Cambridge Assessment
International Education

Cambridge International AS & A Level

ACCOUNTING **9706/31**

Paper 3 Structured Questions **October/November 2021**

INSERT **3 hours**

INFORMATION

- This insert contains all of the required information and questions. The questions are provided in the insert for reference only.
- You may annotate this insert and use the blank spaces for planning. **Do not write your answers** on the insert.

This document has **12** pages.

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Section A: Financial Accounting

Question 1

Source A1

EN plc is a manufacturing company. Its statement of changes in equity for the year ended 31 December 2020 was as follows.

	Ordinary share capital	Share premium	General reserve	Revaluation reserve	Retained earnings	Total
	$000	$000	$000	$000	$000	$000
Balance at 1 January 2020	200	50			190	440
Rights issue of shares	100	80				180
Final dividend (2019)					(25)	(25)
Bonus issue of shares	50				(50)	0
Interim dividend (2020)					(15)	(15)
Transfer			40		(40)	0
Revaluation of premises				120		120
Profit for the year					10	10
Balance at 31 December 2020	350	130	40	120	70	710

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) State which bookkeeping entry reduced the ability of the company to pay dividends legally in the future. [1]

Additional information

1 On 1 January 2020 the business had a bank overdraft of $42 000. It paid interest of $3000 on the overdraft during the year ended 31 December 2020.

2 Depreciation charges for the year totalled $112 000.

3 During the year ended 31 December 2020 some machinery was disposed of for $47 000. This had originally cost $92 000 and depreciation of $31 000 had been provided on it.

4 Several new delivery vehicles were purchased during the year, at a total cost of $185 000. New machinery costing $106 000 was also purchased.

5 On 1 April 2020 the company issued a 10% debenture of $200 000. By the year end only six months' interest had been paid.

6 The working capital of the company, excluding the bank account and accrued interest, increased by $45 000 during the year ended 31 December 2020.

7 The directors planned to expand the factory during 2021, using funds raised by the debenture issue.

(b) Prepare the statement of cash flows for the year ended 31 December 2020 in accordance with IAS 7. [15]

(c) Advise the directors whether or not the performance of the company is satisfactory. Justify your answer. [4]

(d) Discuss the decision to issue the debenture to fund the planned expansion. [5]

[Total: 25]

Question 2

Source A2

DW Limited is a small manufacturing company which seeks to implement the requirements of International Accounting Standards. Its financial year end is 31 December.

At the end of 2019, the directors decided to replace the manual accounting system with a computerised one. At the beginning of 2020, the company bought the computer equipment and the software, and sent staff on a training course.

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Outline the next steps the company needed to take to implement the computerised accounting system. Your answer should consider the need for both accuracy and security. [8]

Additional information

The company accountant prepared the draft income statement of the company for the year ended 31 December 2020. When the finance director reviewed it he thought that it might contain errors. He identified five areas where he thought an error might have occurred. These were as follows.

1 The staff training had cost $5000. Since the employees of the company usually stay with the company for about ten years, the accountant had decided to charge $500 to expenses for staff training each year for ten years, starting in 2020.

2 An impairment review had considered vehicles with a carrying amount of $72 000. It found that their fair value was $67 000 and their value in use was $65 000. The accountant included an impairment loss on vehicles of $7000 in expenses.

3 An impairment review had considered machinery with a carrying amount of $98 000. It found that its fair value was $81 000 and its value in use was $102 000. The accountant included an impairment loss on machinery of $17 000 in expenses.

4 Water damage had destroyed inventory costing $8000 on 5 January 2021. The accountant took this loss into account when preparing the income statement.

5 The premises had been revalued upwards by $28 000 at the year end. The accountant omitted to record this.

(b) Complete the table given in the question paper showing the **effect of the correction** of errors on the draft profit for the year.

In the second column enter the amount by which the draft profit for the year would change due to any correction of errors. State whether the correction increases or decreases the profit. If no correction is needed enter **Nil**.

In the third column explain why the correction is needed, or why no correction is needed. [15]

(c) Explain why the errors, corrected in **(b)**, had not been caused by the computerised accounting system. [2]

[Total: 25]

Question 3

Source A3

Eunice and Malcolm had been in partnership for five years. They had agreed at the start that Eunice would provide most of the capital and Malcolm would provide labour by devoting his time to running the business. They, therefore, decided on a profit sharing ratio of 4:1.

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Suggest **two** ways, other than the profit sharing ratio, in which a partnership could reward the introduction of capital and labour by partners. [2]

Additional information

Eunice and Malcolm decided to retire and agreed to sell their business to FD Limited, receiving shares in return.

(b) State **three** differences between being a partner in a partnership and a shareholder in a limited company. [6]

Additional information

The partnership was sold on 31 December 2020. The summarised statement of financial position of the partnership on that date was as follows.

		$
Non-current assets		88 000
Trade receivables		19 600
Bank		100
		107 700
Capital accounts	– Eunice	80 000
	– Malcolm	15 000
Current accounts	– Eunice	10 000
	– Malcolm	(5 000)
Trade payables		7 700
		107 700

FD Limited took over all the assets and liabilities of the partnership including the bank account. The purchase consideration was $175 000, consisting of 140 000 ordinary shares of $1 each. These were divided between Eunice and Malcolm on the basis of the balance on each partner's capital account on dissolution.

(c) Calculate the number of shares received by **each** partner. [6]

Additional information

The profit for the partnership had been $30 000 a year.

FD Limited had a profit for the year of $600 000 in the year ended 31 December 2020. On that date the company had 1 million ordinary shares in issue. It was the policy of the company to have a dividend cover of 3 times.

(d) Advise Malcolm whether or not he made the right decision when agreeing to sell the partnership. Support your answer with calculations. [7]

Additional information

FD Limited took over the non-current assets at a valuation of $130 000. All other assets and liabilities were taken over at their book values.

(e) Prepare the journal entry recording the acquisition of the partnership in the books of FD Limited. A narrative is **not** required. [4]

[Total: 25]

Question 4

Source A4

X Soc is a charitable not for profit organisation. It is run by a group of volunteers and its aim is to provide specialist wheelchairs for disabled athletes. It runs a charity shop in the city centre where people donate unwanted items which are then sold to earn a profit for the organisation. It also receives cash donations from the public and grants from the national government.

X Soc was formed on 1 January 2020. At the end of the first year of operation the following accounts were prepared.

X Soc

Charity shop trading account for the year ended 31 December 2020

	$	$
Revenue		126 000
Shop rent	18 000	
Shop operating costs	17 400	
		35 400
Profit for the year		90 600

Receipts and payments account for the year ended 31 December 2020

	$		$
Grants	80 000	Administrative expenses	14 220
Cash donations	96 520	Advertising and fundraising	27 240
Cash sales	126 000	Purchase of computer	7 000
		Payments to wheelchair suppliers	212 660
		Shop rent	19 000
		Shop operating costs	14 680
		Balance c/d	7 720
	302 520		302 520

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Explain how the trading account of a charity shop is different from that of a business. [4]

Additional information

1 Advertising costs included $7200 for a series of advertisements running from November 2020 to April 2021.

2 On 31 December 2020 deposits paid for wheelchairs ordered but not yet manufactured amounted to $39 400.

3 Accruals at the year end included $450 for administrative expenses.

4 It was decided that the cost of the computer should be written off in equal instalments over five years.

(b) Prepare the income and expenditure account for the year ended 31 December 2020. [7]

(c) Prepare the statement of financial position at 31 December 2020. [8]

(d) Suggest **two** ways in which X Soc could increase its income. [2]

(e) Explain why the accumulated fund of a not for profit organisation may not be equal to the balance on its bank account. [2]

(f) Explain why the financial statements of some not for profit organisations may contain entries for subscriptions. [2]

[Total: 25]

Section B: Cost and Management Accounting

Question 5

Source B1

AR plc has been setting its budgets for 2022. It has prepared the following production budget (in **units**).

	January	February	March	April	May	June
Opening inventory	35	36	36	34	33	31
Production	121	130	148	159	138	104
	156	166	184	193	171	135
Sales	(120)	(130)	(150)	(160)	(140)	(100)
Closing inventory	36	36	34	33	31	35

The following additional information is also available.

1 The variable cost of **each** unit is expected to be:

Direct material	8 metres at $5 per metre	Paid in the month following purchase.
Direct labour	Normally $80	Paid in month of working. When more than 140 units are produced in any one month, an overtime premium will be paid amounting to an extra $10 for each unit in excess of 140.
Variable overheads	$25	Paid in the month of production.

2 It is the policy of the company to maintain an inventory of direct materials equal to one quarter of the quantity needed in the coming month.

3 The directors plan to replace a substantial amount of machinery in April 2022. The new machinery will cost $13 000 and the sale proceeds of the old machinery are expected to be $2000.

4 Other running costs of $3800 are expected to be paid monthly.

5 The selling price is expected to be $200 per unit. 25% of sales are cash sales and 75% are credit sales. Credit customers pay in full in the month after the sale.

6 The balance on the bank account on 1 March 2022 is expected to be $1700.

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Prepare the purchases budget for direct materials (in dollars) for **each** of the months February, March and April 2022. [6]

(b) Prepare the cash budget for **each** of the months March and April 2022. [14]

(c) Comment on the suitability of the month of April for the replacement of the machinery. [2]

Additional information

One of the directors has suggested that the company limit production to 140 units every month to avoid having to pay the overtime premium and so reduce costs.

(d) Advise the directors whether or not they should limit production to 140 units a month. Justify your answer. [3]

[Total: 25]

Question 6

Source B2

W Limited started business on 1 January 2021. It manufactures one product in two sizes, small and large. It sets its selling prices at total cost plus a mark-up of 50%.

It provided the following information for January 2021.

	Small	Large
Production units	5000	1000
Direct material per unit	0.5 kilos at $10/kilo	2 kilos at $10/kilo
Direct labour per unit	15 minutes at $8/hour	45 minutes at $8/hour

Production overheads amounted to $30 000 and selling and administrative costs to $24 000 for the month. These fixed costs were absorbed on a per unit basis.

Answer the following questions in the question paper. Questions are printed here for reference only.

(a) Prepare a statement showing the production cost **and** the selling price of **one** unit for each size of product. [6]

Additional information

An analysis of the monthly production overheads showed the following.

Activity	$
Machine set ups	10 200
Order processing	12 600
Quality inspections	7 200
Total	30 000

These activities took place as follows.

	Small	Large
Machine set ups (times)	72	30
Order processing (times)	120	60
Quality inspections (times)	12	12

(b) Prepare a revised statement showing the production cost **and** the selling price of **one** unit for each size of product using the activity information. (The basis of apportionment for the selling and administrative costs should be unchanged.) [8]

Additional information

On 31 January 2021 it was established that 400 units of the small product and 200 units of the large product remained unsold. There was no work in progress.

The profit for January 2021 using absorption costing was calculated at $48 400.

(c) Calculate the profit which would have been earned if selling prices had been amended to account for the levels of activity which took place. [6]

(d) Advise the directors whether or not they should change the basis of allocation of overheads and the selling prices. Justify your answer. [5]

[Total: 25]