Cambridge International AS & A Level

**Cambridge Assessment International Education**
Cambridge International Advanced Subsidiary and Advanced Level

**ACCOUNTING** **9706/31**

Paper 3 Structured Questions **October/November 2019**

INSERT **3 hours**

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**READ THESE INSTRUCTIONS FIRST**

This Insert contains all of the required information and questions. The questions are provided in the Insert for reference only.

Anything you write in this Insert will not be marked.

The businesses described in this Insert are entirely fictitious.



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## Section A: Financial Accounting

**Question 1**

### Source A1

A Social Club had the following assets and liabilities at 1 April 2018.

| | $ |
|---|---|
| Non-current assets | 14 500 |
| Bank overdraft | 3 600 |
| Trade payables | 2 250 |
| Accrued electricity expenses | 1 550 |
| Prepaid insurance | 300 |
| Inventory | 2 200 |
| Subscriptions in arrears | 150 |
| Subscriptions in advance | 100 |

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

**(a)** Explain what is meant by the term 'accumulated fund'. [2]

**(b)** Calculate the accumulated fund at 1 April 2018. [3]

**Additional information**

The annual subscription has been unchanged for the past few years. During the year ended 31 March 2019, a total of $13 900 was received from 278 members who paid their annual subscription in full. One member, who owed the club for the previous year's subscription, was unable to pay and this amount was written off.

At 31 March 2019, six members had not paid their annual subscription and one member had paid the following year's subscription in advance.

**(c)** Prepare the subscriptions account for the year ended 31 March 2019. [8]

**(d)** Prepare an extract from the statement of financial position at 31 March 2019 to show how the balances on the subscriptions account are recorded. [4]

**Additional information**

The annual surplus of income over expenditure has fallen steadily in recent years.

The treasurer is considering introducing a life membership scheme to improve this. He believes that the total life membership should be recorded in full as income in the income and expenditure account when it is received.

**(e)** Discuss **two** ways other than a life membership scheme by which the club could increase the future annual surplus. [4]

**(f)** Discuss if the treasurer's proposed accounting treatment for life membership is correct. Justify your answer by reference to any relevant accounting concept. [4]

[Total: 25]

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**Question 2**

**Source A2**

A new director of R Limited has raised some concerns about their role in the company. He has also questioned the role of the company's auditors.

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

**(a) (i)** Explain what is meant by the term 'stewardship'. [2]

**(ii)** State **two** duties of the auditor of a limited company. [2]

**Additional information**

The directors of R Limited have provided the following information at 31 December 2018.

| | $ |
|---|---|
| Ordinary shares of $1 each | 200 000 |
| Share premium | 20 000 |
| 8% Debenture (2025) | 150 000 |
| General reserve | 54 000 |
| Retained earnings at 1 January 2018 | 96 000 |
| Debenture interest paid | 4 000 |
| Interim dividend paid | 6 250 |
| Land and buildings | |
| cost | 450 000 |
| accumulated depreciation | 25 000 |
| Plant and machinery | |
| cost | 40 000 |
| accumulated depreciation | 15 000 |
| Vehicles | |
| cost | 24 000 |
| accumulated depreciation | 8 000 |
| Inventory at 31 December 2018 | 65 000 |
| Trade receivables | 42 000 |
| Cash and cash equivalents | 37 000 |
| Trade payables | 35 000 |
| Profit from operations | 65 250 |

The 8% debenture (2025) was issued on 1 January 2017.

A bonus issue of shares of 1 ordinary share for every 20 shares held was made on 31 December 2018. This had not yet been recorded in the books of account. The directors wish to keep the reserves in their most flexible form.

A provision for tax of $14 700 is to be made.

The directors have proposed a final dividend of $0.15 per share on all shares in issue at the year end.

**(b)** Prepare an extract from the income statement for the year ended 31 December 2018, to show the profit for the year, starting with the profit from operations. [2]

**(c)** Prepare the statement of changes in equity for the year ended 31 December 2018. A total column is **not** required. [4]

**(d)** Prepare the statement of financial position at 31 December 2018. [6]

**Additional information**

In February 2019 it was discovered that plant and machinery with a net book value of $15 000 had become obsolete. It could be sold for $8000 with a selling cost of $1200.

The cash flows from the machinery's continued use showed:

| | future cash flows | 10% discount factor |
|---|---|---|
| year 1 | $4000 | 0.909 |
| year 2 | $5000 | 0.826 |
| year 3 | $3000 | 0.751 |

**(e)** Calculate the impairment loss. [4]

**Additional information**

The financial statements will be presented to the shareholders for their approval at the annual general meeting on 31 March 2019. The directors have decided that it is too late to include the impairment loss in the financial statements.

**(f)** Discuss the decision of the directors making reference to any relevant International Accounting Standards (IAS). [5]

[Total: 25]

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**Question 3**

**Source A3**

J plc commenced trading on 1 January 2016.

On that date there was a share issue of 800 000 ordinary shares with a nominal value of $0.50 each, at an issue price of $0.75.

During the year ended 31 December 2018 the following took place.

1 On 1 January 2018 a 12% debenture of $250 000 repayable in 2027 was issued.

2 The company made a rights issue of 1 ordinary share for every 4 shares held. The rights issue was fully subscribed raising $225 000 in total.

The following information was available for the year ended 31 December 2018.

| | $ |
|---|---|
| Profit from operations | 382 000 |
| Profit for the year | 204 000 |
| Ordinary dividend paid | 45 000 |
| Cash and cash equivalents | 55 000 |

At 31 December 2018

1 The total assets were $1 582 000, of which current assets totalled $420 000.

2 The current ratio was 1.75 : 1.

3 The market value of one ordinary share was $2.50.

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

**(a)** Prepare the equity and liabilities section of the statement of financial position at 31 December 2018. [5]

**(b)** Calculate the following to **two** decimal places for the year ended 31 December 2018.

**(i)** Dividend cover [2]

**(ii)** Gearing ratio [2]

**(iii)** Price earnings ratio [3]

**(c)** Analyse the financial performance of J plc. [8]

**Additional information**

A group of shareholders have said they will propose at the Annual General Meeting that the directors pay an extra cash dividend of $0.30 per share because of the high profit for the year.

**(d)** Advise the directors whether or not they should pay the extra cash dividend. Justify your answer by considering other options available to the directors. [5]

[Total: 25]

**Question 4**

**Source A4**

X Limited acquired the partnership business of Amy and Beth on 1 January 2018. The statement of financial position of each business at 31 December 2017 was as follows:

| | Amy and Beth | X Limited |
|---|---|---|
| | $ | $ |
| Non-current assets | 142 000 | 654 000 |
| | | |
| Current assets | | |
| Inventory | 38 000 | 82 000 |
| Trade receivables | 49 000 | 83 700 |
| Cash and cash equivalents | 4 000 | 98 400 |
| | 91 000 | 264 100 |
| | | |
| Total assets | 233 000 | 918 100 |
| | | |
| Equity and liabilities | | |
| Ordinary shares of $1 each | | 700 000 |
| Retained earnings | | 144 500 |
| Capital account | | |
| Amy | 120 000 | |
| Beth | 80 000 | |
| | 200 000 | |
| Current account | | |
| Amy | 3 500 | |
| Beth | (1 500) | |
| | 2 000 | |
| Current liabilities | | |
| Trade payables | 31 000 | 73 600 |
| | | |
| Total equity and liabilities | 233 000 | 918 100 |

The following information is also available.

1 X Limited took over all the assets and liabilities of the partnership business, except the cash and cash equivalents, at the following values.

| | $ |
|---|---|
| Non-current assets | 148 000 |
| Inventory | 41 000 |
| Trade receivables | 47 000 |
| Trade payables | 30 000 |

2 The purchase consideration was $240 000. This consisted of an issue of 90 000 ordinary shares divided equally between the partners. Each ordinary share had a market value of $2.50 at 1 January 2018.

The balance was paid in cash.

3 Amy and Beth share profits and losses in a ratio of 4 : 3.

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

**(a)** Calculate the profit or loss made by the partners on the sale of their business to X Limited. [4]

**(b)** Prepare the capital accounts of Amy and Beth to show the closure of their partnership business. [5]

**(c)** Prepare the statement of financial position of X Limited at 1 January 2018 immediately after the acquisition of the partnership. [9]

**(d)** State **two** advantages to a company of purchasing another business. [2]

**Additional information**

Retained earnings of X Limited at 31 December 2017 and 31 December 2018 were as follows.

| | 31 December 2017 | 31 December 2018 |
|---|---|---|
| | $ | $ |
| Retained earnings – start of the year | 81 500 | 144 500 |
| Profit for the year | 168 000 | 145 000 |
| Dividend paid | (105 000) | (97 500) |
| Retained earnings – end of the year | 144 500 | 192 000 |

**(e)** Assess whether or not X Limited has made the right decision to acquire the partnership business. Support your answer using relevant calculations. [5]

[Total: 25]

## Section B: Cost and Management Accounting

**Question 5**

### Source B1

The directors of P Limited plan to launch a new product which has an expected life of 4 years. A new machine is required for this and the directors are considering buying Machine X.

Details of Machine X are as follows.

| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Cost | 400 000 | | | | |
| Annual receipts | | 390 000 | 420 000 | 460 000 | 370 000 |
| Annual payments | | 280 000 | 280 000 | 270 000 | 250 000 |

The machine has a useful life of 4 years with no residual value. It will be depreciated using the straight-line method.

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

**(a)** Calculate the accounting rate of return (ARR) of Machine X. [5]

**(b)** State **two** advantages and **two** disadvantages of using ARR. [4]

**Additional information**

P Limited's cost of capital is 10%.

The following are the discount factors for 10%.

| | |
|---|---|
| Year 1 | 0.909 |
| Year 2 | 0.826 |
| Year 3 | 0.751 |
| Year 4 | 0.683 |

**(c)** Calculate the net present value (NPV) of Machine X. [5]

**Additional information**

P Limited requires an internal rate of return (IRR) of 13% on any capital investment.

If a discount factor of 16% is used, Machine X will have a **negative** NPV of $13 130.

**(d)** Calculate the IRR of Machine X. [3]

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**Additional information**

A similar machine, Machine Y, is available. It also has a useful life of 4 years. The following information for Machine Y is available.

| | |
|---|---|
| Initial cost | $480 000 |
| NPV | $33 200 |
| ARR | 25% |
| IRR | 13.5% |

**(e)** Advise the directors of P Limited which machine they should buy. Justify your answer. [5]

**Additional information**

The directors are also considering buying another machine, Machine Z, at a cost of $110 000. This will be used to produce another product which has an expected life of 3 years. The annual receipts from the sale of the product will be $100 000. Annual payments will be $45 000. This will remain constant for each of the 3 years. P Limited's cost of capital remains at 10%.

The directors are confident about the accuracy of their forecast for annual payments. They are **not** confident about their forecast for annual receipts.

**(f)** Calculate the annual receipts which give a zero NPV for Machine Z. [3]

[Total: 25]

**Question 6**

**Source B2**

Oscar runs a manufacturing business and operates a standard costing system.
The following information relates to the year ended 31 March 2019.

| | Budgeted | Actual |
|---|---|---|
| Production (units) | 7500 | 7300 |
| Material usage | 6 kilos per unit | 42 500 kilos |
| Material cost | $5 per kilo | $230 000 |
| Labour usage | 4 hours per unit | 32 000 hours |
| Labour cost | $8 per hour | $236 000 |

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

**(a)** State **two** disadvantages of operating a standard costing system. [2]

**(b)** Calculate the following variances:

**(i)** material price [2]

**(ii)** material usage [2]

**(iii)** labour rate [2]

**(iv)** labour efficiency [2]

**(v)** total labour. [1]

**(c)** Identify **one** possible reason for **each** of the following variances calculated in part **(b)**:

**(i)** material price variance

**(ii)** material usage variance

**(iii)** labour rate variance

**(iv)** labour efficiency variance.

[4]

**(d)** Prepare a statement to reconcile for actual production the standard labour and material costs with the actual costs. [8]

**Additional information**

Oscar has not changed his standard costs for three years.

**(e)** Advise Oscar whether or not he should change his standard costs. Justify your answer. [2]

[Total: 25]

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