Cambridge International AS & A Level

**Cambridge International Examinations**
Cambridge International Advanced Subsidiary and Advanced Level

**ACCOUNTING** **9706/32**

Paper 3 Structured Questions **October/November 2017**

**3 hours**

No Additional Materials are required.

*9634996629*

**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 **9** printed pages, **3** blank pages and **1** Insert.


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CAMBRIDGE International Examinations

## Section A: Financial Accounting

**1** The GT Boating Club is a not-for-profit organisation which collects funds by subscriptions paid annually.

At 1 January 2016 the following assets and liabilities were held by the club:

| | $ | |
|---|---|---|
| Boathouse | 240 000 | |
| Fixtures and fittings | | |
| Cost | 15 000 | |
| Accumulated depreciation | 10 000 | |
| Trade payables | 1 750 | |
| Total inventory | 1 100 | |
| Bank | 6 150 | debit |
| Insurance paid in advance | 1 100 | |
| Electricity owing | 450 | |
| Subscriptions in arrears | 600 | |
| Subscriptions in advance | 400 | |

Additional information

1 The club runs a restaurant for the exclusive use of members and their guests. During the year ended 31 December 2016 the revenue of the restaurant was $45 000.

2 The opening restaurant inventory was 75% of the total club inventory. The closing restaurant inventory had doubled at 31 December 2016.

3 During the year ended 31 December 2016 the club paid $28 350 for restaurant purchases.

All the club's trade payables at 1 January 2016 related to the restaurant suppliers. This had risen by 20% at 31 December 2016.

4 The club paid insurance for the year of $4800 and electricity of $2000. Half of these costs are charged to the restaurant.
At 31 December 2016 the club still owed $950 for insurance.

**REQUIRED**

**(a)** Prepare a statement to calculate the restaurant profit for the year ended 31 December 2016. The statement should also clearly show the gross profit. [10]

**Additional information**

Another local boating club runs a similar restaurant. Its latest accounts showed that the restaurant had achieved a gross margin of 45%.

**REQUIRED**

**(b) (i)** Calculate the difference between the gross margins of both restaurants. [2]

**(ii)** Discuss **three** actions which the club could take to improve the gross margin. [6]

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**Additional information**

The club is now considering the introduction of a life membership subscription.

The annual subscription is $100 and the proposed life subscription would be $1000.

Gurmukh, a retired gentleman, is considering joining the club and seeks your advice on whether or not he should pay an annual subscription or the life membership.

**REQUIRED**

**(c)** Explain the accounting treatment of the life subscriptions. [2]

**(d)** Advise Gurmukh whether or not he should become a life member. Justify your advice. [5]

**[Total: 25]**

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**[Turn over**

**2** FS plc's statement of financial position on 1 January 2016 showed the following:

| | $000 |
|---|---|
| Ordinary share capital (shares of $1 each) | 1000 |
| Share premium | 300 |
| General reserve | 100 |
| Retained earnings | 220 |

During the year ended 31 December 2016 the following took place:

1 On 30 June 2016, an interim dividend of $55 000 was paid.

2 On 1 October 2016, an issue of 700 000 ordinary shares was made at $1.80 per share. All the funds raised from this share issue were used to buy a second factory on 7 January 2017.

3 On 1 November 2016, a bonus issue of shares was made with 3 new shares being issued for every 10 held. Reserves were maintained in their most flexible form.

4 For the year ended 31 December 2016, the company made a profit from operations of $288 000. Finance charges of $52 000 had been paid. The directors provided $41 000 for the tax liability for the year.

5 At 31 December 2016, $40 000 was transferred to general reserve and a final dividend of $75 000 was proposed.

**REQUIRED**

**(a)** Prepare the statement of changes in equity for the year ended 31 December 2016 (a total column is **not** required). [12]

**(b)** Explain how the proposed final dividend should be treated in the financial statements for the year ended 31 December 2016. [2]

**(c)** Explain the treatment in the financial statements for the year ended 31 December 2016 of the purchase of the second factory on 7 January 2017. [3]

**Additional information**

A shareholder at the Annual General Meeting said that the purchase of the new factory would cause non-current asset turnover to fall, with an adverse effect on shareholder confidence.

**REQUIRED**

**(d)** Advise the directors whether or not they should be concerned about the shareholder's comment. Justify your answer. [5]

**(e)** State how an upward revaluation of an existing non-current asset is recorded in the financial statements of a company. [3]

**[Total: 25]**

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**3** LS Limited has completed its first year of trading. The company has four directors, of whom two are not shareholders. The auditors are currently carrying out the end of year audit.

**REQUIRED**

**(a) (i)** Explain the term 'stewardship'. [2]

**(ii)** Explain how directors carry out their role of stewardship within a limited company. [2]

**(iii)** Explain the purpose of an end of year audit. [2]

**Additional information**

The draft financial statements for the year showed the following:

| | $ |
|---|---|
| Sales | 182 000 |
| Sales returns | 8 000 |
| Purchases | 154 000 |
| Purchases returns | 12 000 |

All sales were at a mark-up of 150%.

During the audit the auditors discovered that included in the sales records was a sales invoice for $6000 which had been prepared for a customer but not yet been sent. The customer had received the inventory on a sale or return basis, but had yet to decide whether or not to keep the inventory.

**REQUIRED**

**(b) (i)** Calculate what should have been the value of the closing inventory. [5]

**(ii)** Calculate the gross profit for the year. [1]

**Additional information**

During the year the warehouse manager had been absent from work for a long period of time. There had been little control over the movement of inventory. Staff had valued the inventory **actually** in the warehouse at the end of the year at $24 000.

**REQUIRED**

**(c)** Calculate the percentage change in gross profit if the inventory valuation from the warehouse had been used. [3]

**(d)** Discuss **three** possible reasons for the difference between the warehouse inventory valuation and the calculated value of inventory. [6]

**(e)** Discuss whether the directors should use the warehouse inventory valuation or the amount from the accounting records as the inventory figure in the financial statements. Justify your answer. [4]

**[Total: 25]**

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**4** Summarised financial information for E Limited for the year ended 31 August 2016 is as follows:

Summarised Income Statement

| | $000 |
|---|---|
| Revenue | 8 800 |
| Cost of sales | 5 045 |
| Gross profit | 3 755 |
| Expenses | 2 175 |
| Profit from operations | 1 580 |
| Finance costs | 235 |
| Profit for the year | 1 345 |

Summarised Statement of Financial Position

| Assets | $000 |
|---|---|
| Non-current assets | 4 815 |
| Current assets | 3 210 |
| Total assets | 8 025 |
| | |
| 3 000 000 ordinary shares of $0.50 each | 1 500 |
| Share premium | 500 |
| Retained earnings | 2 540 |
| | 4 540 |
| | |
| Non-current liabilities – 8% debentures repayable 2020 | 2 935 |
| Current liabilities – trade payables | 550 |
| | 8 025 |

Additional information

1 The market value of one ordinary share at 31 August 2016 was $1.55.

2 Dividends paid for the year ended 31 August 2016 were $325 000.

**REQUIRED**

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

**(i)** income gearing

**(ii)** gearing

**(iii)** dividend cover

**(iv)** price earnings [5]

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**Additional information**

The directors of E Limited had expansion plans and on 1 September 2016 raised $2 000 000 by issuing 10% debentures repayable in 2026. The profit from operations for the year ended 31 August 2017 was $1 600 000 and the market price of one ordinary share on that date was $1.30. Dividends paid for the year were $275 000.

**REQUIRED**

**(b) (i)** Prepare an extract from the income statement for the year ended 31 August 2017, starting with the profit from operations. [2]

**(ii)** Prepare the equity and non-current liabilities section of statement of financial position at 31 August 2017. [2]

**(c) (i)** Calculate the same ratios as in part **(a)** at 31 August 2017 to **two** decimal places. [4]

**(ii)** Assess the effect of the new debenture issue on these ratios. [8]

**(d)** Discuss **two** disadvantages to the company of the issue of the debentures. [4]

**[Total: 25]**

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**[Turn over**

## Section B: Cost and Management Accounting

**5** Wong Ho owns a small factory. A machine has started to break down regularly and needs to be replaced.

A replacement machine is expected to cost $55 000. It is expected to last 5 years and will be depreciated using the straight-line method of depreciation. At the end of the period the machine will be scrapped with no residual value.

The following information is available for the replacement machine:

1 The selling price for each unit produced by the machine is expected to be $40 for years 1 and 2.
This is expected to increase by 25% for year 3.
There is no expected change for year 4.
However, the selling price is expected to increase by a further 10% for year 5.

2 The cost of production for each unit produced is expected to be $20 for years 1 and 2. This will increase by 25% for year 3 and then remain unchanged.

3 The present value for the net cash flows for the years 1 to 5 have been calculated as follows:

| Year | Discount factor 14% | Present value $ |
|---|---|---|
| 1 | 0.877 | 3 683.40 |
| 2 | 0.769 | 6 536.50 |
| 3 | 0.675 | 9 483.75 |
| 4 | 0.592 | 14 977.60 |
| 5 | 0.519 | 21 019.50 |

**REQUIRED**

**(a)** Distinguish between the payback method of investment appraisal and the net present value method. [4]

**(b)** Calculate the expected net present value for the replacement machine. [1]

**(c)** **(i)** Calculate the annual net cash flows for years 1 to 5 for the replacement machine. [5]

**(ii)** Calculate the payback period for the replacement machine. [2]

**(iii)** Calculate the number of units for **each** year that Wong Ho expects to produce with the replacement machine. [8]

**(d)** Recommend whether or not Wong Ho should purchase the replacement machine. Justify your answer. [5]

**[Total: 25]**

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**6** J Limited sells a single product at a mark-up of 25%. The following information is available:

1 Sales revenue:

| | $ |
|---|---|
| 2017 | |
| November | 150 000 |
| December | 180 000 |
| | |
| 2018 | |
| January | 200 000 |
| February | 210 000 |
| March | 225 000 |
| April | 240 000 |

2 All sales are on credit and customers have a credit period of 2 months.

3 All purchases are on credit and suppliers are paid in the month following purchases.

4 Inventory level at the end of each month will be maintained at 25% of the sales volume in the following month.

5 Monthly operating costs are expected to be $18 000, which includes $3000 depreciation.

6 Balance at bank at 1 January 2018 is expected to be $4500.

**REQUIRED**

**(a)** Prepare the cash budget for **each** of the three months from January to March 2018. [9]

**(b)** Prepare a budgeted income statement for the three-month period ending 31 March 2018. [3]

**(c)** Prepare a reconciliation of the profit from operations for the three-month period ending 31 March 2018 to the net cash at 31 March 2018. [8]

**Additional information**

The directors are considering investing $60 000 in a new computer system to improve inventory control. According to the payment terms, 50% is payable in March 2018 and the remaining 50% in the following month.

**REQUIRED**

**(d)** Advise the directors whether or not they should purchase the new computer. Justify your answer. [5]

**[Total: 25]**

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