

Pearson Edexcel
International Advanced Level

Accounting (Modular Syllabus)
Unit 2: Corporate and Management Accounting

Monday 8 June 2015 – Morning
Source booklet

Paper Reference
WAC02/01

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PEARSON

SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

- 1 The Statements of Financial Position of Maltese Construction plc at 31 March 2014 and 31 March 2015 were as follows:

| | 31 March 2014 | 31 March 2015 |
|--|------------------|------------------|
| ASSETS | £ | £ |
| Non-current Assets | | |
| Property, plant and equipment at cost | 5 428 000 | 5 728 000 |
| Provision for depreciation | (1 650 000) | (1 979 000) |
| Property, plant and equipment carry over | 3 778 000 | 3 749 000 |
| Shares held in other companies | 1 085 000 | 1 260 000 |
| | 4 863 000 | 5 009 000 |
| | | |
| Current Assets | | |
| Inventories | 744 000 | 656 000 |
| Trade and Other receivables | 621 000 | 537 000 |
| Cash and cash equivalents | 326 000 | 435 000 |
| | 1 691 000 | 1 628 000 |
| | | |
| Total Assets | <u>6 554 000</u> | <u>6 637 000</u> |
| | | |
| EQUITY AND LIABILITIES | | |
| Equity & Reserves | | |
| Share capital – Ordinary shares of £1 | 3 500 000 | 3 000 000 |
| 3% Redeemable preference shares of £1 | 320 000 | 320 000 |
| Share Premium | 700 000 | 650 000 |
| Retained earnings | 453 000 | 757 000 |
| | 4 973 000 | 4 727 000 |
| | | |
| Non-current Liabilities | | |
| 6% Bank Loan | ----- | 1 500 000 |
| | | 1 500 000 |
| | | |
| Current Liabilities | | |
| 5.5% Debenture 2014 | 1 000 000 | ----- |
| Trade and Other payables | 373 000 | 342 000 |
| Current Tax payable | 208 000 | 68 000 |
| | 1 581 000 | 410 000 |
| | | |
| Total Equity and Liabilities | <u>6 554 000</u> | <u>6 637 000</u> |
| | | |

Additional information:

- (i) Plant bought for £900 000, with depreciation to date of £360 000 was sold for £420 000 on 4 April 2014.
- (ii) Property was bought for £1 200 000 on 11 May 2014.
- (iii) On 16 May 2014 ordinary shareholders received a final dividend for year ended 31 March 2014 of 2 pence (£0.02) per share.
- (iv) A redemption of 500 000 £1 Ordinary shares at a premium of 10 pence (£0.10) per share was made on 31 August 2014.
- (v) On 1 October 2014, the following took place:
 - 5.5% debenture of £1 000 000 was redeemed
 - 6% bank loan of £1 500 000 was received
- (vi) Ordinary shareholders received an interim dividend of 1 pence (£0.01) per share on 20 October 2014.
- (vii) A purchase of shares in other companies took place on 12 December 2014.
- (viii) Preference shareholders received their dividends in full during the year.
- (ix) Profit after interest but before tax for the year ended 31 March 2015 was £481600.

Required:

- (a) Prepare a Statement of Cash Flow for the year ended 31 March 2015 in accordance with International Accounting Standard (IAS) 7 Statement of Cash Flows (revised). (40)
- (b) Evaluate the change in the gearing ratio of Maltese Construction plc from 31 March 2014 to 31 March 2015. State the formula that you have used. (12)

(Total for Question 1 = 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** Nazir Aiman bought a business producing t-shirts on 1 April 2014. When the business was purchased, the inventory was 4 200 t-shirts at an agreed value of £16 800. You are in practice as an accountant, and your client, Nazir, has asked you to prepare the accounts for the year ended 31 March 2015. Nazir has asked you to value the closing inventory using both the marginal costing method and the absorption costing method.

The following information is available for the year ended 31 March 2015.

- Fixed overheads – £2 450 per week
- Semi-Variable costs – £850 fixed element per week plus 22 pence (£0.22) per t-shirt
- Direct materials – 95 pence (£0.95) per t-shirt
- 25 direct staff are employed, who each work 8 hours and 20 minutes a day, for 5 days a week
- Direct labour – 25 minutes work per t-shirt at a wage rate of £6.00 per hour
- The quantity of t-shirts produced is determined by the speed of the direct labour, not the size of the order
- Sales price – £6.50 per t-shirt
- The business has a contract to supply a major overseas retailer with 2 400 t-shirts a week, which it fulfils. There are no other customers.
- Assume 50 weeks in a year

Required:

- (a) Calculate the quantity of t-shirts produced in one year. (6)
- (b) Prepare for Nazir, a statement showing the net profit, for the year ended 31 March 2015, using:
- (i) marginal costing inventory valuation
 - (ii) absorption costing inventory valuation
- (20)

Nazir is aware that his level of inventory is increasing. He has tried to find customers who may buy some of the inventory. He has received offers from a:

- (i) shop owner who has offered to buy 3 000 t-shirts at £4.00 per t-shirt.
- (ii) market trader who has offered to buy 2 000 t-shirts at £5.50 per t-shirt.
- (iii) wholesaler who has offered to buy 4 000 t-shirts at £3.50 per t-shirt.

Required:

- (c) Advise Nazir Aiman whether to accept the offer from the:
- (i) shop owner
 - (ii) market trader
 - (iii) wholesaler
- (14)

Nazir has stated, "I must prepare my final accounts using absorption costing, because it makes me more profit".

Required:

- (d) Evaluate this statement and advise Nazir whether he should use marginal costing or absorption costing to value his inventory.

(12)

(Total for Question 2 = 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 Purple Waves plc has been granted a licence to operate a mobile phone network in another country for 5 years. The cost of the licence and other start-up costs total £400 million.

The finance director has prepared two possible options to finance the funding of the project. The details of each option are shown below.

| Option A | £m | Interest Rate/ Expected return |
|-------------------|------------|-----------------------------------|
| Debenture | 100 | 9% |
| Bank Loan | 50 | 8% |
| Preference Shares | 50 | 6% |
| Ordinary Shares | <u>200</u> | 4% |
| Total | 400 | |

| Option B | £m | Interest Rate/ Expected return |
|-------------------|------------|-----------------------------------|
| Debenture | 50 | 8% |
| Bank Loan | 200 | 9% |
| Preference Shares | 40 | 4% |
| Ordinary Shares | <u>110</u> | 4% |
| Total | 400 | |

Required:

- (a) For each funding option, calculate the weighted average cost of capital. (12)
- (b) (i) Select the most appropriate funding option for the directors of Purple Waves plc. (2)
- (ii) Give **one** reason for your choice of funding option. (2)

Additional Information:

- In year 1, the number of customers is estimated to be 1 million paying £180 each, a year.
- In years 2 and 3, the number of customers is estimated to be 1.8 million each year, paying £190 a year.
- In years 4 and 5, the number of customers is estimated to be 2.2 million each year, paying £200 a year.
- In year 1 the running costs (including depreciation) are estimated to be £285 million per year.
- In years 2 and 3, the running costs (including depreciation) are estimated to be £300 million for each year.
- In years 4 and 5, the running costs (including depreciation) are estimated to be £340 million for each year.
- Depreciation is estimated to be £80 million for each year.
- The directors of Purple Waves plc require investments to give an average rate of return (accounting rate of return) of 10%.
- A table showing the discount factors is given.

| Year | 3% | 4% | 5% | 6% | 7% | 8% | 9% |
|------|-------|-------|-------|-------|-------|-------|-------|
| 1 | 0.971 | 0.962 | 0.952 | 0.943 | 0.935 | 0.926 | 0.917 |
| 2 | 0.943 | 0.925 | 0.907 | 0.890 | 0.873 | 0.857 | 0.842 |
| 3 | 0.915 | 0.889 | 0.864 | 0.840 | 0.816 | 0.794 | 0.772 |
| 4 | 0.888 | 0.855 | 0.823 | 0.792 | 0.763 | 0.735 | 0.708 |
| 5 | 0.863 | 0.822 | 0.784 | 0.747 | 0.713 | 0.681 | 0.650 |

Required:

- (c) Calculate the Net Present Value of the project at the end of year 5. (15)
- (d) Calculate the average rate of return (accounting rate of return) of the project. (9)
- (e) Evaluate the project for the company, using the calculations made, and considering any other relevant factors. (12)

(Total for Question 3 = 52 marks)

Answer space for question 3 is on pages 15 to 23 of the question paper.

SECTION B**SOURCE MATERIAL FOR USE WITH QUESTION 4**

- 4** George and Mary run a farm. The business is seasonal, and on 1 July 2015, they expect to be overdrawn by £4 000. They have been asked to meet the bank manager to discuss the overdraft. The bank manager has asked George and Mary to bring a monthly cash budget for the 6 months 1 July 2015 to 31 December 2015 to the meeting. George and Mary have asked you, their accountant, to draw up the monthly cash budget.

The following information is available:

- The farm shop is only open in July and August and sells fruit for cash. Sales are expected to be £80 per day, 7 days a week.
- Expenses of the farm shop are £10 per day.
- The wheat is to be harvested in August and sold to a flour producer for £195 per ton. The harvest is estimated to be 45 tons. The flour producer will pay in September.
- In August and September, fruit will be sold to supermarkets for £2 500 for **each** month. The supermarkets will pay two months after the sale.
- Vegetables will be harvested and sold in September, October and November, for £900 **each** month, to a factory. The factory will pay one month after the sale.
- In November and December, animals will be taken to the market and sold for cash, for £130 per animal. Each month, 5 animals will be sold at the market.
- In July, August and September, a farm worker will be employed and paid £175 per week.
- Feed and fertiliser £235 per month
- Power and fuel £175 per month
- Depreciation £150 per month
- Other fixed costs £25 per week
- Drawings for George and Mary will be £180 each per week.
- Assume 4 weeks in a month.

Required:

- (a) Prepare a monthly cash budget for the farm, for **each** month of the 6 month period 1 July 2015 to 31 December 2015.

(24)

At the meeting, the bank manager recommends a 6 month bank loan for George and Mary from 1 July 2015 for £6 000.

Required:

(b) Evaluate the Bank Manager's recommendation.

(8)

(Total for Question 4 = 32 marks)

Answer space for question 4 is on pages 24 to 26 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 5

- 5** Middle East Medical plc agreed to purchase Lifejoy plc on 1 April 2015. The directors of Middle East Medical plc have agreed to take over all of the assets of Lifejoy plc, except cash and cash equivalents and to settle all the liabilities except the current tax payable. The purchase price was agreed as a cash payment of £1.03 for every one share held in Lifejoy plc.

The Statements of Financial Position of the two companies at 31 March 2015, before any revaluations, were as follows:

| | MIDDLE EAST MEDICAL plc | | LIFEJOY plc | |
|-------------------------------------|------------------------------------|--------------------|--------------------|-------------------|
| | £ | £ | £ | £ |
| Assets | | | | |
| Non-current Assets | | | | |
| Property, plant and equipment | 355 000 000 | | 80 382 000 | |
| Intangible assets | <u>98 000 000</u> | | <u>2 000 000</u> | |
| | | 453 000 000 | | 82 382 000 |
| Current Assets | | | | |
| Inventories | 27 800 000 | | 3 120 000 | |
| Trade and Other Receivables | 14 660 000 | | 624 000 | |
| Cash and Cash equivalents | <u>258 117 000</u> | | <u>78 000</u> | |
| | | <u>300 577 000</u> | | <u>3 822 000</u> |
| Total Assets | | <u>753 577 000</u> | | <u>86 204 000</u> |
| | | | | |
| Equity and Liabilities | | | | |
| Equity | | | | |
| Ordinary Shares of £1 each | 250 000 000 | | | |
| Ordinary Shares of £0.25 each | | | 24 000 000 | |
| Share Premium | 100 000 000 | | 24 000 000 | |
| Retained earnings | <u>286 595 000</u> | | <u>16 760 000</u> | |
| | | 636 595 000 | | 64 760 000 |
| | | | | |
| Non-current Liabilities | | | | |
| Mortgage | 100 000 000 | | ----- | |
| Bank Loan | ----- | | <u>20 000 000</u> | |
| | | 100 000 000 | | 20 000 000 |
| Current Liabilities | | | | |
| Trade and Other payables | 12 263 000 | | 524 000 | |
| Current tax payable | 4 719 000 | | 795 000 | |
| Short term provisions | ----- | | <u>125 000</u> | |
| | | <u>16 982 000</u> | | <u>1 444 000</u> |
| Total Equity and Liabilities | | <u>753 577 000</u> | | <u>86 204 000</u> |

Additional information:

The assets of Lifejoy plc were revalued as follows:

- Property with a book value of £14 000 000 to a current market value of £17 750 000
- Plant with a book value of £6 000 000 was reduced by £1 200 000
- Trade Receivables were reduced by 10%
- A newly granted patent for a medical cure, classed as an intangible, was to be valued at £12 000 000 and entered into the books of Lifejoy plc

Required:

- (a) Calculate the purchase price of Lifejoy plc. (4)
- (b) Prepare the Acquisition Account in the books of Middle East Medical plc to show the purchase of Lifejoy plc. (6)
- (c) Prepare the Statement of Financial Position of Middle East Medical plc at 1 April 2015 after the purchase of Lifejoy plc. (14)
- Middle East Medical plc financed the purchase of Lifejoy plc by cash.
- (d) Evaluate the use of cash to finance the purchase of a company. (8)

(Total for Question 5 = 32 marks)

Answer space for question 5 is on pages 27 to 31 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 6

- 6 Tangapur Paper Limited produces paper at its factory. The company has a standard costing system.

The following information is available for the month of April 2015.

| | BUDGET | ACTUAL | VARIANCE |
|----------------------|-----------------|-----------------|----------|
| | £ | £ | £ |
| Revenue | 165 000 | 162 500 | |
| Less | | | |
| Material Costs | (47 890) | (49 910) | |
| Labour Costs | (24 640) | (24 057) | |
| Variable Overheads | <u>(36 620)</u> | <u>(38 880)</u> | |
| = Cost of Sales | (109 150) | (112 847) | |
| Gross Profit | 55 850 | 49 653 | |
| Less Fixed Overheads | <u>(54 750)</u> | <u>(54 750)</u> | |
| Net Profit | 1 100 | (5 097) | |

Required:

- (a) Complete the Variance column, in the answer booklet, for the month of April 2015.

(7)

The following information is also available for April 2015:

- The budgeted production of 420 tons of paper for April 2015 was achieved.
- Budgeted labour was 28 workers, each working 40 hours a week, for four weeks in a month, at £5.50 per hour.
- One worker left on 31 March and was not replaced. This left 27 workers for the month of April.
- Management called an emergency meeting on 1 April and explained to workers the company was experiencing financial problems. Workers agreed to accept a 10 pence (£0.10) an hour reduction in pay with immediate effect.
- Due to mechanical problems, and to complete the budgeted production, all the workers worked 5 hours overtime at the reduced rate of pay.

Required:

(b) Calculate the:

- (i) labour efficiency variance for the month of April 2015. (5)
- (ii) labour rate variance for the month of April 2015. (5)

The budget for May 2015 has been produced. The budgeted fixed overheads for May 2015 are £56 290.

A junior member of the accounting staff stated "I see that the figure for fixed overheads for May 2015 has risen. I thought the fixed overheads figure did not change."

Required:

- (c) (i) Briefly explain why a fixed overhead figure may change. (1)
- (ii) Give **three** examples of fixed overheads that may rise, and explain briefly why they may increase. (6)
- (d) Evaluate the usefulness of a standard costing system to Tangapur Paper Limited. (8)

(Total for Question 6 = 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 Jiao Suen holds 500 shares in China Capital plc. She bought the shares on 31 March 2014 for £1.87 per share. At the end of the financial year ended 31 March 2015, she is considering two options:

- to keep the shares in China Capital plc

OR

- sell the shares in China Capital plc and buy shares in Kowloon Investments plc.

Jiao Suen has obtained a copy of the accounts of Kowloon Investments plc from the internet. The accounts show the following information.

| Information for Kowloon Investments plc | |
|--|--|
| Authorised share capital | 80 million (80 000 000) 75 pence (£0.75) Ordinary shares |
| Issued share capital | 60 million (60 000 000) 75 pence (£0.75) Ordinary shares |
| Net profit before interest and tax | £5 760 000 |
| Net profit after interest and tax | £4 320 000 |
| Total Equity | £49 500 000 |
| Non-Current liabilities | £10 500 000 |
| Total ordinary dividend paid for year | £ 2 880 000 |
| Share price | £1.20 |

Required:

(a) Using the information for Kowloon Investments plc calculate the following ratios:

- | | |
|----------------------------------|-----|
| (i) Return on Capital Employed | (3) |
| (ii) Earnings per ordinary share | (3) |
| (iii) Price/earnings ratio | (3) |
| (iv) Dividend paid per share | (3) |
| (v) Dividend cover | (3) |
| (vi) Dividend yield | (3) |

Jiao Suen has been sent a copy of the final accounts of China Capital plc for the financial year ended 31 March 2015. These accounts show:

| Information for China Capital plc | |
|--|------------------------------|
| Return on capital employed | 8.1% |
| Earnings per ordinary share | 15 pence (£0.15) per share |
| Price/earnings ratio | 14 times |
| Dividend paid per share | 6.3 pence (£0.063) per share |
| Dividend cover | 2.38 times |
| Dividend yield | 3% |
| Share price at 31 March 2014 | £1.87 |
| Share price at 31 March 2015 | £2.10 |

Required:

(b) Calculate the:

(i) total capital gain made by Jiao Suen, due to the rise in the share price, over the financial year ended 31 March 2015, for the shares she holds in China Capital plc. (3)

(ii) total income received by Jiao Suen as a result of the dividends paid for the financial year ended 31 March 2015, for the shares she holds in China Capital plc. (3)

(c) Evaluate whether Jiao Suen should keep her shares in China Capital plc, or sell her shares and buy shares in Kowloon Investments plc. (8)

(Total for Question 7 = 32 marks)

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

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