Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ACCOUNTING **9706/32**

Paper 3 Structured Questions **October/November 2019**

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.

This document consists of **12** printed pages.

Section A: Financial Accounting

Question 1

Source A1

The directors of Z Limited have produced a draft income statement for the year ended 30 June 2019. The following remaining balances have been extracted from the books of account.

	Debit $	Credit $
8% Debentures (2021–2022)		250 000
Cash and cash equivalents	116 300	
Freehold property at valuation	525 000	
Inventory at 30 June 2019	69 000	
Plant and machinery at cost	386 800	
Plant and machinery accumulated depreciation		200 500
Ordinary shares of $1 each		500 000
Motor vehicles at cost	240 000	
Motor vehicles accumulated depreciation		147 000
Retained earnings		46 000
Revaluation reserve		165 000
Share premium		50 000
Trade and other payables		64 800
Trade and other receivables	86 200	
	1 423 300	1 423 300

During the year ended 30 June 2019, the following transactions had occurred in respect of non-current assets.

1 New machinery had been purchased at a cost of $43 000.

2 Machinery that had originally cost $2200, which had been fully depreciated, was scrapped. No sales proceeds were received.

3 A new motor vehicle had been purchased at a total cost of $36 000. The cost had been settled by the payment of $20 800 by cheque and the part-exchange of an old motor vehicle. The part-exchange motor vehicle had originally cost $24 000 and at the date of sale had been depreciated by $10 000.

4 The freehold property had been revalued from its original cost of $360 000.

5 Depreciation charged during the year ended 30 June 2019 was as follows.

Freehold property	Nil
Plant and machinery	$20 700
Motor vehicles	$59 000

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

(a) Calculate the cost, accumulated depreciation and the net book value for each class of non-current asset at **30 June 2018**.

	Cost $	Accumulated depreciation $	Net book value $
Freehold property			
Plant and machinery			
Motor vehicles			

[7]

Additional information

The directors have decided that the following adjustments should be made to the financial statements for the year ended 30 June 2019 before they are finalised.

1 Irrecoverable debts of $18 000 should be written off.

2 Prepaid expenses amounted to $25 000.

3 The value of closing inventory should be increased by $6000.

(b) Prepare a statement of financial position for Z Limited at 30 June 2019. [8]

(c) Explain the factors that should be considered before deciding which method to use when depreciating a non-current asset. [4]

Additional information

The directors of Z Limited wish to raise $1 million for expansion. They are considering the following two ways of raising the necessary finance.

1 Issue a further 8% debenture (2025–2027) for the full amount of funds required; or

2 Make an offer of a rights issue at a premium of $0.50 per share.

(d) Advise the directors which method of raising the finance they should use. Use any ratios as appropriate to support your answer. [6]

[Total: 25]

Question 2

Source A2

Liam is a trader based in Ireland. His draft income statement for the year ended 31 December 2018 was as follows.

	$	$	$
Revenue			750 000
Inventory at 1 January 2018		28 000	
Purchases	420 000		
Less: goods on consignment	50 000	370 000	
		398 000	
Inventory at 31 December 2018		32 500	
Cost of sales			365 500
Gross profit			384 500
Profit on consignment			15 000
Distribution costs		103 200	
Administrative expenses		136 300	
			239 500
Profit for the year			160 000

During the year Liam had sent 1000 machines with a cost of $50 each to his agent Clarissa in Puerto Rico, where they had a selling price of $80 each. By the end of the year only 750 machines had been sold.

Liam had paid $4000 to ship the machines to Puerto Rico. He had in error entered this in his carriage outwards account and included it in distribution costs, instead of entering it in the consignment account.

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

(a) **(i)** Explain the effect of this error on the profit on consignment. Support your answer with figures. [3]

(ii) Explain the effect of this error on the profit for the year. Support your answer with figures. [3]

Additional information

Clarissa was entitled to a commission equal to 10% of sales. She paid import duties of $2000 when the goods arrived in Puerto Rico.

(b) Prepare the consignment account for the year ended 31 December 2018 with the error corrected. [10]

(c) Calculate the correct **total** value of inventory to be included in Liam's statement of financial position at 31 December 2018. [3]

Additional information

Liam has the opportunity to enter into **another** consignment in a country which is much closer. The machines could only be sold there for $74 each.

(d) Discuss the benefits to Liam if he enters into this new consignment. Justify your answer. [4]

(e) Explain **one** difference between an agent in a consignment and a party in a joint venture. [2]

[Total: 25]

Question 3

Source A3

Jack and Paul were two sole traders. They decided to merge their businesses and form a partnership on 1 July 2018. Their statements of financial position at 30 June 2018 were as follows.

	Jack	Paul
	$	$
Non-current assets		
Plant and equipment	118 000	103 700
Current assets		
Inventory	36 000	47 000
Trade receivables	31 500	29 500
Bank	6 200	3 400
	73 700	79 900
Current liabilities		
Trade payables	27 700	33 100
Net assets	164 000	150 500
Capital 1 July 2017	160 000	150 000
Profit for the year	44 000	20 500
Drawings	(40 000)	(20 000)
	164 000	150 500

The following was agreed for the purpose of the merger.

1 The value of each business was: Jack $195 000; Paul $152 000.

2 Jack's plant and equipment would be revalued at $128 000.

3 Paul's inventory would be revalued at $40 000.

4 Paul's trade receivables would be reduced by 2% for making allowance for doubtful debts.

All other assets and liabilities would be transferred at the book value.

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

(a) Calculate the value of **total** goodwill arising from the terms of the merger. [3]

Additional information

The following were the terms of the partnership.

1 Initial capital contributed by Jack and Paul would be $200 000 and $160 000 respectively, to be settled by net assets transferred and cash.

2 The profit and loss sharing ratio between Jack and Paul will be 3 : 2.

3 Goodwill arising from the merger is to be written off against each partner's capital account immediately after the merger.

(b) Prepare the statement of financial position for the partnership at 1 July 2018. [10]

Additional information

The partners also agreed to the following terms of the partnership.

1 Partners' salaries will be $24 000 each.

2 Each partner will take their salary and share of profit as drawings.

The profit for the year ended 30 June 2019, before appropriation, was $66 000.

(c) Prepare the current account for each partner for the year ended 30 June 2019. [5]

(d) Calculate, to **two** decimal places, the return on capital employed (ROCE) for the year ended 30 June 2019. [2]

(e) Evaluate whether or not Jack and Paul have benefited financially from merging their businesses. Justify your answer. [5]

[Total: 25]

Question 4

Source A4

R Limited does not hold any inventory.

The non-current assets schedule of R Limited for the year ended 31 December 2018 was as follows.

	Equipment	Motor vehicles	Total
	$000	$000	$000
Cost			
At 1 January 2018	190	220	410
Additions	80	-	80
Disposals	-	(40)	(40)
At 31 December 2018	270	180	450
Accumulated depreciation			
At 1 January 2018	47	96	143
Charge for the year	27	21	48
Eliminated on disposals	-	(17)	(17)
At 31 December 2018	74	100	174
Net book value			
At 31 December 2018	196	80	276
At 1 January 2018	143	124	267

The statement of changes in equity of R Limited for the year ended 31 December 2018 was as follows.

	Ordinary share capital ($1 shares)	Share premium	General reserve	Retained earnings	Total
	$000	$000	$000	$000	$000
At 1 January 2018	1000	100	25	150	1275
Issue of shares	120	24			144
Transfer			50	(50)	-
Ordinary dividend paid				(80)	(80)
Profit for the year				135	135
At 31 December 2018	1120	124	75	155	1474

The following information is also available.

1 Finance charges for the year amounted to $16 000. All had been paid by the year-end.

2 Proceeds from the sale of the motor vehicle were $30 000.

3 During the year trade receivables increased by $22 000 and trade payables decreased by $18 000.

4 The net increase in cash and cash equivalents during the year was three times the amount of the overdraft at the start of the year.

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

(a) Identify the type of business which keeps no inventory of goods for resale. [1]

(b) Prepare the statement of cash flows for R Limited for the year ended 31 December 2018 in accordance with IAS 7. (Ignore taxation.) [18]

(c) State why the revaluation of a non-current asset is not disclosed in a statement of cash flows. [1]

Additional information

The finance director of R Limited has produced the cash budget for the year ending 31 December 2019. This shows at that date the company will again have an overdraft.

(d) Discuss the possible reasons for this. [5]

[Total: 25]

Section B: Cost and Management Accounting

Question 5

Source B1

Young manufactures two products, Product X and Product Y. The following budgeted information is available.

	Product X	Product Y
Production units	5000	5000
Machine hours	10000	20000
Labour hours	5000	7500
Direct materials (per unit)	$60	$75
Direct labour (per hour)	$25	$30

Total production overheads, $180000, are to be allocated to each product on the basis of machine hours. A 50% mark-up will be added to the production cost of each product to set the selling price.

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

(a) Calculate for **each** product the **unit** production cost **and** unit selling price. [7]

Additional information

On the advice of the management accountant, Young is considering using activity based costing (ABC) to allocate the production overheads to both products. The following information is available.

	$	Product X	Product Y
Machine set up	120000	20 times	10 times
Materials handling	45000	10 receipts	5 receipts
Inspection	15000	150 hours	100 hours
	180000		

(b) State what is meant by 'Activity Based Costing (ABC)'. [1]

(c) Recalculate for **each** product the unit production cost **and** the unit selling price using ABC. [7]

(d) **(i)** Calculate the difference between the unit production overhead charged to Product X and to Product Y using **each** method. [3]

(ii) Calculate the difference between the unit selling price using the two costing methods for Product X and Product Y.

[2]

(e) Advise Young whether or not he should change the method of allocating production overhead costs to ABC. Justify your answer. [5]

[Total: 25]

Question 6

Source B2

Abida is a manufacturer of a product which has a seasonal peak demand during certain months. The following budgeted information is available.

	June	July	August	September	October	November
Sales (units)	5000	12 000	18 000	6000	3000	1800

Each unit of production requires 1.5 kilos of direct material at $3 per kilo. There will be a cost increase of 10% in August, and this will be in force for the rest of the year.

The following information is also available.

1 Abida manufactures the product one month before the month of sale.

2 Closing inventory is 20% of the following month's sale.

3 Purchases of direct material are made one month before production starts. The company **only** purchases sufficient raw materials each month to meet the following month's production requirement.

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

(a) Prepare for **each** of the four months June to September:

(i) the production budget in units [5]

(ii) the purchases budget in both kilos **and** dollars. [5]

Additional information

Abida encourages her managers to prepare their own departmental budgets.

(b) State **two** advantages and **three** disadvantages to Abida of continuing to allow the departmental managers to prepare their own budgets. [5]

Additional information

Abida had also prepared an annual budget for a second product she manufactures. The following budgeted information is available for the year for this product.

	Per unit
Selling price	$10.50
Direct materials at $3.30 per kilo	1.5 kilos
Direct labour at $6.50 per hour	0.5 hours

Fixed costs $27 000 per year.

The actual activity level for the year was 85 000 units. The following actual information is also available.

	Per unit
Selling price	$10.25
Direct materials at $3.00 per kilo	1.5 kilos
Direct labour at $7.00 per hour	0.6 hours

Fixed costs $28 000 for the year.

(c) State **two** reasons why flexible budgeting may help a business. [2]

(d) Prepare the flexed budgeted profit statement for the year. Your statement should show clearly the variances between the actual and flexed budgeted figures. [8]

[Total: 25]