Cambridge Assessment International Education

Cambridge International AS & A Level

ACCOUNTING **9706/32**

Paper 3 Structured Questions **October/November 2020**

INSERT **3 hours**

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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

FG Limited is a manufacturing business. The rate at which it accounts for factory profit has not changed for some years. Inventory is valued at transfer price.

The company's accountant produced draft financial statements for the year ended 31 December 2019 as follows.

Draft manufacturing account for the year ended 31 December 2019

	$
Cost of raw materials consumed	31 200
Direct labour	52 800
Prime cost	84 000
Overheads	54 900
Change in work in progress	1 100
Production cost of manufactured goods	140 000
Factory profit	28 000
Transfer price	168 000

Draft income statement for the year ended 31 December 2019

	$	$
Revenue		320 800
Inventory 1 January 2019	36 000	
Transfer price	168 000	
	204 000	
Inventory 31 December 2019	30 000	
Cost of sales		174 000
Gross profit		146 800
Factory profit		28 000
Change in provision for unrealised profit		1 000
Distribution costs	42 700	
Administrative expenses	78 900	121 600
Draft profit for the year		54 200

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

(a) Explain **two** reasons why a factory profit is added in an **income statement**. [4]

Additional information

After the preparation of the draft financial statements the following errors were discovered.

1 The rent expense, \$60 000, should have been split 70% factory, 10% distribution centre and 20% offices. In error it had been split 50% factory, 10% distribution centre and 40% offices.

2 An item of factory machinery, cost \$50 000, had been bought on 1 January 2019. This had been recorded in error as office equipment. Factory machinery is depreciated at the rate of 20% per annum and office equipment at 10% per annum.

3 An error had occurred in counting the inventory of finished goods at the year end. The value in the draft financial statements was based on an inventory of 5000 units but in fact there were only 4000 units.

(b) Calculate for the year ended 31 December 2019:

(i) the **correct** value for the production cost of manufactured goods [3]

(ii) the **correct** value of factory profit. [1]

(c) Prepare for the year ended 31 December 2019:

(i) the **corrected** provision for unrealised profit account [3]

(ii) the **corrected** income statement. [9]

Additional information

One of the directors has suggested that the company should stop accounting for factory profit.

(d) Advise the directors whether or not they should stop accounting for factory profit. Justify your answer. [5]

[Total: 25]

Question 2

Source A2

The books of account of RF plc for the year ended 31 December 2019 showed the following.

Plant and machinery

	$000		$000
Balance b/d	100		
Bank	38	Balance c/d	138
	138		138

Provision for depreciation of plant and machinery

	$000		$000
		Balance b/d	20
Balance c/d	32	Income statement	12
	32		32

Motor vehicles

	$000		$000
Balance b/d	60	Disposal	16
		Balance c/d	44
	60		60

Provision for depreciation of motor vehicles

	$000		$000
Disposal	4	Balance b/d	25
Balance c/d	31	Income statement	10
	35		35

Retained earnings

	$000		$000
Dividend	8	Balance b/d	33
General reserve	18	Profit for the year	15
Balance c/d	22		
	48		48

Interest payable

	$000		$000
Bank	5	Balance b/d	2
Balance c/d	1	Income statement	4
	6		6

The following information is also available.

During the year ended 31 December 2019 the following had taken place.

1 Inventory had increased by $17 000.

2 Trade receivables had increased by $3000.

3 The bank balance had gone from an overdraft of $7000 to a positive balance.

4 The company had issued 72 000 ordinary shares of $0.50 each at par value.

5 A new bank loan of $5000 had been received.

6 Trade payables had decreased by $6000.

7 A motor vehicle had been sold for $15 000.

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

(a) Prepare the statement of cash flows for the year ended 31 December 2019. (Ignore taxation.) [19]

(b) Explain how a premium on an issue of shares is dealt with differently in a statement of cash flows as compared to the books of account of a company. [3]

(c) State **three** reasons why a company might prepare a statement of cash flows. [3]

[Total: 25]

Question 3

Source A3

Alice and Babak had both been trading as sole traders for some years when they decided to merge their businesses to form a partnership. The merger took place on 1 January 2020.

The book values of the assets and liabilities of the businesses immediately prior to the merger were as follows.

	Alice	Babak
	$	$
Premises	18 000	Nil
Equipment	7 400	8 900
Vehicle	Nil	5 200
Intangible asset	200	Nil
Inventory	4 100	3 500
Trade receivables	2 600	1 800
Trade payables	1 400	700
Bank	(300)	6 100

The terms of the merger were as follows.

1 The profit sharing ratio of the partnership would be Alice 2 : Babak 1.

2 Alice's premises would be revalued at $32 000.

3 Part of Alice's inventory, valued at $400, would be written off.

4 An impairment loss of $800 on Babak's vehicle would be accounted for.

5 Alice would transfer her personal vehicle to the business at a valuation of $2000.

6 The bank accounts would be merged and Alice would pay in enough cash that the value of the capital accounts would be in the profit sharing ratio.

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

(a) Suggest **two** items, purchased by a business, which could be included in its intangible assets. [2]

(b) Prepare, showing the adjustments made during the merger on 1 January 2020,

(i) the capital account of Babak [3]

(ii) the capital account of Alice. [6]

(c) Prepare the statement of financial position of the partnership immediately after the merger on 1 January 2020. [9]

Additional information

Whilst operating as sole traders both Alice and Babak maintained their books of account on a manual basis. Babak has suggested that the partnership should use a computerised accounting system.

(d) Advise Alice whether or not she should agree to using a computerised accounting system. Justify your answer. [5]

[Total: 25]

Question 4

Source A4

RP Limited provided the following information for the year ended 31 January 2020.

	$000
Cash sales	1140
Credit sales	7260
Cash purchases	630
Credit purchases	4670
Inventory at 1 February 2019	1150
Inventory at 31 January 2020	1650
Trade receivables	1500
Trade payables	760

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

(a) Calculate the working capital cycle ratio. **Round up** your answer to the next whole day. [8]

Additional information

The industry average for the working capital cycle ratio is 100 days.

(b) Compare your answer to **(a)** with the industry average. Suggest reasons for the difference. [5]

(c) Explain why having cash sales and cash purchases might affect the usefulness of the working capital cycle ratio to the directors. [2]

(d) Calculate the net working assets to revenue ratio. [4]

Additional information

The industry average for the net working assets to revenue ratio is 21%.

(e) Compare your answer to **(d)** with the industry average. Suggest reasons for the difference. [3]

Additional information

One of the directors has suggested offering cash discount to credit customers.

(f) Advise the directors whether or not the company should start offering cash discount to credit customers. Justify your answer. [3]

[Total: 25]

Section B: Cost and Management Accounting

Question 5

Source B1

WJ plc uses a system of budgetary control. It prepares budgets for periods of four weeks each. Its sales budget for the first four periods of the year shows the following.

period	sales in units
1	6000
2	5600
3	6400
4	7200

The company spreads its sales and production evenly throughout the four weeks in each period.

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

(a) State **three** factors which might affect the accuracy of a sales budget. [3]

Additional information

It is the policy of WJ plc to keep an inventory of finished goods sufficient to meet the budgeted sales for the first week of the coming period.

(b) Prepare the production budget (in units) for **each** of the periods 1 to 3. [8]

Additional information

Each unit of production requires five kilos of raw material. It is the policy of the company to keep an inventory of raw material sufficient for the production process for the first two weeks of the coming period.

The raw material costs $10 per kilo.

(c) Prepare the purchases budget for **both** period 1 and period 2:

(i) in kilos [7]

(ii) in dollars. [2]

Additional information

One of the directors has made two suggestions to increase profits.

Suggestion 1	to continue to use the same supplier of raw materials but to buy a lower quality of raw materials
Suggestion 2	to continue to buy the same quality of raw materials but to use a cheaper supplier

(d) Advise the directors whether or not they should accept either of these suggestions. Justify your answer. Ignore the effect on variances. [5]

[Total: 25]

Question 6

Source B2

XP plc uses a system of standard costing. It manufactures and sells one product. The following per unit information is available.

Direct material	2 kilos at $6 per kilo
Direct labour	4 hours at $10 per hour
Fixed overheads	$3.50 per direct labour hour

The master budget for March was based on sales of 15 000 units at a selling price of $100 per unit.

Actual sales in March amounted to 14 000 units at a selling price of $104 each.

The materials usage variance for the month was $22 800 (Favourable) and the materials price variance was $36 300 (Adverse).

Actual direct labour for the month was 53 200 hours at $10.40 per hour.

The fixed overhead expenditure variance for the month was $10 000 (Favourable) and the fixed overhead volume variance was $14 000 (Adverse).

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

(a) Calculate for the month of March:

(i) the amount of direct materials used (in kilos) [3]

(ii) the amount paid per kilo for the direct materials [3]

(iii) the labour rate variance [2]

(iv) the labour efficiency variance [2]

(v) the actual profit. [5]

(b) Prepare a statement reconciling the profit of $476 000 from the flexed budget with the actual profit. [6]

(c) Name **two other** variances which the directors could calculate if they wished to do further analysis of the change in the fixed overheads. [2]

(d) Suggest **one** reason for the company's:

(i) materials price variance [1]

(ii) materials usage variance. [1]

[Total: 25]

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