Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ACCOUNTING **9706/33**

Paper 3 Structured Questions **May/June 2017**

3 hours

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Answer **all** questions.
All accounting statements are to be presented in good style.
International accounting terms and formats should be used as appropriate.
Workings should be shown.
You may use a calculator.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **10** printed pages, **2** blank pages and **1** insert.

Section A: Financial Accounting

1 The following balances were extracted from the books of XY plc on 31 January 2017.

	$
Land and buildings - at cost	700 000
Equipment - at cost	320 000
Motor vehicles - at cost	230 000
Accumulated depreciation	
Land and buildings	100 000
Equipment	186 000
Motor vehicles	96 000
Ordinary shares of $5 each	500 000
Share premium	120 000
Retained earnings at 1 February 2016	125 000
Inventory at 1 February 2016	37 100
Trade receivables	102 000
8% Loan	150 000
Provision for doubtful debts	2 100
Revenue	985 000
Purchases	428 000
Administrative expenses	346 000
Distribution costs	144 000
Interim dividend paid	20 000

Additional information

1 Inventories at 31 January 2017 included 100 units of damaged items. These items, with a unit cost of $80, were all sold on 2 February 2017 for $65 each.
At 31 January 2017 all other inventories were valued at cost, $36 000, and had a net realisable value of $85 400.

2 The administrative expenses include an amount of $30 000 for a machine purchased on 1 February 2016. The machine has a useful life of three years and will then be scrapped with nil proceeds. Any costs related to the machine should be charged to the cost of sales.

3 The figure for land and buildings (at cost) includes land which had cost $300 000.

4 During the year, XY plc purchased a motor vehicle which cost $60 000. This was settled by a payment of $40 000 from the bank and the part exchange of an old vehicle. This old vehicle had originally cost $75 000 and had been depreciated by $27 000. Only the bank payment had been recorded in the books of account.

5 Depreciation is to be charged on the following basis:

Land	not depreciated
Buildings	straight-line method over 25 years, charged to cost of sales
Equipment	straight-line method over 5 years, charged to administrative expenses
Motor vehicles	reducing balance method at 20% per annum, charged to distribution costs.

The company policy is to charge a full year's depreciation in the year of purchase and none in the year of sale.

6 Trade receivables included an irrecoverable debt of $8800. A provision for doubtful debts of 4% is to be maintained. These items need to be included in administrative expenses.

7 The loan was obtained on 1 September 2016.

REQUIRED

(a) State **two** objectives of financial statements of a limited company. [2]

(b) Prepare the income statement for the year ended 31 January 2017. [15]

Additional information

In October 2016 XY plc made a bonus issue of 1 ordinary share for every 10 ordinary shares held. No entry had been made in the books of account.

REQUIRED

(c) Prepare the statement of changes in equity for the year ended 31 January 2017. (A total column is not required.) [4]

Additional information

The directors are considering making a further issue of bonus shares rather than paying a cash dividend.

REQUIRED

(d) Advise the directors which course of action they should take. Justify your answer. [4]

[Total: 25]

2 The directors of G Limited prepared the following draft statement of financial position at 31 December 2016:

G Limited
Statement of Financial Position at 31 December 2016

	$
Non-current assets	642 000
Current assets	
Inventory	78 000
Trade receivables	189 000
Other receivables	3 000
Cash and cash equivalents	54 000
	324 000
Total assets	966 000
Equity and liabilities	
Equity	
Ordinary shares of $1 each	550 000
Retained earnings	235 000
	785 000
Current liabilities	
Trade payables	171 000
Other payables	10 000
	181 000
Total equity and liabilities	966 000

The auditor brings the following items to the attention of the directors:

1 G Limited entered into an 18-month rental agreement for a warehouse on 1 May 2016. The following payments totalling $220 000 were made and charged as an expense in the draft income statement:

$20 000 rental deposit which is refundable at the end of the lease period; and
$200 000 total rent covering the period from 1 May 2016 to 28 February 2017.

2 After an inspection of G Limited's office premises by the local authority in December 2016, it was found that the fire exits did not meet the safety specifications. A penalty of $27 000 is probable and G Limited will incur a cost of $47 000 to rebuild the fire exits. No accounting entries had been made for this.

3 A customer who owed $12 000 at 31 December 2016 was declared bankrupt on 12 January 2017. It is probable that only 20% of the debt is recoverable. No accounting entries had been made for this.

REQUIRED

(a) Prepare the **revised** statement of financial position at 31 December 2016. [10]

(b) Explain how **each** of items 1 and 2 should be treated in the financial statements. [5]

(c) Explain the role of an external auditor. [4]

(d) Explain why the audit report of a limited company is addressed to the company's shareholders and not its directors. [2]

Additional information

G Limited adopted the Weighted Average Cost (AVCO) method to ascertain the value of inventories in 2016. The purchase price has been increasing over recent years. The directors are now considering changing to First in, First out (FIFO) method to value inventory in 2017.

REQUIRED

(e) Advise the directors whether or not the method of valuing inventory should be changed. Justify your answer. [4]

[Total: 25]

3 Greaves and Hurst participated in a joint venture sharing profits and losses in the ratio 2 : 1.

Greaves provided goods valued at $15 000 and incurred costs of $900.
Hurst provided goods valued at $10 000 and incurred costs of $800.

Greaves sold **all** of the goods for $35 000.

It was agreed that a commission of 10% of the sales value would be paid to the person making the sale.

The joint venture was then dissolved.

REQUIRED

(a) Explain **two** benefits to Greaves and Hurst of forming a joint venture. [4]

(b) Calculate the share of profit made by Greaves and Hurst from the joint venture. [6]

Additional information

A separate set of books of account are maintained to record the transactions of the joint venture. Greaves and Hurst kept their own transactions with the joint venture in their own books.

REQUIRED

(c) Prepare the following ledger accounts:

(i) Greaves account with the joint venture

(ii) Hurst account with the joint venture [9]

Additional information

Following the closure of the joint venture, Greaves and Hurst have received more orders and are considering forming a partnership.

REQUIRED

(d) Advise Greaves and Hurst whether or not they should form a partnership. Justify your answer by discussing advantages and disadvantages of forming the partnership. [6]

[Total: 25]

4 James has recently retired and received some cash which he wishes to invest in a company. There are two options. He could invest in either LM plc or AB plc.

The summarised information for the two companies extracted from their financial statements at 31 March 2017 is as follows:

	LM plc $	AB plc $
Ordinary share capital	300 000	500 000
4% non-redeemable preference shares of $1 each	100 000	150 000
Retained earnings 1 April 2016	50 000	125 000
10% debentures (2025)	150 000	50 000
Profit for the year	125 000	175 000

The nominal value of the ordinary shares of LM plc is $0.50 and of AB plc $1.

The market price of the ordinary shares at 31 March 2016 of both companies was $2. At 31 March 2017, this had fallen by 10% for LM plc but increased by 10% for AB plc.

Both companies paid a dividend per share of $0.10 for the year ended 31 March 2017.

REQUIRED

(a) Calculate the following ratios for **both** companies. Give your answers to **two** decimal places.

(i) Earnings per share

(ii) Price earnings

(iii) Dividend yield

(iv) Dividend cover [4]

(b) Evaluate the performance of **each** company using **each** of the ratios calculated in part **(a)**. [8]

Additional information

The industry average gearing ratio is 25%.

REQUIRED

(c) **(i)** Explain what you understand by gearing. [2]

(ii) Calculate the gearing ratio for **both** companies to **two** decimal places. [2]

(iii) Analyse the gearing ratios of LM plc and AB plc. [5]

(d) Advise James which company he should invest in. Give reasons for your answer. [4]

[Total: 25]

Section B: Cost and Management Accounting

5 EF plc manufactures a single product. No inventories of materials or finished goods are maintained.

The following budgeted information is available for March:

Production and sales	1000 units
Unit revenue and costs	
Selling price	$150
Direct material	4 kilos at $6 per kilo
Direct labour	6 hours at $10 per hour
Variable overhead	$2 per direct labour hour
Fixed overhead	$14 per unit

In March the company actually made and sold 800 units.

REQUIRED

(a) State **two** reasons why a business prepares a flexed budget. [2]

(b) Prepare a statement to show the budgeted profit for the month of March. [6]

Additional information

The actual cost of direct labour in March was $50 176. Staff had been paid at the rate of $9.80 per hour.

REQUIRED

(c) Calculate the following variances for March:

(i) direct labour rate [2]

(ii) direct labour efficiency [2]

(iii) total direct labour [1]

Additional information

In April the staff continued to be paid at $9.80 per hour. The variances for April were calculated as follows:

direct labour rate	$1620 favourable
direct labour efficiency	$18 000 adverse

REQUIRED

(d) Calculate

(i) the number of hours actually worked in April [2]

(ii) the number of units actually made and sold in April. [5]

(e) Suggest **two** possible reasons why the efficiency variance was adverse in April. [2]

Additional information

The management of the company is evaluating a plan to retrain the existing workers to improve their efficiency.

REQUIRED

(f) Discuss the disadvantages to EF plc if they proceed with this plan. [3]

[Total: 25]

6 Ahmed manufactures two products. He has recently started using Activity Based Costing (ABC) for allocating the overhead costs to these products. The budgeted data for one month is available as follows:

	Product X	Product Y
Demand (units)	10 000	14 000
Number of orders	20	60
Number of production runs	12	36
	Per unit	Per unit
Direct labour hours	0.75	1.5
Machine hours	2.5	0.5
Direct costs ($)	100	50

Total factory overhead costs	$
Machine maintenance costs	264 000
Ordering costs	54 000
Production run costs	24 000
	342 000

REQUIRED

(a) Calculate the **full** cost per unit for Product X and Product Y using ABC. [10]

Additional information

Ahmed previously used direct labour hours as a basis to charge overheads to each product.

REQUIRED

(b) Calculate the overhead charged to each product using the direct labour hour rate. [3]

(c) Explain the effect that changing the method has had on the overhead cost of each product. [4]

Additional information

A customer requires 50 units of Product X and has offered to pay Ahmed a total of $8450 for them. Ahmed uses 40% mark-up on all his products.

REQUIRED

(d) Recommend whether or not Ahmed should accept the offer. Justify your decision using appropriate calculations and considering **both** financial and non-financial factors. [6]

(e) State **two** reasons why a business may use ABC for allocating overhead costs. [2]

[Total: 25]

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