Paper Reference(s)

6002/01

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary/Advanced Level

Unit 2 – Corporate and Management Accounting

Thursday 12 June 2008 – 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. Rainbow plc produces paints at its factory. The paints are then delivered to the company's warehouse, before sale to customers. The trial balance at 31 March 2008 was as follows.

	Debit £	Credit £
Advertising	53 000	
Bad debts	1 000	
Bank	96 000	
Creditors		75 000
Debtors	41 000	
Direct materials	312 000	
Factory buildings at cost	1 600 000	
Goodwill	120 000	
Interest on Bank Loan	32 000	
Long Term Bank Loan		400 000
Motor lorries – net book value	250 000	
Office expenses	48 000	
Ordinary Shares £1		500 000
Profit and Loss Account		462 000
Rent on warehouse premises	65 000	
Sales		1 678 000
Stock of finished goods at 1 April 2007	74 000	
Wages	423 000	
	3 115 000	3 115 000

Additional information at 31 March 2008

(i) Stock of finished goods £65 000.

(ii) Interest owing on bank loan is £3 000.

(iii) Rent on warehouse premises includes £5 000 paid in advance.

(iv) Wages consist of

	£
Warehouse staff	112 000
Lorry drivers	86 000
Direct factory labour	225 000

(v) On 1 April 2007, the factory building was purchased. Assuming a nil residual value and using the straight line method, the factory building is to be depreciated over a 50 year life.

(vi) A Provision for Corporation tax of £72 000 is to be made.

Required:

Final accounts must be prepared using Format 1 as required by the Companies Act 1985. Show all workings clearly labelled in arriving at your figures.

Note :
- Notes required by the Companies Act 1985 are not required.
- Ignore all the exemptions permitted for small and medium sized companies.

(a) Prepare for Rainbow plc

(i) a Profit and Loss account for the year ended 31 March 2008.

(24)

(ii) the Balance Sheet as at 31 March 2008.

(16)

(b) Evaluate the importance of the Directors' Report that accompanies the financial statements of a company.

(12)

(Total 52 marks)

Answer space for question 1 is on pages 2 to 7 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Karatoya Limited has a registered share capital of 900 000 £1 Ordinary shares. The company had the following balances at 1 April 2007.

Issued Share Capital

£1 Ordinary Shares	£500 000
Share Premium	£100 000

Reserves

Profit and Loss reserve	£312 000
General reserve	£80 000

The directors required the issue of further shares, in order to take advantage of a business opportunity.

During the twelve months to 31 March 2008, the following events occurred relating to share capital.

(i) On 1 May 2007, the company offered 200 000 ordinary shares at a price of £1.40 on the following terms:
60p on application (including the 40p premium)
50p on allotment
30p first and final call

(ii) On 18 May 2007 applications had been received for 290 000 shares. The directors rejected applications for 40 000 shares and allotted shares to the remaining applicants on the basis of 4 shares for every 5 applied for.

(iii) On 25 May 2007 monies were returned to the unsuccessful applicants.

(iv) The balances due on allotment were fully received on 30 June 2007.

(v) The first and final call was made on 1 September 2007 and the amounts were fully received on 30 September 2007.

Required:

(a) The following ledger accounts to record the above transactions:
- Ordinary share capital
- Share premium
- Application and allotment
- First and final call.

All accounts should show dates, narratives and balances at the start and the end of the year where applicable.

(20)

The following events also took place during the year.

(i) On 1 October 2007, a building recorded in the accounts at £250 000 was revalued to £300 000.

(ii) On 1 November 2007, a transfer of £40 000 was made to the General Reserve.

Required:

(b) Journal entries to record transactions (i) and (ii). Narratives are **not** required.

(4)

The profit for the year ended 31 March 2008 was £246 000. The directors decided on a generous dividend payment for the year ended 31 March 2008. They decided to pay as a dividend, half of all the revenue reserves. The share price had a market value of £1.85 at 31 March 2008.

Required:

(c) Calculate the dividend per share paid for the year ended 31 March 2008.

(12)

(d) Calculate the dividend yield, clearly stating the formula used.

(4)

The directors of Karatoya Limited were also considering the possibility of raising finance for the business opportunity through a bank loan.

(e) Evaluate the use of a bank loan **or** ordinary shares as alternative methods of raising finance.

(12)

(Total 52 marks)

Answer space for question 2 is on pages 8 to 14 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. The balance sheets of Green Square plc as at 31 March 2007 and 31 March 2008 were as follows:

	31 March 2007 £	31 March 2008 £
Fixed assets		
Fixed assets at cost	600 000	660 000
Provision for depreciation	(200 000)	(215 000)
Fixed assets net book value	400 000	445 000
Current assets		
Stock	59 800	50 200
Debtors	25 200	25 800
Cash	4 000	1 000
	89 000	77 000
Current liabilities		
Creditors	(23 000)	(21 000)
Taxation due	(17 000)	(23 000)
Proposed dividends	(8 600)	(10 200)
Bank overdraft	(22 000)	(18 000)
	(70 600)	(72 200)
Long term liabilities		
16% Debenture	(50 000)	(50 000)
Net assets	368 400	399 800
Share capital and reserves		
Ordinary shares of £1 each	200 000	300 000
9 % Preference shares of £1 each	80 000	----------
General reserve	25 000	55 000
Profit and loss reserve	63 400	44 800
Total capital and reserves	368 400	399 800

The profit and loss appropriation account for the year ended 31 March 2008 is as follows.

Net operating profit	56 600
Taxation	(23 000)
Profit after tax	33 600
Transfer to General reserve	(30 000)
Dividends	(22 200)
Retained earnings for year	(18 600)
Retained earnings at 31 March 2007	63 400
Retained earnings at 31 March 2008	44 800

Additional information:

(i) At 31 March 2007, dividends of £5 000 were owed to ordinary shareholders and £3 600 was owed to preference shareholders. These dividends were paid during April 2007.

(ii) On 1 April 2007, machinery which cost £30 000, with a book value of £25 000, was sold for £19 000.

(iii) A transfer to the General Reserve of £30 000 was made during the year .

(iv) A £90 000 extension to the building was built and paid for during the year.

(v) An issue of 100 000 £1 Ordinary shares was made on 30 September 2007. On the same date, Preference shares worth £80 000 were redeemed.

(vi) A final dividend of £3 600 was paid to Preference shareholders on 30 September 2007. An interim dividend was paid to Ordinary shareholders during October 2007.

(vii) Interest on the bank overdraft for the year was £3 800.

Required:

(a) A statement reconciling the net operating profit to the net cash flow from operating activities for the year ended 31 March 2008.

(12)

(b) A cash flow statement for the year ended 31 March 2008 in accordance with Financial Reporting Standard (FRS) 1 Cash Flow Statements (revised).

(22)

(c) An analysis of the changes in bank and cash balances for the year ended 31 March 2008.

(6)

(d) Evaluate the relative importance of liquidity and profitability to a business.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 15 to 20 of the question paper.

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. Ranjeev Ali has decided to open his own business making leather jackets. He is not sure whether to produce high quality jackets or low quality jackets. If Ranjeev produces high quality jackets, he will use good quality material, each jacket will take longer to complete, and he will have to employ higher skilled labour. He will also have higher fixed costs. Ranjeev will be able to sell each high quality jacket at a higher price, but he would sell more jackets if he produced low quality jackets.

Ranjeev has prepared some estimated figures, shown below.

	High quality jacket	Low quality jacket
Material costs per square metre	£11	£8
Material required per jacket (sq. metres)	3	3
Labour costs per hour	£15	£13
Labour time per jacket (hours)	4	3
Fixed Costs per month	£2 300	£2 000
Selling Price per jacket	£149	£99
Estimated number of sales per month (units)	160	210

Required:

(a) Calculate the expected break even point **in units** for a month, for both the high quality jacket and the low quality jacket.

(12)

(b) Calculate the margin of safety **in units** for one month, for both the high quality jacket and the low quality jacket.

(4)

(c) Calculate the expected profit for a month, for both the high quality jacket and the low quality jacket.

(8)

(d) Evaluate which type of jacket Ranjeev should produce.

(8)

(Total 32 marks)

Answer space for question 4 is on pages 21 to 24 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. Hercules plc produces window frames to order. As demand may fluctuate, the directors of Hercules plc produce a flexible budget at the start of each month, using the latest figures available.

The following figures for an output of 2 000 units a month are available on 1 June 2008.

- Timber cost per unit produced — £4.80
- Labour cost per unit produced — £26
- Semi-variable costs
  - Transport — £800 per month plus £0.80 per unit produced
  - Water and Electricity — £625 per month plus £0.60 per unit produced
- Fixed costs — £11 500 per month
- Selling Price — £55 per unit
- For every 500 units produced above 2 000, the cost of timber per unit reduces by 5% **on all units**
- For every 500 units sold above 2 000, the selling price reduces by 10% **on all units**.

Required:

(a) A flexible budgeted profit and loss account for the month of June for the following output levels:
- 2 000 units
- 2 500 units
- 3 000 units.

(16)

(b) (i) Describe the effect on profit as output and sales increase.

(2)

(ii) Discuss what actions the directors of Hercules plc should take in these circumstances.

(6)

(c) Evaluate the use of flexible budgets to managers.

(8)

(Total 32 marks)

Answer space for question 5 is on pages 25 to 27 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. Capital Ventures is a new company, formed to sell merchandise for a major sporting event to be held in four years' time. After the major sporting event, the company will stop trading.

The directors have approached two merchant banks for funding. Each bank has put together a funding proposal of £30 million for the directors to consider. The details of each proposal are shown below.

Proposal A	£ million	Interest Rate/ Expected return
Debenture	5	16%
Bank Loan	5	14%
Preference Shares	5	12%
Ordinary Shares	15	10%
Total	30	

Proposal B	£ million	Interest Rate/ Expected return
Debenture	12	15%
Bank Loan	3	13.5%
Preference Shares	3	12.5%
Ordinary Shares	12	11%
Total	30	

Required:

(a) (i) For each funding proposal, calculate the weighted average cost of capital.
(10)

(ii) Select a funding proposal for the directors of Capital Ventures, giving a reason for your choice.
(2)

The expected sales for Capital Ventures are

Year 1	£300 000
Year 2	£500 000
Year 3	£1 200 000
Year 4	£60 000 000

The expected running costs for Capital Ventures (including depreciation) are

Year 1	£1 300 000
Year 2	£1 400 000
Year 3	£2 000 000
Year 4	£6 000 000

Depreciation is expected to be £800 000 per year for the first three years, and £1 000 000 for year 4.

Required:

(b) Calculate the Net Present Value (NPV) of the project to sell merchandise.

Select the most appropriate discount factor for the calculation of the Net Present Value (NPV) from the discount factors given in the table.

(12)

Year	10%	11%	12%	13%	14%	15%
1	0.909	0.901	0.893	0.885	0.877	0.870
2	0.826	0.812	0.797	0.783	0.769	0.756
3	0.751	0.731	0.712	0.693	0.675	0.658
4	0.683	0.659	0.636	0.613	0.592	0.572

(c) Evaluate the project for the company, using the calculations made, and considering any other relevant factors.

(8)

(Total 32 marks)

Answer space for question 6 is on pages 28 to 30 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. Hotel Maximus Limited purchased the smaller Hotel Splendide Limited on 1 April 2008. The directors of Hotel Maximus Limited agreed to take over all of the assets except the bank and cash balances, and to settle the liabilities. The purchase price was agreed at £2 000 000, which was settled by the issue to Hotel Splendide Limited shareholders of 1 000 000 ordinary shares of £1 each at a premium of £0.90 per share, with the balance settled in cash.

The balance sheets of the two companies on 31 March 2008 were as follows:

	Hotel Maximus Limited		Hotel Splendide Limited	
	£	**£**	**£**	**£**
Buildings	5 000 000		1 500 000	
Fixtures and Fittings	400 000		88 000	
Furniture	200 000		52 000	
Vehicles	30 000		–	
		5 630 000		1 640 000
Stock	25 000		6 000	
Debtors	5 000		2 000	
Bank	117 000		5 000	
Cash	32 000		1 000	
	179 000		14 000	
Short Term Loan	–		(50 000)	
Creditors	(64 000)		(10 000)	
	(64 000)		(60 000)	
Working capital		115 000		(46 000)
Net Assets		5 745 000		1 594 000
Ordinary Shares of £1 each	2 000 000		1 000 000	
Share Premium	1 000 000		200 000	
Profit & Loss Reserve	2 745 000		394 000	
Capital Employed		5 745 000		1 594 000

Additional information:

The assets of Hotel Splendide Limited were revalued as follows:

- Buildings to a current market value of £1 600 000
- Fixtures and fittings to a value of £75 000
- Furniture to a value of £30 000
- Stock to a net realisable value of £3 000
- Debtors to a value of £1 000.

Required:

(a) Calculate the goodwill paid by Hotel Maximus Limited in the purchase of Hotel Splendide Limited.

(8)

(b) Calculate the value of the cash received by Andy Kyriakies who holds 3600 shares in Hotel Splendide Limited.

(4)

(c) Prepare the balance sheet of Hotel Maximus Limited as at 1 April 2008.

(12)

(d) Evaluate the possible treatment of the goodwill in the accounts of Hotel Maximus Limited after 1 April 2008.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 31 to 33 of the question paper.

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