Paper Reference(s)
6002/01

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary/Advanced Level

Unit 2 – Corporate and Management Accounting

Tuesday 8 June 2010 – 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. Bengal Bay Railway plc had the following balances in the books at 31 March 2010, subject to final adjustments.

	Debit	Credit
	£	£
Accruals		7 400
Buildings	2 120 000	
Bank loan		3 000 000
Bank overdraft		652 000
Called-up share capital not paid	2 800	
Cash in hand	345 000	
Creditors		122 000
Debtors	24 000	
General reserve		500 000
Interest on bank loan		25 000
Land	5 150 000	
Licences and patents purchased	750 000	
Ordinary share capital called up		9 997 200
Plant and machinery	3 987 000	
Prepayments	4 760	
Profit and loss account		220 490
Provision for taxation		61 000
Provision for legal costs		250 000
Rent receivable	3 970	
Share premium account		1 999 440
Stocks of consumables	127 000	
Trains and locomotives	4 320 000	

Notes and final adjustments:

(i) The land is to be revalued upwards by £350 000 to its market value on 31 March 2010.

(ii) The bank requires the loan to be repaid in full on 31 December 2011.

Required:

(a) Prepare the balance sheet for Bengal Bay Railway plc as at 31 March 2010 **in accordance with format one of the Companies Act 1985**.

(40)

(b) A director has made the following comment at a Board meeting:

"In order to reduce expenditure, we should not have an Auditors' Report with the final accounts this year, as the Auditors' Report is not important."

Evaluate this statement.

(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. Lee Ping plans to go into business preparing ready-meals for supermarkets.

Lee Ping must first raise the capital for the business.

- In July 2010 he will open a business bank account, into which he will pay £6 500 of his savings and £8 500 cash received from an insurance policy.
- In August 2010 he will ask family and friends to buy a total of £15 000 of ordinary shares in his business.
- In September 2010 he will arrange a bank loan for £20 000.

Required:

(a) Prepare a Capital Budget for the months of July to September 2010.

(4)

In the first week of October 2010, Lee Ping plans to pay for the following:

- 4 machines to produce the meals, at a cost of £2 680 each
- 3 months factory rent at a cost of £995 per month
- furniture at £1 250
- a computer at £595
- a delivery van at £5 000.

He also plans for the first week in October to employ 3 workers, to be employed for 45 hours per week, at a rate of £5.50 per hour. Workers will be paid at the end of each week.

Additional information:

(i) Production will start in Week 2 of October. The 4 machines will run for 9 hours per day, 5 days per week. Each machine will produce 75 meals per hour.

(ii) Lee Ping will purchase raw materials for the meals on the day of production, at a cost of £0.32 per meal. All raw materials will be paid for by cash on the day of purchase.

(iii) Meals will be delivered to the supermarkets at the end of the day of production. Delivery van running costs will be £60 per day.

(iv) The supermarkets will pay Lee Ping £0.76 per meal. All sales to the supermarkets will be on credit. Revenue from sales will be received as follows:

- 50% one month after the sale
- 50% two months after the sale.

(v) Assume 4 weeks in each month.

(b) Prepare a Cash Budget for the 3 months October to December 2010.

(36)

(c) Evaluate the importance to Lee Ping of drawing up a Cash Budget before starting his business.

(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 Directors of Caledonian Bank plc have decided to merge with Highland Bank plc to form a new company. The new company is to be called St Andrew's Bank plc and is to have an Authorised Share Capital of 100 000 000 (100 million) ordinary shares of £1 each. The new company was formed on 1 April 2010.

The balance sheets of the two existing companies on 31 March 2010 were as follows:

	Caledonian Bank plc £ 000 000 (m)		**Highland Bank plc £ 000 000 (m)**	
Fixed Assets				
Buildings	16		17	
Machinery	1		2	
Fixtures and fittings	2		3	
Vehicles	2		3	
		21		25
Current Assets				
Stock	2		3	
Debtors	25		22	
Bank	4		2	
Cash	5		2	
		36		29
Current Liabilities				
Creditors	(3)		(7)	
Working capital		33		22
Net Assets		**54**		**47**
Ordinary shares of £1 each	40		50	
Share premium	10		10	
Profit & loss reserve	4		(13)	
Capital and reserves		**54**		**47**

Additional Information:

(i) St Andrew's Bank plc is to settle the purchase consideration by issuing to the shareholders of Caledonian Bank plc and Highland Bank plc, ordinary shares of £1 in St Andrew's Bank plc, valued at £1.25 each.

(ii) St Andrew's Bank plc is to take over the assets and liabilities at book value, with the following exceptions:

- The buildings were revalued at:
  Caledonian Bank plc £14 m
  Highland Bank plc £13 m
- The machinery was valued at:
  Caledonian Bank plc £0.6 m
  Highland Bank plc £1.4 m
- The fixtures and fittings were valued at:
  Caledonian Bank plc £1.4 m
  Highland Bank plc £1.6 m
- The vehicles were valued at:
  Caledonian Bank plc £1 m
  Highland Bank plc £1 m
- Debtors of £6 m of Caledonian Bank plc were written off as bad debts
  Debtors of £11 m of Highland Bank plc were written off as bad debts
- Goodwill was valued at £3 m for Caledonian Bank plc
  Goodwill for Highland Bank plc was valued at £0
- The purchase price of Caledonian Bank plc was £47 m.

Required:

(a) (i) Calculate the purchase price of Highland Bank plc.

(7)

(ii) State how many shares the members of Highland Bank plc will receive in St Andrew's Bank plc.

(4)

(b) In the books of Caledonian Bank plc, prepare the:

(i) Realisation account

(8)

(ii) Sundry shareholders account.

(7)

(c) Prepare the balance sheet of St Andrew's Bank plc as at 1 April 2010.

(14)

Sandra was a shareholder in Highland Bank plc.

(d) As Sandra's accountant, evaluate the merger on her behalf.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 16 to 23 of the question paper.

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. Marcos Kypries owns a factory producing blinds. Marcos uses a standard costing system and management by exception.

The budget and some actual figures for production for April were:

	Budget	**Actual**
Production (units)	1 050	1 050
Direct Materials	£6 615	?
Direct Labour	£7 056	?

- Each blind was budgeted to use 9 square metres of material in production and this was achieved.
- The budgeted price of material of £0.70 per square metre was achieved.
- 7 workers were employed and each worker produced the budgeted figure of 150 blinds for April.
- To produce the output, workers were budgeted to work 40 hours per week, for the 4 weeks in the month. Actual hours worked were 42 hours for each of the 4 weeks.
- The budgeted labour wage rate was £6.30 per hour, but an average actual rate of £6.50 per hour was paid.

Required:

(a) Calculate for the month of April, the total amount spent on:

(i) direct material **(4)**

(ii) direct labour. **(4)**

(b) Calculate for the month of April the:

(i) labour rate variance **(4)**

(ii) labour efficiency variance **(4)**

(iii) total labour cost variance. **(2)**

(c) Suggest and explain **two** actions Marcos could take to reduce the total labour cost variance.
(6)

(d) Evaluate the effectiveness of management by exception to Marcos.
(8)

(Total 32 marks)

Answer space for question 4 is on pages 24 to 27 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. You are the accountant for Red Arrow plc. You will have to report on the final accounts of the company to the Board of Directors meeting. Information concerning the performance of the company for the financial year ended 31 March 2010 is as follows:

Authorised share capital	5 000 000 (5 million) £1 Ordinary shares
Issued share capital	4 000 000 (4 million) £1 Ordinary shares
Net profit after interest and tax	£280 000
Capital employed	£6 000 000 (6 million)
Total ordinary dividend paid for year	£240 000
Share price	£0.84 per share

Required:

(a) Calculate the following ratios, clearly stating the formula used:

(i) Return on Capital employed **(4)**

(ii) Earnings per ordinary share **(4)**

(iii) Dividend paid per share **(4)**

(iv) Dividend cover **(4)**

(v) Price/earnings ratio **(4)**

(vi) Dividend yield. **(4)**

At the board meeting, you must report how Red Arrow plc has performed as a business compared to the industry average.

Figures for the industry average are as follows:

Return on capital employed	6.5%
Earnings per ordinary share	8p per share
Dividend per share	5.5p per share
Dividend cover	2.5 times
Price/earnings ratio	9 times
Dividend yield	4%

(b) Evaluate how Red Arrow plc has performed as a business compared to the industry average, for the financial year ended 31 March 2010. **(8)**

(Total 32 marks)

Answer space for question 5 is on pages 28 to 31 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. The directors of Airwaves plc are considering making a bid to operate the satellite television channel being offered by the government. The licence to operate the television channel will be for five years. Airwaves plc has carried out research to discover possible costs and revenues of the project.

The following figures have been estimated:

(i) The initial cost of the project will be £50 000 000. This will include all fixed assets required for the project, at a cost of £25 000 000. The fixed assets are to be written off over 5 years using the straight line method.

(ii) Running expenses, including depreciation, for the first two years are forecast to be £10 000 000 per year. In year three, running expenses, including depreciation, are forecast to rise by £2 000 000. In years four and five, running expenses are expected to stay at the same level as in year three.

(iii) For the first year it is expected the channel will have 90 000 customers, each paying a £150 subscription fee per year. In years two and three, it is expected the channel will have 110 000 customers, each paying a £175 subscription fee per year. In years four and five, it is expected the channel will have 130 000 customers, each paying a £200 subscription fee per year.

(iv) It is company policy only to invest in projects achieving an accounting rate of return (average rate of return) of 8% per year.

Required:

(a) Calculate for the project the:

(i) payback period, showing your answer in years and months

(16)

(ii) accounting rate of return (average rate of return).

(8)

(b) 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 32 to 35 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. You are an accountant and attend a meeting of business people in your town. At this meeting you are asked to answer questions concerning break-even analysis.

Required:

(a) Answer the following questions put forward by local business people at the meeting.

(i) "Can you explain the difference between semi variable costs and variable costs, and give **three** examples of each?"

(8)

(ii) "Is contribution the same as profit?"

(8)

A client, Amin Singh, has given you the following information and requires your advice. Amin plans to go into business making flash drives for computers. His fixed costs are expected to be £1 250 per month. Variable costs are expected to be £3.84 per unit produced. Amin has been told by a large wholesaler of computer equipment that he can sell to them at a selling price of £6.00 per unit. He tells you that he aims to make a profit of £2 000 per month.

(b) Calculate the number of items Amin has to sell in order to achieve his target profit of £2 000 per month.

(8)

(c) Evaluate the effectiveness of break-even analysis as an aid to business decision-making.

(8)

(Total 32 marks)

Answer space for question 7 is on pages 36 to 39 of the question paper.