ACCOUNTING

Paper 3 Structured Questions

SPECIMEN INSERT

3 hours

READ THESE INSTRUCTIONS FIRST

This Insert contains all of the required information and questions. The questions are provided in the Insert for reference only.

Anything you write in this Insert will not be marked.

The businesses described in this Insert are entirely fictitious.
Question 1

Ayanda and Bola have been in partnership for many years, sharing profits in the ratio of 3 : 2 respectively. The annual profit has been $60 000 for some years.

On 1 June 2013 the partnership books of account showed the following balances.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital account</td>
<td></td>
</tr>
<tr>
<td>Ayanda</td>
<td>40 000</td>
</tr>
<tr>
<td>Bola</td>
<td>25 000</td>
</tr>
<tr>
<td>Current account</td>
<td></td>
</tr>
<tr>
<td>Ayanda</td>
<td>17 000</td>
</tr>
<tr>
<td>Bola</td>
<td>2 500</td>
</tr>
<tr>
<td>Bank</td>
<td>3 500</td>
</tr>
<tr>
<td>Trade payables</td>
<td>4 000</td>
</tr>
</tbody>
</table>

On that date the business was sold to Hetl Limited for a purchase consideration of $140 000. This consisted of 50 000 $1 ordinary shares in Hetl Limited with a market value of $1.80, to be shared equally, and the balance in cash. Hetl Limited took over all the assets and liabilities of the business with the exception of the bank account and the trade payables.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Calculate the gain on realisation arising from the sale of the partnership.

(b) Calculate the amount in cash due to each partner on the sale of the partnership.

(c) Prepare the partnership bank account showing the entries to close the account.

Additional information

Bola thinks it is unfair that Ayanda received more cash than she did.

(d) Give four reasons why it is fair that Ayanda received more cash than Bola.

Additional information

Hetl Limited pays a dividend of $0.25 per share each year. Surplus funds can be put on deposit in a bank and earn 6% interest a year.

Ayanda has accepted a job with Hetl Limited at a salary of $20 000 a year.

(e) Compare Ayanda’s current income with his earnings as a partner.

(f) Suggest one non-financial reason why Ayanda might prefer to be an employee rather than a partner.
Question 2

Source A2

Lee started a business in Indonesia on 1 January 2013 selling lawn mowers.

During the first year of trading Lee bought 1000 lawn mowers at $50 each. He shipped 400 of these to Albert, his agent in Jamaica. Lee also sold 550 lawn mowers in Indonesia.

The following additional information is available.

- Freight charges paid by Lee: $3600
- Landing duties paid by Albert: $400
- Rate of commission paid to Albert: 10%
- Cash remitted by Albert to Lee: $19,000

Lee’s income statement for the year ended 31 December 2013 included the following.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross profit</td>
<td>22,000</td>
</tr>
<tr>
<td>Consignment profit</td>
<td>6,720</td>
</tr>
<tr>
<td>Selling, distribution and administration costs (arising in Indonesia)</td>
<td>17,600</td>
</tr>
</tbody>
</table>

Lee’s statement of financial position at 31 December 2013 included the following inventory.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jamaica</td>
<td>4,800</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2,500</td>
</tr>
<tr>
<td>Total inventory</td>
<td>7,300</td>
</tr>
</tbody>
</table>

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Prepare the consignment account in the books of Lee for the year ended 31 December 2013.

(b) Prepare Albert’s account in the books of Lee for the year ended 31 December 2013.

(c) Calculate the number of unsold lawn mowers Albert was holding on 31 December 2013.

Additional information

Lee is considering whether to concentrate his efforts on sales in Indonesia or in Jamaica.

(d) Advise Lee where to concentrate his sales effort. Support your answer with calculations.
Question 3

The following information is available about Whittlesford plc on 31 December 2011.

\[
\begin{array}{l|c}
\text{500,000 ordinary shares of $1 each} & 500,000 \\
\text{Share premium} & 200,000 \\
\text{General reserve} & 70,000 \\
\text{Retained earnings} & 298,300 \\
\end{array}
\]

Further information is as follows:

1. The draft profit for the year ended 31 December 2012 was $122,800.
2. On 1 January 2012 property was revalued from $520,000 to $780,000.
3. On 31 January 2012 a rights issue of 1 share for every 5 held was made at a premium of $0.25 each.
4. On 30 June 2012 an interim dividend of $0.08 per share was paid.
5. On 31 October 2012 a bonus issue of shares of 1 for every 4 held was made. The directors decided to keep the reserves in their most flexible form.
6. On 31 December 2012 $40,000 was transferred to general reserve and a final dividend of $0.12 per share was proposed.
7. On 5 January 2013 it was discovered that a customer who had owed $4,200 at the year end had been declared bankrupt. It was also discovered that goods in inventory at the year end, with a cost of $3,000, had been water damaged and could now only be sold for $600.
8. On 17 January 2013 a burglary at the business premises resulted in the loss of computer equipment, $15,700.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Explain what is meant by keeping reserves in their most flexible form.

(b) Prepare the statement of changes in equity for Whittlesford plc for the year ended 31 December 2012.

(c) Explain whether the event on 17 January 2013 was an adjusting event or a non-adjusting event.

(d) State three characteristics of an auditor’s report.
Additional information

The auditor’s report for Whittlesford plc did not give an unqualified opinion on the financial statements because $150,000 of investments included in non-current assets have become worthless but have not been written off.

(e) Assess the effect that this auditor’s report will have on shareholders.
Question 4

Source A4

Five friends each have $20,000 to invest and are considering whether to invest in ABC plc or DEF plc. The following information is available from the latest financial statements of ABC plc.

Summarised income statement

<table>
<thead>
<tr>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue 4,700,000</td>
</tr>
<tr>
<td>Cost of sales 2,115,000</td>
</tr>
<tr>
<td>Gross profit 2,585,000</td>
</tr>
<tr>
<td>Expenses 1,645,000</td>
</tr>
<tr>
<td>Profit from operations 940,000</td>
</tr>
<tr>
<td>Debenture interest 50,000</td>
</tr>
<tr>
<td>Profit for the year 890,000</td>
</tr>
</tbody>
</table>

Summarised statement of financial position

<table>
<thead>
<tr>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets 2,100,000</td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
</tr>
<tr>
<td>Inventory 880,000</td>
<td></td>
</tr>
<tr>
<td>Trade receivables 480,000</td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents 10,000</td>
<td></td>
</tr>
<tr>
<td>Total assets 3,470,000</td>
<td></td>
</tr>
<tr>
<td>1,000,000 ordinary shares of $1 each 1,000,000</td>
<td></td>
</tr>
<tr>
<td>Share premium 400,000</td>
<td></td>
</tr>
<tr>
<td>Revaluation reserve 800,000</td>
<td></td>
</tr>
<tr>
<td>Retained earnings 450,000</td>
<td></td>
</tr>
<tr>
<td>2,650,000</td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities – debentures 500,000</td>
<td></td>
</tr>
<tr>
<td>Current liabilities – trade payables 320,000</td>
<td></td>
</tr>
<tr>
<td>3,470,000</td>
<td></td>
</tr>
</tbody>
</table>

Other information about ABC plc is as follows:

1. The dividends paid in the year amounted to $440,000.
2. All sales and purchases are made on credit.
3. The value of inventory has remained stable over several years.
4. The market value of one share is $5.60.

The following information is also available about DEF plc.

- Earnings per share $0.57
- Dividend per share $0.48
- Gearing ratio 43.4%
- Income gearing 17.7%
- Trade payables payment period 97 days
- Price earnings ratio 7.18
- Dividend cover 1.19 times
- Dividend yield 11.7%
- Par value of one share $1
The five friends all have different criteria for their investment decision.

Jazgul is an ethical investor and is concerned that suppliers get their money in good time.

Jackson needs a good cash flow and seeks a high return in terms of cash in the short term.

Khan seeks capital growth.

Madge wishes to be confident in a company’s ability to maintain earnings in the future.

Bernard is risk averse and wants to invest in a company which is on a sound financial footing.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Identify and calculate for each potential investor the ratio for ABC plc which would particularly interest him or her.

(b) Explain what the ratio you have calculated for each investor shows the investor.

(c) Decide which is the most suitable investment for each investor.
Question 5

Source B1

Harko runs a successful retail business. His typical annual results have been as follows:

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>210 000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>115 500</td>
</tr>
<tr>
<td>Gross profit</td>
<td>94 500</td>
</tr>
<tr>
<td>Variable selling and administrative expenses</td>
<td>48 000</td>
</tr>
<tr>
<td>Fixed expenses</td>
<td>19 500</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>27 000</td>
</tr>
</tbody>
</table>

Harko is now considering building an extension to his premises.

The following information is available:

1. The building cost would be $265 000.
2. Because of the increase in floor space he anticipates that sales volume would increase by 40%.
3. The gross profit margin would be maintained.
4. The inventory level would need to be increased by $10 000 in year 1 only.
5. The existing variable expenses would increase by 30%.
6. The business would in future have to rent garage space for the delivery vehicle at a cost of $2000 a year.
7. Harko intends to retire at the end of year 4 and sell the business as a going concern. He expects the purchase consideration for the business (including inventory) to be $600 000 without the extension or $910 000 if he proceeds with the extension.

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Calculate the annual cash flows arising from the building of the extension.

Additional information

Harko's cost of capital is 10%. Discount factors are as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Discount factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1.000</td>
</tr>
<tr>
<td>1</td>
<td>0.909</td>
</tr>
<tr>
<td>2</td>
<td>0.826</td>
</tr>
<tr>
<td>3</td>
<td>0.751</td>
</tr>
<tr>
<td>4</td>
<td>0.683</td>
</tr>
</tbody>
</table>

(b) Calculate the net present value (NPV) of building the extension. Round calculations to the nearest dollar ($).

(c) Advise Harko whether he should proceed with the extension, based on your figures from (b).
(d) Outline why Harko might have doubts about proceeding with the extension, based on the NPV.

(e) Explain why Harko chose to use net present value as a basis for his decision rather than the payback method.
Question 6

Source B2

Aziz Manufacturing Limited produces one product.

The budgeted costs and revenues are as follows.

- Units produced and sold: 800 per month
- Standard selling price: $100 per unit
- Standard direct materials: 4 kilos at $6 per kilo
- Standard direct labour: 3 hours at $12 per hour

All overheads are fixed.

In April 850 units were produced and sold. Selling price was maintained at $100 per unit. Actual costs were as follows.

- Direct materials: 3485 kilos costing $19,516 in total
- Direct labour: 2720 hours costing $35,360 in total

Answer the following questions in the Question Paper. Questions are printed here for reference only.

(a) Prepare the original budget and the flexed budget for April to show total budgeted contribution.

(b) Calculate the actual total contribution achieved in April.

(c) Prepare a statement to reconcile the contribution from the flexed budget in (a) with the actual contribution from (b).

(d) Suggest one reason why each of the following variances had arisen.

(i) Material usage variance

(ii) Labour rate variance

(e) State two similarities in use between standard costing and activity based costing.