Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ACCOUNTING **9706/32**

Paper 3 Structured Questions **February/March 2017**

3 hours

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Answer **all** questions.
All accounting statements are to be presented in good style.
International accounting terms and formats should be used as appropriate.
Workings should be shown.
You may use a calculator.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **11** printed pages, **1** blank page and **1** Insert.

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CAMBRIDGE International Examinations

Section A: Financial Accounting

1 XY Limited produces annual financial statements in accordance with International Accounting Standards. Its non-current assets consist of both tangible and intangible assets.

REQUIRED

(a) Define an intangible asset in accordance with IAS 38. [3]

Additional information

The following are the selected balances from the trial balance produced for the year ended 31 March 2016.

	$
Revenue	680 000
Purchases	378 000
Distribution costs	70 152
Administrative expenses	145 267
Inventories at 1 April 2015	117 257
Provision for doubtful debts	1 569
6% Debenture (2022)	150 000
Trade receivables	87 450
Trade payables	26 550

The directors of XY Limited also provided the following information:

1 The inventories at 31 March 2016 were valued at cost, $108 543. This included a batch of inventory which had been valued at its cost price of $50 000. It can now only be sold for $35 000.

2 The debenture was issued on 1 October 2015 and no interest has been paid at 31 March 2016.

3 The provision for doubtful debts is to be increased to 2% of trade receivables. The increase is to be split equally between distribution costs and administrative expenses.

4 There was an amount of $2480 outstanding for administrative expenses.

5 There was a prepayment of $3635 for distribution costs.

6 The tax charge for the year is estimated to be $12 385.

REQUIRED

(b) Prepare the income statement for XY Limited for the year ended 31 March 2016. [13]

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Additional information

All of the company revenues and purchases are operated on a credit basis.
The company allows all of its customers 30 days' credit. The company is also allowed 30 days' credit by all of its suppliers.

REQUIRED

(c) Calculate the working capital cycle (in days). [4]

(d) Discuss whether or not the liquidity of XY Limited could be improved. Justify your answer. [5]

[Total: 25]

2 Euan was the external auditor of Z Limited.

REQUIRED

(a) Explain the difference between the role of an external auditor and the role of an internal auditor of a limited company. [4]

Additional information

For the purpose of carrying out the audit, Euan was presented with the following draft financial statements which were prepared by the directors of Z Limited.

Draft Income Statement for year ended 31 December 2016

	$
Revenue	848 000
Cost of sales	494 000
Gross profit	354 000
Administrative and distribution expenses	254 200
Profit for the year	99 800
Dividend paid	20 000
Dividend proposed	30 000
Retained earnings for the year	49 800
Retained earnings 1 January 2016	94 600
Retained earnings 31 December 2016	144 400

Draft Statement of Financial Position at 31 December 2016

	$
Assets	
Non-current assets	
Freehold property	700 000
Machinery and equipment	457 400
Goodwill	200 000
	1 357 400
Current assets	
Inventories	44 500
Trade receivables	74 800
Cash and cash equivalents	36 000
	155 300
Total assets	1 512 700
Equity and liabilities	
Equity	
Ordinary shares	1 000 000
Revaluation reserve	300 000
Retained earnings	144 400
Total equity	1 444 400
Current liabilities	
Trade payables	38 300
Dividend payable	30 000
	68 300
Total equity and liabilities	1 512 700

The directors of Z Limited provided Euan with the following information.

1 At 31 December 2016 the directors proposed a final dividend of $30 000. This had been included in the draft financial statements.

2 The company purchased a machine in 2016 for $150 000 to print graphics on the products requested by the customers. The machine had been depreciated by 20% using the straight-line method.

3 The demand for printing services is expected to decrease in the future. The directors suggest that the new machine should be depreciated at 30% by using the reducing balance method. This has not yet been actioned.

4 Z Limited's share capital and revaluation reserve (from freehold property) at 1 January 2016 amounted to $1 000 000 and $100 000 respectively.

5 A professional valuer suggested that the goodwill of the company would be $200 000. This amount had been included in the non-current assets and the revaluation reserve.

6 Inventory valued at cost, $44 500, had been included in the draft financial statements. Further information was available.

	Purchase Price	Estimated Selling Price
	$	$
Inventory		
Category A	24 200	33 800
Category B	15 100	24 000
Category C	5 200	4 100

REQUIRED

(b) Recommend how information 1, 3, 5 and 6 should be treated in the financial statements. [8]

(c) Calculate the **revised profit** for the year ended 31 December 2016 after taking into account your recommendations in **(b)**. [3]

(d) Prepare the statement of changes in equity for the year ended 31 December 2016. [4]

(e) Prepare the **redrafted** statement of financial position at 31 December 2016. [3]

(f) Discuss what actions Euan should take if the directors do not adjust the financial statements. [3]

[Total: 25]

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[Turn over

3 The AB Cricket Club prepares its financial statements annually.

REQUIRED

(a) Identify **three** differences in the terminology used in the financial statements of a club compared to a profit-making organisation. [3]

Additional information

The club runs a small snack bar. The following information is available for the year ended 31 December 2016.

1 The snack bar takings for the year totalled $52 750.

2 The food inventory was valued at $260 at 1 January 2016. This had been reduced by 40% at 31 December 2016.

3 All food is purchased from one supplier. The supplier was paid $33 785 during the year.

4 At 1 January 2016 the supplier was owed $460. There was $585 owing to the supplier at 31 December 2016.

REQUIRED

(b) Prepare the snack bar trading account for the year ended 31 December 2016. [6]

Additional information

1 The annual subscription per member has remained at $250 for many years.

2 There are currently 310 members. There were no resignations or new members joining during 2016.

3 At 31 December 2015, there were 7 members who had not paid their 2015 subscription and 2 members who had paid their subscriptions for 2016.

4 At 31 December 2016, there were 12 members who had not paid their 2016 subscription and 3 members who had paid their 2017 subscription.

REQUIRED

(c) Prepare the subscriptions account for the year ended 31 December 2016. [7]

Additional information

The club buildings are in urgent need of repairs. The committee has decided to carry out the required work during 2017.

The club is proposing a scheme whereby local businesses are invited to sponsor matches.

At 31 December 2016 there was a small debit balance on the bank account.

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REQUIRED

(d) Identify **four** actions **other than sponsorship** that could be taken by the club to fund the repairs of the buildings. [4]

(e) State the advantages and disadvantages to the club if the proposed sponsorship is adopted. [5]

[Total: 25]

4 Sachin is a trader buying and selling electrical appliances which cost $150 per unit. His brother, Tajid, is located overseas and it was planned that he would sell some of the appliances. During the year ended 31 December 2016 Sachin sent 1000 appliances to Tajid.

The following information is also available.

1 The rate of commission charged by Tajid is 10% on sales.

2 Tajid planned to sell the appliances at a mark-up of 40%.

3 All appliances were sold. However, the final 250 units of the consignment could only be sold for $180 per unit.

4 Sachin paid transportation costs of $3000.

5 Tajid paid selling expenses of $4000 and $1500 import duty.

6 On 31 December 2016 Tajid made a full remittance to Sachin to settle the account.

REQUIRED

(a) Prepare the consignment account in Sachin's books for the year ended 31 December 2016. [9]

(b) Prepare Tajid's account in the books of Sachin for the year ended 31 December 2016. [3]

(c) Prepare the goods sent on consignment account in the books of Sachin for the year ended 31 December 2016. [2]

(d) Prepare Sachin's account in the books of Tajid for the year ended 31 December 2016. [5]

(e) Identify **two** possible reasons for the fall in the selling price of the appliances. [2]

Additional information

Sachin has an additional $150 000 to invest. He is considering whether to send an identical consignment to Tajid or to invest in a new project in his home country which would guarantee a return of 12% on the investment.

REQUIRED

(f) Discuss whether Sachin should send a further consignment to Tajid or invest in the new project. Justify your answer by giving **three** reasons for your decision. [4]

[Total: 25]

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Section B: Cost and Management Accounting

5 Joshua makes a single product and uses standard costing.

REQUIRED

(a) State **one** reason why each of the following variances may arise for a business.

(i) favourable material usage [1]

(ii) adverse labour efficiency [1]

Additional information

The standard costs for the month of June were:

		Per unit
		$
Direct material	5 kilos at $2 per kilo	10
Direct labour	2 hours at $8 per hour	16
Fixed production overhead	2 hours at $4 per hour	8
		34

Budgeted production for June was 19 000 units.

Actual data for the month of June was:

		$
Direct material	83 100 kilos	182 820
Direct labour	37 500 hours	281 250
Fixed production overheads		115 000

Actual production for the month of June was 17 500 units. There were no opening or closing inventories.

REQUIRED

(b) Calculate the following variances for the month of June:

(i) Material price [2]

(ii) Material usage [2]

(iii) Labour rate [2]

(iv) Labour efficiency [2]

(v) Fixed overhead efficiency [3]

(vi) Fixed overhead capacity [3]

Additional information

There was a favourable fixed overhead expenditure variance of $37 000.

REQUIRED

(c) Prepare a statement reconciling the standard cost of production with the actual cost of production. [4]

Additional information

Jenny, Joshua's sister, has told Joshua that it is not necessary to continue operating a standard costing system.

REQUIRED

(d) Advise Joshua whether or not he should continue to use standard costing. Justify your answer. [5]

[Total: 25]

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6 The main cutting machine of LH Limited needs to be replaced. A replacement machine will cost $260 000.

The current machine cuts 40 000 units a year. The number of units is expected to be reduced by 10% in year 1 due to the time taken to install the new machine. The number of units is expected to increase to 42 000 units a year for both year 2 and year 3.

The following information is available.

1 The cost of capital is 14%.

2 It is assumed that revenues are received and costs are paid at the end of the year.

3 Each unit of production costs $26 to manufacture. This will increase to $27.80 in year 2 and $28.50 in year 3.

4 Each unit is expected to sell for $30 in years 1 and 2, increasing by 5% in year 3.

5 It is assumed that all production is sold.

The following is an extract from the present value table for $1.

	12%	14%	16%	18%	20%
Year 1	0.893	0.877	0.863	0.847	0.833
Year 2	0.797	0.769	0.743	0.718	0.694
Year 3	0.712	0.675	0.641	0.609	0.579

REQUIRED

(a) Distinguish between the net present value method of investment appraisal and the internal rate of return. [4]

(b) Calculate the expected net present value for the replacement machine. [9]

(c) Calculate the expected internal rate of return of the replacement machine. [7]

(d) Analyse the benefits to LH Limited of purchasing the replacement machine. [5]

[Total: 25]

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