with International Accounting Standard 1 (Revised).

(6)

(b) Prepare for Home Gaming plc as at 31 December 2011 **EITHER:**

- the balance sheet using Format 1 as required by the Companies Act 1985 **OR**
- the Statement of Financial Position in accordance with International Accounting Standard 1 (Revised).

(34)

The Statement of Financial Position, when drawn up in accordance with International Accounting Standard 1 (Revised), may not show Net Current Assets (Liabilities), also called Working Capital. A Balance Sheet, when drawn up in accordance with the Companies Act 1985, does show Net Current Assets (Liabilities).

Required:

(c) Evaluate whether you think it is beneficial to show Net Current Assets (Liabilities) on the Statement of Financial Position (Balance Sheet) for a company.

(12)

(Total 52 marks)

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

Question Number	Answer	Mark
1(a)	Statement of Change in Equity Opening Balance Jan 1 2011 (214000) Dr Dividends (44000) Dr Comprehensive Income for the Year 351000 Balance at Dec 31 2011 93000	**(6)**

Question Number	Answer				Mark
1(b)	**Statement of Financial Position as at 31 December 2011** √			**34 marks**	
	ASSETS				
	Non-current assets √				
	Property, Plant & Equipment				
	Buildings	1754000			
	Fittings	117000			
	Machinery	380000 √ any 3			
	Furniture	83000			
	Computer Equipment	649000 √ next 2			
			2983000		
	Goodwill		85000 √		
	Other Intangible Assets				
	Copyright	125000 √			
	Patents	165000 √			
			290000		
				3358000 √	
	Current Assets				
	Inventories		132000 √		
	Trade and Other Receivables				
	Trade receivables	27900 √			
	Prepayments	5400 √			
	Rent Received	2000 √			
			35300		
	Cash and Cash Equivalents				
	Cash		3000 √		
				170300 √	
	Total Assets √			**3528300** √ o/f √ C	
	EQUITY AND LIABILITIES √				
	Equity				
	Share Capital				
	Ordinary shares of £1		2000000 √		**(34)**
	Other Reserves				
	Share Premium	125000			
	Revaluation Reserve	15000			
	General Reserve	110000 √ all 3			
			250000		
	Retained Earnings		93000 √		
				2343000 √	
	Non-Current Liabilities √				
	Long Term Borrowings				
	Debenture 13% 2016	800000 √			
	Bank loan	100000 √			
				900000 √	
	Current Liabilities				
	Trade and other Payables				
	Trade Payables	11000			
	Accruals	3300			
	Debenture Interest	52000 √ any 3			
	Loan Interest	10000			
	Dividend Payable	44000 √ next 2			
			120300		
	Short Term Borrowings				
	Overdraft		41000 √		
	Current Tax Payable				
	Income Tax Payable		124000 √		
				285300 √	
	Total Equity and Liabilities √			**3528300**√o/f √C	

Q1 Mark Scheme		
a) Appropriation Account		
Opening Balance Jan 1 2011	-214000	√
Profit for year	475000	√
Taxation	-124000	√
Dividends	-44000	√
Balance at Dec 31 2011	93000	√ o/f √ C

Home Gaming plc Balance sheet as at 31 December 2011				
B Fixed assets				
I Intangible assets √				
Goodwill	85000			√
Copyright	125000			√
Patents	165000			√
		375000		
II Tangible Assets √				
Buildings	1754000			
Fittings	117000			
Machinery	380000			√ any 3
Furniture	83000			
Computer equipment	649000			√ next 2
		2983000		
			3358000	√ O/F
C Current Assets				
I Stocks				
Stocks	132000			√
II Debtors				
Debtors	27900			√
Prepayments	5400			√
Rent Received	2000			√
IV Cash at bank and in hand				
Cash In Hand	3000			√
		170300		√ O/F
E Creditors: Amounts falling due within one year				
Bank Overdraft	41000			√
Debenture Interest	52000			
Interest on Bank Loan	10000			
Trade Creditors	11000			√ any 3
Accruals	3300			
Dividend Payable	44000			√ next 2
Taxation Payable	124000			√
		285300		√ O/F

F Net current assets (liabilities) √			-115000	
G Total assets less current liabilities √			3243000	√ O/F
H Creditors: amounts falling due after more than one year √				
Bank Loan	100000			√
Debenture 13% 2016	800000			√
			900000	√
			2343000	√ O/F √ C
K :Capital and reserves √				
I Ordinary share capital called up	2000000			√
II Share premium account	125000			
III Revaluation reserve	15000			
IV Other Reserves - General Reserve	110000			√ all 3
V Profit and loss account	93000			√ O/F
			2343000	√ O/F √C
Total 34 Marks				

Accruals 3300 may be shown under Accruals and Deferred Income
Income tax 124000 may be shown under Provisions and Deferred charges

Question Number	Answer	Mark
1(b)	<u>**Statement of Change in Equity**</u> √ Retained Earnings Opening Balance Jan 1 2011 -214000 Dr √ Dividends -44000 Dr √ Comprehensive Income for the Year 351000 √ √ Balance at Dec 31 2011 93000 √o/f √ C	**(6)**

Question Number	Answer	Mark
1(c)	FOR benefit of showing Net Current Assets (Liabilities) Allows the user to see <u>clearly/easily</u>√ which is largest of current assets and current liabilities √	

	This enables the user to judge the net amount of liquid assets √ If Net Current Liabilities, √ then clearly the entity has a liquidity problem. √ and allows them to take action √ Helps potential investors √ to make a decision whether to invest. √ Helps suppliers √ make a decision concerning possible credit to be given. √ AGAINST benefit of showing Net Current Assets (Liabilities) Net Current Assets only shows an amount in a monetary value.√ This does not show if this amount is sufficient. √ The amount required would be affected by the entity's size √ and industry. √ More useful measures of liquidity are the Current Ratio √ and Acid (Quick) Ratio. √ These could be calculated √ using either of the two formats. √ It may be better to show all the monies put into the entity √ on the same side of the Statement of Financial Position / Balance Sheet ie Total Equity and Liabilities.√ Maximum of 8 marks for arguing one side only. Evaluation: It is / is not necessary to show Net Current Assets (Liabilities) on the Statement of Financial Position. √√ (2 marks for Evaluation).	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. The directors of Bazaar Electricals Limited have purchased a new store. The store contains four departments of different sizes.

The department sizes are:

Department	A	B	C	D
Sales floor space (square metres)	100	80	60	50

The directors have decided to sell four different products, one product in each department, for the next year.

The following information is to be used to determine which product will be sold in each department:

Washing Freezers

(12)

rder,

(2)

ɔtain

(2)

Required:

(b) Calculate the maximum profit for the year for Bazaar Electricals Limited.

(14)

A salesperson from Homebake Ovens Limited offers to supply the store with ovens to sell. The salesperson wishes to sell the ovens in Department D.

She tells the store manager the following figures are predicted.

- Average selling price per oven £325
- Variable costs per oven £125
- Sales floor space required per oven 1.25 square metres
- Rate of stock turnover 6 times per year

Required:

(c) Calculate the total expected contribution per year that would result if ovens were to be sold in Department D.

(10)

(d) Evaluate whether Bazaar Electricals Limited should sell ovens in Department D.

(12)

(Total 52 marks)

Answer space for question 2 is on pages 9 to 13 of the question paper.

Question Number	Answer	Mark
2(a)(b)		

(i) Product	Televisions	Computers	Washing Machines	Freezers	Mark
Sales per square metre	£400 √	£750 √	£350 √	£150 √	
Variable costs per square metre	£200 √	£500 √	£125 √	£75 √	
Contribution per square metre.	£200 √	£250 √	£225 √	£75 √	
					(12)
(ii) Ranking order of contribution	3	1 √ any 2 O/F	2	4 √ any 2 O/F	(2)
(iii) Department Selection	C	A √ any 2 O/F	B	D √ any 2 O/F	(2)
(b) Total Contribution	£200 x 60 x 8	£250 x 100 x 8	£225 x 80 x 8	£75 x 50 x 8	
	= £96 000 √√	=£200 000 √√	= £144000 √√	= £30 000 √√	

O/f rule applies for Rows 3,4, 5, 6 and 7

Total Contribution for Store =
£96 000
£200 000
£144 000
£30 000
£470 000 √√ o/f

Profit for Store = £470 000 √ o/f - £255 000 √ = £215 000 √ o/f √ (14)

Question Number	Answer	Mark
2(c)	Selling price per oven £325 Variable costs per oven £125 Contribution per oven £ 200 √ Number of items that can be sold in Department D = $\frac{50\ √}{1.25\ √}$ = 40 √ Number of items sold per year = 40 √ x 6 √ = 240 √ Total contribution for ovens in dept D = (240 x £200) √ = £48 000 √ o/f √ C	**(10)**

Question Number	Answer	Mark
2(d)	FOR selling ovens in dept D Contribution for selling ovens in D is greater √ by £18 000 than freezers. √ Figures are only predictions√ actual figure for sales/contribution etc could be higher √ Fewer items need to be sold √ to make contribution of e.g. £30 000 √ 400 freezers compared to 150 ovens √ i.e. 250 less items √ AGAINST selling ovens in dept D Figures are only predictions√ actual figure for sales/contribution etc could be lower. √ What does the store know about the quality of the ovens? √ Has the manager of the store seen the product/ had a demonstration? √ What does the store know about reliability of supply, delivery√ and after sales service of the ovens? √ Will this mean not selling one of the other products? √ What effect will this have? √ Maybe they supply one of the other products as well. √ Maximum of 8 marks for arguing 1 side only Conclusion (2 marks) Bazaar Electricals Limited should/should not sell ovens in dept D √√	**(12)**

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. Atlantic Foods plc, a large American food producer, agreed to purchase the smaller UK food producer, Rowlands plc. The purchase took place on 6 January 2012. The directors of Atlantic Foods plc agreed to take over all of the assets except bank and cash balances, and to settle all the liabilities.

The balance sheet of Rowlands plc as at 31 December 2011 showed

All assets £40 800 000
All liabilities £15 900 000
Equity and reserves £24 900 000

The following revaluations took place in the books of Rowlands plc in January 2012, before the takeover:

- Buildings were increased by 10% to a current market value of £10 450 000
- Machinery with a value of £1 500 000 was written down to a scrap value of £180 000
- Computer equipment with a book value of £600 000 was written off to a value of zero
- An exact figure for Trade Payables (Creditors) was agreed at £2 100 000, down from £2 200 000
- Stock was written down by £500 000 to its net realisable value.

Additional information concerning Rowlands plc

- Bank balance £2 400 000 debit
- Cash balance £300 000
- The Profit and loss reserve balance is £4 900 000
- Equity share capital is £20 000 000, consisting of Ordinary shares of £1.25 each
- For every £1.25 share held in Rowlands plc, each shareholder would receive the following:
  – one £1 share in Atlantic Foods plc at a premium of £0.66 (the trading price is £1.66 a share)
  – £0.59 cash

Required:

(a) Show the Journal entries to close the following accounts in the books of Rowlands plc, **before** any revaluations have taken place. Narratives are not required.

(i) Buildings
(ii) Trade Payables (Creditors)
(iii) Ordinary Shares of £1.25

(8)

(b) Calculate the purchase price paid by Atlantic Foods plc for Rowlands plc.

(8)

(c) Calculate the Goodwill paid by Atlantic Foods plc for Rowlands plc

(12)

(d) Prepare the Sundry shareholders account in the books of Rowlands plc

(8)

(e) Explain how the Goodwill paid will be treated in the accounts of Atlantic Foods plc.

(4)

JD Dalton holds shares in Atlantic Foods plc.

(f) Evaluate the take-over on behalf of JD Dalton.

(12)

(Total 52 marks)

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

Question Number	Answer					Mark
3(a)	Jan 6	Realisation a/c	9 500 000 √√		√	
		Buildings a/c		9 500 000	√	
	Jan 6	Trade Payables a/c	2 200 000		√	
		Realisation a/c		2 200 000	√	
	Jan 6	Ordinary Shares of £1.25 a/c	20 000 000		√	
		Sundry Shareholders a/c		20 000 000	√	(8)

Question Number	Answer			
3(b)	**Purchase Price**			
	No. of Ordinary shares in Rowlands plc	20 000 000√	16 000 000√√	
		1.25√		
	Shareholders receive/ Purchase Price	£1.00		
		£0.66		
		£0.59√		
	16 000 000	£2.25√	£36 000 000	√ o/f √ C

Question Number	Answer			Mark
3(c)	**Calculation of Goodwill**			
	Purchase Price	36 000 000	√	
	Original Book value of Rowlands plc	(24 900 000)	√	
	Adjustments - Buildings	(950 000)	√√	
	- Machinery	1 320 000	√	
	- Computer	600 000	√	
	- Trade payables	(100 000)	√	
	- Stock	500 000	√	
	Excluding Bank	2 400 000	√	
	Excluding Cash	300 000	√	
	Goodwill	15 170 000	√ o/f √ C	(12)

Question Number	Answer			Mark
3(d)	**Rowlands plc Sundry Shareholders Account**			
	Atlantic Foods √ 36 000 000 √	Share capital	20 000 000 √	
	(Purchase Consideration)	Profit + Loss reserve	4 900 000 √	
		Profit on Realisation√√	11 100 000 √√	
	36 000 000		36 000 000	(8)

Question Number	Answer	Mark
3(e)	Answers could include : Goodwill will appear in the balance sheet of Atlantic Foods plc as an intangible asset√ , under the heading of Non-current assets. √ Correct treatment of goodwill would be to amortize √ over its useful economic life. √ Likely to derive benefits from the expenditure over a number of years, √ so spread the cost of this expenditure over a number of years √ ie matching concept √ gives a True and Fair view of the accounts. √ To write off immediately may make profit unrealistically low, √ and tax charge would be unfairly low. √ In line with recommended practice √ ie FRS 10 √	**(4)**

Question Number	Answer	Mark
3(f)	Answers may include : Maximum of 8 marks if argument is one-sided. Case FOR takeover : Atlantic Foods may improve in the future √ and the share price could rise above £1.66. √ This will give Atlantic Foods a foothold/start or greater presence √ in UK. √ Atlantic Foods may benefit from economies of scale √ and make more profits. √ Likelihood of dividends in the future. √ Investment may be more secure √ as business is now enlarged. √ Case AGAINST takeover: Goodwill paid is very high √ – about 60% √ above net asset values. √ Atlantic Foods may suffer from diseconomies of scale √ and see profits reduced. √ Atlantic Foods has to pay out a large amount of cash √ (£9 440 000) √ which will have a negative effect on liquidity. √ Issue of more shares √ will see value of Atlantic Foods shares fall. √ and / or less dividends per share √ and / or reduction in voting power √ Conclusion 2 marks available Should relate to points made above.	**(12)**

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. Narayang Doors Limited has opened a factory and is to go into business producing doors, which are sold to a major chain of hardware stores. The following information is available.

- Materials for production will be delivered from Week 2 in Month 1. Each week, £3 150 of materials will be delivered. These materials will produce 75 doors a week.
- Production will start in Week 3 in Month 1. In each week, 75 doors will be produced which is the maximum production capacity of the factory.
- Sales are budgeted to be 72 doors a week, starting from Week 4 in Month 1.

  Any doors produced but not sold will be placed into stock in the warehouse.
- Materials are budgeted to be paid for 3 weeks after delivery. For example, materials delivered in Week 1 will be paid for in Week 4.
- Customers are budgeted to pay 4 weeks after a sale. For example, a door sold in Week 4 Month 1 will be paid for in Week 4 Month 2.
- The budgeted selling price of a door is £89.
- Assume 4 weeks in each month.

Required:

(a) Prepare, for the first **three** months of trading for Narayang Doors Limited: (The budgets should show MONTHLY totals and not weekly totals)

(i) A purchases budget in pounds (£s).

(3)

(ii) A purchases budget in units (doors).

(3)

(iii) A production budget in units (doors)

(3)

(iv) A sales budget in units (doors).

(3)

(v) A stock budget in units (doors). The budget should show the number of units going into stock each month, and the total number of units in stock at the end of each month.

(6)

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

(3)

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

(3)

(b) Narayang Doors Limited budgets to pay trade payables (creditors) after three weeks, and allows trade receivables (debtors) to pay after four weeks. Evaluate this method of cash budgeting (credit control).

(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)	(i) Purchases Budget (£)	

MONTH 1	MONTH 2	MONTH 3	Mark
£9 450√	£ 12 600√	£12 600 √	**(3)**

ii) Purchases Budget – Units

MONTH 1	MONTH 2	MONTH 3	Mark
225√	300√	300√	**(3)**

iii) Production Budget - Units

MONTH 1	MONTH 2	MONTH 3	Mark
150√	300 √	300 √	**(3)**

iv) Sales Budget - Units

MONTH 1	MONTH 2	MONTH 3	Mark
72 √	288 √	288 √	**(3)**

v) Stock Budget - Units

	MONTH 1	MONTH 2	MONTH 3	Mark
To Stock each month	78 √	12 √	12 √	
Total in Stock	78 √	90 √	102 √	**(6)**

vi) Creditors Budget (£)

MONTH 1	MONTH 2	MONTH 3	Mark
£ 9 450√	£ 9 450√	£ 9 450√	**(3)**

vii) Debtors Budget (£)

MONTH 1	MONTH 2	MONTH 3	Mark
£ 6 408√	£ 25 632√	£ 25 632√	**(3)**

Question Number	Answer	Mark
4(b)	**For Method** Narayang may have little choice in method as terms may be decided by supplier(s) √ who may be in a strong position √ especially as Narayang are a new business. √ Narayang may be able to negotiate better terms in the future, √ especially if they prove to be a regular customer, √ and/or a reliable supplier.√ After the first two months, √ cash flow will be regular, √ with receipts of £25 632 and payments of £12 600 for supplies. √ Discounts could be given for prompt payment √ **Against Method** Firm is waiting longer to collect sales receipts than they are taking to pay suppliers. √ This gives a simple working capital cycle √ of one week. √ Negative effect on cash flow √ in the first two months of business. √ Selling on credit may result in bad debts√ Maximum of 4 marks for arguing one side only **Evaluation:** Method is good/bad √√ 2 marks available for overall conclusion, should relate to points made above.	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. You are the Finance Director for Kowloop Water plc. You have to present some important accounting ratios to the next Board Meeting.

The following information is available after the final accounts have been drawn up for the year ended 31 December 2011.

Ordinary shares of £1 each	£10 000 000
6% Preference shares of £1 each	£5 000 000
Profit and loss reserve	£6 000 000
5 year Bank Loan	£7 000 000
13% Debenture (2016)	£12 000 000
Net profit for year after interest and tax	£400 000
Dividend payable for year	£280 000
Market price of share	£1.20

Required:

(a) Calculate the gearing ratio, clearly stating the formula used.
(4)

(b) Evaluate the gearing ratio figure, stating how this figure could be improved.
(4)

(c) Calculate the following

(i) Earnings per share
(3)

(ii) Price/earnings ratio
(3)

(iii) Dividend cover
(3)

(iv) Dividend yield
(3)

(d) Evaluate the ratios calculated in (c) above.
(4)

(e) State **two** ways in which each of the ratios calculated in (c) above could be improved for the business
(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)	Gearing ratio = Debt / Capital Employed x100 √ OR Debt / Equity x 100 √ = 24 000 000 √ / 40 000 000 √ x 100 24 000 000 √ / 16 000 000 √ x 100 = 60% √ OR 150% √	**(4)**

Question Number	Answer	Mark
5(b)	The gearing ratio is too high, √ being over 50% (100%). √ O/F It would be better if the ratio were between 30% and 50% √ It could be improved by (max of two √√) : - issuing more ordinary shares - Redeeming preference shares - Paying off bank loan - Redeeming the debenture Making more profit and keeping it in reserves.	**(4)**

Question Number	Answer	Mark
5(c)	(i) Earnings per share = £400 000 √ / 10 000 000 √ = 4 pence per share √ (ii) Price/earnings ratio = 120 √ / 4 O/F√ = 30 times O/F √ (iii) Dividend cover = 400 000 √ / 280 000 √ = 1.429 times √ (iv) Dividend yield = (2.8 x 100) √ / £1.20 √ = 2.33% √	**(12)**

Question Number	Answer	Mark
5(d)	(i) EPS is low √ (relating to own figure) (ii) Price/earnings ratio is fairly high √ (relating to own figure) (iii) Dividend cover is acceptable √ (relating to own figure) (iv) Dividend yield is acceptable in today's market / low √ (relating to own figure)	**(4)**

Question Number	Answer	Mark
5(e)	The ratios could be improved by: EPS - increasing profits √ or redeeming ordinary shares √ Price/earnings - raising share price √ by increasing profits √ or redeeming ordinary shares √ Dividend cover – increasing annual profits √ or paying a lower dividend √ Dividend yield - paying a higher dividend, √ after making higher profits √	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. Whirlwind Motorcycles Limited makes top of the range motorcycles. The directors decided to introduce a standard costing system, starting in December 2011.

The following figures were obtained for the month of December 2011.

	BUDGET	ACTUAL
	£	**£**
Sales	96 000	94 800
Less		
Material Costs	26 990	27 840
Labour Costs	32 640	33 660
Variable Overheads	17 970	15 635
= Cost of Goods Sold	77 600	77 135
Gross Profit	18 400	17 665
Less Fixed Overheads	14 430	14 430
Net Profit	3 970	3 235

Required:

(a) Explain the stages in establishing a **standard costing** system.

(4)

(b) Complete the last column in the table to show the variances for the month of December 2011.

(8)

The following information is also available for December 2011:

- A production figure of 6 motorcycles was budgeted and achieved.
- Budgeted labour costs were 20 workers, each working 160 hours in the month, at £10.20 per hour.
- To complete the budgeted production, 10 workers each had to work 5 hours overtime, at "double time" pay rate.

Required:

(c) Calculate the

(i) labour efficiency variance for the month of December, stating the formula used.

(6)

(ii) labour rate variance for the month of December, stating the formula used.

(6)

(d) Evaluate the usefulness of a standard costing system to Whirlwind Motorcycles Limited.

(8)

(Total 32 marks)

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

Question Number	Answer	Mark
6(a)	Answers may include : For product, obtain a product specification√ giving standard quantities for materials and labour√ 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. √ Looking at figures for past cost of sales √	**(4)**

Question Number	Answer	Mark
6(b)	see table below	**(8)**

	BUDGET	ACTUAL	VARIANCE	
Sales	96000	94800	1200	ADV √
Less				
Material Costs	26990	27840	850	ADV √
Labour Costs	32640	33660	1020	ADV √
Variable Overheads	17970	15635	2335	FAV √
= Cost of Goods Sold	77600	77135	465	FAV √
Gross Profit	18400	17665	735	ADV √
Less Fixed Overheads	14430	14430	0	0 √
Net Profit	3970	3235	735	ADV √

Question Number	Answer	Mark
6(c)(i)	Labour Efficiency Variance = (Actual Hours - Standard hours) √ x Standard Rate √ = (3250 √ - 3200 √) x 10.20 √ = £510 Adverse √ o/f	**(6)**

Question Number	Answer	Mark
6(c)(ii)	Labour Rate Variance = (Actual Rate - Standard Rate) √ x Actual Hours √ = ($\frac{£33\ 660}{3\ 250}$ √ - £10.20 √) x 3250 √ = £510 Adverse √ o/f	**(6)**

Question Number	Answer	Mark
6(d)	Evaluation Answers may include. FOR usefulness Allows performance to be compared √ with predetermined standards. √ Variances can be analysed √ and action taken to control costs. √ Helps eliminate waste, √ idle time, inefficiency etc √ Allows management by exception, √ which sees action taken only for large variances. √ AGAINST usefulness Takes time, expertise √ and money to prepare. √ Inaccurate standards set √ may be misleading and unhelpful. √ Maximum of 4 marks for one-sided argument. Conclusion Standard costing is useful √√	**(8)**

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. You are in practice as an accountant and have a meeting with a client, Varnavas Constantinou, who owns a fast food restaurant where meals are cooked and then delivered.

The accounts of Varnavas show:

(i) Rent of premises is £ 1 080 per quarter (per three month period).

(ii) Cost of gas to produce one meal is £0.10.

(iii) Direct labour is £0.25 per meal cooked.

(iv) A motor scooter was purchased for delivery, at a cost of £2 500. The scooter has a life of 4 years and a scrap value of £100. Depreciation is to be charged on a straight line basis.

(v) Delivery costs per meal are £0.35.

(vi) Insurance for the year is £504.

(vii) Cost of electricity is £15 a week plus £0.05 per meal cooked.

(viii)Selling price of a meal is £3.95.

(ix) Sales are 6 200 meals per year.

Note: Assume that there are 4 weeks in a month and 48 weeks in a working year.

Required:

Answer the following questions put forward by Varnavas, using the information above.

(a) "Is profit the same as the margin of safety?" Explain your answer. **(6)**

(b) "How many meals **per month** must I sell in order to break even?" **(12)**

(c) "How much profit do I make in **one year**?" **(6)**

Varnavas says "It is easier to control fixed costs than variable costs."

(d) Evaluate this statement. **(8)**

(Total 32 marks)

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

Question Number	Answer	Mark
7(a)	Profit is equal to total sales revenue √ less total costs. √ Margin of safety is equal to actual sales revenue √ less sales revenue required to break even.√ OR actual output / sales units √ less output / sales to break even √ Therefore, the two are not the same. √√	**(6)**

Question Number	Answer	Mark
7(b)	Fixed Costs Rent £360 per month √ Depreciation £50 per month √√ Insurance £42 per month √ Electricity £60 per month √ Total FC £512 per month √ Variable costs per unit Total £ 0.75 per unit √ Contribution per unit (£ 3.95 - £ 0.75) √ = £3.20 √ Break Even Point = <u>£512</u> o/f √ / £3.20 o/f √ = 160 meals o/f √	**(12)**

Question Number	Answer	Mark
7(c)	Profit for year Contribution (3.20 x 6 200) = £19 840 o/f √√ Less FC (12 x £512) = £6 144 o/f √√ Profit = £13 696 √ O/F √ C	**(6)**

Question Number	Answer	Mark
7(d)	Case for easier control of FIXED costs. It is possible to decide the length of life of a non-current asset, √ thus controlling the depreciation charge per year. √ It may be possible to negotiate with the landlord √ to fix a monthly rent charge. √ It may be possible to negotiate with the bank √ over the interest rate charged on a loan. √ Fixed costs do not change with output but variable costs do √ Case for easier control of VARIABLE costs. It is possible to fix direct wages, √ and someone will be willing to work for this rate. √ It may be possible to negotiate with suppliers √ for the price of raw materials. √ Some fixed costs maybe impossible to change eg loan interest/repayments√, business rates √, depreciation √, insurance √ (one tick per item up to a maximum of two ticks) Maximum of 4 ticks for arguing one side. Conclusion - Two √√ It is easier to control fixed / variable costs.	**(8)**