Cambridge Assessment International Education

Cambridge International AS & A Level

ACCOUNTING **9706/32**

Paper 3 Structured Questions **February/March 2020**

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. Blank pages are indicated.

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Section A : Financial Accounting

Question 1

Source A1

T Limited, a manufacturing company, extracted the following balances from its books of account for the year ended 31 December 2019.

	$
Sales revenue	782 000
Purchases of raw materials	200 400
Direct wages	206 400
Direct manufacturing expenses	8 600
Rent and rates	72 000
Repairs	18 000
Carriage inwards	6 600
Carriage outwards	16 300
Inventory at 1 January 2019	
Raw materials	17 300
Work in progress	20 400
Finished goods (cost)	55 000
Other administrative expenses	66 200

The following information is also available.

1 T Limited transfers the finished goods to the trading section of the income statement at total production costs plus a mark-up which is not constant. The transfer price represents the amount that T Limited would have had to pay if the goods were purchased from an outside supplier.

2 The transfer value for the year ended 31 December 2019 was $632 400. The mark-up for the 2018 transfer value was 20%.

3 Inventory at 31 December 2019:

	$
Raw materials	18 700
Work in progress	21 500
Finished goods (at transfer price)	75 888

4 At 31 December 2019, rent and rates remaining unpaid amounted to $3000.

5 The depreciation charge for the year 2019 amounted to $48 000.

6 The following expenses are to be apportioned as follows:

	Factory	Administrative
Rent and rates	3/5	2/5
Repairs	3/4	1/4
Depreciation	2/3	1/3

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

(a) Prepare the manufacturing account for the year ended 31 December 2019. [8]

(b) Prepare the income statement for the year ended 31 December 2019. [7]

(c) Calculate the amount at which finished goods are included in inventory at 31 December 2019. [2]

(d) Explain, with the support of accounting concepts, the treatment of unrealised profit on finished goods in **both** the income statement and statement of financial position. [5]

(e) Advise the directors of T Limited whether or not they should continue basing the transfer price on the price paid to an outside supplier. Justify your answer. [3]

[Total: 25]

Question 2

Source A2

SS Club had the following balances at 31 December.

	2018	2019
	$	$
Café equipment (net book value)	126 500	101 200
Furniture and fixtures (net book value)	48 200	66 560
Café inventory	13 000	?
Subscriptions in advance	2 600	1 500
Subscriptions in arrears	3 800	4 200
Café trade payables	26 400	29 600
Café wages accrued	5 000	Nil
Cash at bank	33 500	?

The following information related to the year ended 31 December 2019.

1 Café sales $240 000 were on a cash basis. All café takings were banked on the same day. One quarter of the café sales were made to non-members at a gross margin of 50%. The remaining café sales were made to members at a gross margin of 40%.

2 Café purchases were $141 000.

3 No records had been kept for ascertaining café inventory at 31 December 2019.

4 There were no purchases or disposals of café equipment.

5 Café wages recognised in the income and expenditure account were $46 000.

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

(a) Prepare the café trading account for the year ended 31 December 2019, showing clearly the closing café inventory. [5]

Additional information

The club had prepared an income and expenditure account for the year ended 31 December 2019. The following items were shown in the income and expenditure account.

	$
Subscriptions	322 000
Administrative expenses	251 100
Depreciation: furniture and fixtures	16 640

(b) Prepare the receipts and payments account for the year ended 31 December 2019. [8]

(c) State **two** differences between an income and expenditure account and a receipts and payments account. [2]

Additional information

The treasurer is aware that in early 2020, the club will receive two sums of donations from two wealthy members. One donor intends his donation to be used for maintaining the general running of the club in future years. The other donor intends his donation to be used for building a swimming pool in a few years' time.

(d) Explain the appropriate accounting treatment for the donation for:

(i) maintaining the general running of the club in future years [4]

(ii) building a swimming pool in a few years' time. [3]

Additional information

In view of the large cash balance in the club, the committee is thinking of making a distribution to the existing members, just like paying a dividend to shareholders in a limited company.

(e) Advise the committee whether or not the proposed distribution should be made. Justify your answer. [3]

[Total: 25]

Question 3

Source A3

Ahmed and Omar were sole traders in the same trade. They decided to merge their businesses to form a partnership on 1 January 2020.

The books of account of Ahmed and Omar had the following balances of assets and liabilities at 1 January 2020.

	Ahmed	Omar
	$	$
Plant and equipment	203 000	134 000
Motor vehicles	74 000	46 000
Inventories	51 000	36 500
Cash at bank	Nil	28 600
Trade receivables	59 700	53 800
Trade payables	42 500	34 100
Bank overdraft	8 900	Nil

The following was also agreed.

1 The values of each sole trader's business at 1 January 2020 were:

	$
Ahmed	400 000
Omar	300 000

2 The partnership would take over all the assets and liabilities of both businesses at the following values:

	Ahmed	Omar
	$	$
Plant and equipment	230 000	144 000
Motor vehicles	71 000	40 000
Inventories	52 500	34 400
Cash at bank	Nil	28 600
Trade receivables	58 000	52 000
Trade payables	42 500	34 100
Bank overdraft	8 900	Nil

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

(a) Calculate the value of goodwill of **each** of Ahmed's and Omar's businesses. [6]

(b) Prepare the statement of financial position of the partnership at 1 January 2020 if goodwill is included. [6]

Additional information

The profit and loss sharing ratio between Ahmed and Omar is 3:2.

Both partners also agreed that goodwill would not be maintained in the books of account.

(c) Calculate the capital account balance of **each** partner after goodwill is eliminated. [2]

(d) Explain the meaning of the term 'goodwill'. [3]

(e) Explain why the goodwill account is not maintained in the books of the partnership. Support your answer by reference to the accounting concepts. [4]

Additional information

The partners plan to purchase additional equipment costing $80 000. They are considering making loans to the partnership or applying for a bank loan.

(f) State **one** advantage and **one** disadvantage to the partnership of each option. [4]

[Total: 25]

Question 4

Source A4

The summarised statement of financial position of J plc at 31 December 2019 was as follows:

	$000
Non-current assets	3360
Current assets	1320
Total assets	4680
Equity and liabilities	
Equity	
$1 ordinary shares	2000
Share premium	260
Retained earnings	840
Total equity	3100
Non-current liabilities	
6% debentures	800
Current liabilities	780
Total equity and liabilities	4680

The following information is also available.

1 J plc's profit from operations for the year ended 31 December 2019 was $588 000.

2 A dividend of $0.12 per share was paid during the year and a dividend of $0.08 per share was proposed at 31 December 2019.

3 The market price of one ordinary share was $3.20 on 31 December 2019.

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

(a) Calculate, to **two** decimal places, the following ratios:

(i) earnings per share [2]

(ii) price earnings ratio [1]

(iii) dividend cover [1]

(iv) dividend yield. [1]

Additional information

The directors of J plc aim to maintain a higher dividend cover in the coming three years.

(b) Explain why the directors wish to maintain a higher dividend cover. [3]

Additional information

During the year ended 31 December 2019, J plc was sued by a customer for the breach of a sales contract. The case will be heard in court in May 2020. The lawyer of J plc advises the directors that it is highly probable that the company will be found liable and the compensation is likely to be $20 000. No accounting entries have been made to record this.

(c) Define the following terms:

(i) liability [2]

(ii) provision [2]

(iii) contingent liability. [2]

(d) Explain the accounting treatment of the expected compensation of $20 000 in the financial statements by making reference to the relevant International Accounting Standard (IAS). [6]

Additional information

J plc needs additional funds for future expansion. The directors are considering the following two options:

option 1 : rights issue of ordinary shares

option 2 : further issue of 6% debentures.

(e) Advise the directors which of the two options they should choose. Justify your answer. [5]

[Total: 25]

Section B : Cost and Management Accounting

Question 5

Source B1

The sales budget of Z Limited for five months to 31 May 2020 is as follows.

	Units
January	3000
February	4000
March	4800
April	4400
May	5000

The following information is also available.

1 Finished goods inventory at the end of each month is equal to 20% of the following month's sales.

2 Each unit of finished goods requires three kilos of direct materials. Direct materials are purchased every month.

3 Direct materials inventory at the end of each month is equal to 10% of the following month's production needs.

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

(a) **(i)** Explain the meaning of the term 'master budget'. [2]

(ii) State **two** components of a master budget (other than production and purchases). [2]

(b) Prepare the following budgets for **each** of the months of February and March 2020.

(i) Production budget (in units) [4]

(ii) Purchases budget (in kilos) [6]

Additional information

There will be an increasing trend in the purchase price of direct materials. The purchase price of direct materials for the first three months is expected to be:

	per kilo $
January	3.25
February	3.50
March	3.60

Z Limited adopts the first-in, first-out (FIFO) method to value direct materials inventory.

(c) Calculate the budgeted cost of direct materials consumed for the month of February 2020. [4]

(d) Explain the impact on profit of using FIFO and average cost (AVCO) in the circumstances of rising direct materials price. [4]

Additional information

The marketing manager of the company is of the opinion that due to the unpredictable economic climate, it is not worthwhile to prepare a budget.

(e) Discuss whether or not the marketing manager's opinion is correct. Justify your answer. [3]

[Total: 25]

Question 6

Source B2

The directors of W Limited plan to buy a machine costing $480 000 from an overseas manufacturer. The machine has an estimated useful life of four years with no residual value.

Estimated receipts and payments are as follows:

	Receipts $	Payments $
Year 1	260 000	90 000
Year 2	290 000	120 000
Year 3	330 000	140 000
Year 4	130 000	80 000

The cost of capital of W Limited is 10%.

The discount factors are as follows:

	7%	10%
Year 1	0.935	0.909
Year 2	0.873	0.826
Year 3	0.816	0.751
Year 4	0.763	0.683

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

(a) Calculate for the proposed investment:

(i) the payback period (in months) [3]

(ii) the net present value (NPV) [4]

(iii) the internal rate of return (IRR). [4]

(b) Advise the directors whether or not they should buy the machine. Justify your answer by reference to your calculations in **part (a)**. [4]

Additional information

The cost of the machine, $480 000, includes the purchase price plus a 20% tariff (import duty) on the purchase price. Due to a recent trade agreement, it is highly probable that the 20% tariff will be abolished.

On the basis that the tariff is to be abolished, the directors have recalculated the payback period and NPV and decided to buy the machine.

(c) Comment on the directors' decision to buy the machine when the tariff is abolished. Support your answers with relevant calculations. [6]

(d) Explain why the directors of W Limited use the payback period and NPV to make their investment decisions. [4]

[Total: 25]