Pearson Edexcel
International Advanced Level

Accounting (Modular Syllabus)
Unit 2: Corporate and Management Accounting

Friday 10 June 2016 – Afternoon
Source Booklet

Paper Reference
WAC02/01

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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1 Chong and Mei are starting Lantau Insurance Agency Limited, which will sell insurance policies.

The new company is to be funded with a capital of £90 000 in the following ways:

- Friends and family of Chong and Mei will buy shares in the company for 30% of the capital required
- 40% of the capital required will be raised as a bank loan
- The remainder of the capital will be invested equally by Chong and Mei. This is to be raised in the following ratio:
  two thirds shares purchased : one third personal loan.

Required:

(a) Prepare a Capital Budget for the start of the business.

(4)

The terms of the insurance policies sold mean the customer will pay a £30 premium on the date of the sale, then pay a monthly premium of £30 on the same date of each and every following month for the remainder of the policy. All policies have a minimum length of one year. The first three months of premiums collected are retained by Lantau Insurance Agency Limited as an introduction fee.

Chong and Mei are considering two options as business models on how to set up and run the company. Initial costs to set up the business will be £30 000, regardless of the option chosen. This is in addition to the costs shown below.

The two options are:

Option 1:

Operate the business from shop premises in the town centre.

Costs will be:

- Payment for lease on shop premises £10 000
- Purchase of furniture for shop £4 000
- Purchase of computers for shop £2 500
- Rent of shop premises £500 per month
- All other expenses total £1 800 per month.

Staff will receive basic pay, but will not be paid commission. Basic pay will be at a rate of £1 000 per month per employee. Six staff will be employed and each staff member will sell eight insurance policies per month.

Option 2:

Operate the business from an office on the edge of town.

Costs will be:

- Purchase of furniture for office £3 000
- Purchase of computers for office £2 000
- Rent of office premises £400 per month
- All other expenses total £1 600 per month.

Staff will receive basic pay and will also be paid a commission. Basic pay will be at a rate of £500 per month per employee. Staff will find and visit potential customers to sell insurance policies. Commission will be paid to staff at a rate of 25% of premiums paid by customers each month, for the first six months of the policy. Eight sales staff will be employed and each staff member will sell 12 insurance policies per month.

Required:

(b) Prepare a monthly Cash Budget for Lantau Insurance Agency Limited for **each** of the first three months of trading for

(i) Option 1

(17)

(ii) Option 2.

(19)

(c) Evaluate the **two** possible options on behalf of Lantau Insurance Agency Limited.

(12)

(Total for Question 1 = 52 marks)

Answer space for Question 1 is on pages 2 to 8 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 2

2 You are the Finance Director of Bangla Homes Furnishings plc. The directors of Bangla Homes Furnishings plc and Red Sun Department Stores plc decided to merge to form a new company. The new company is called Style plc and has an Authorised Share Capital of 80 000 000 ordinary shares of £1 each. The new company was formed on 1 April 2016.

The Statements of Financial Position of the two companies on 31 March 2016 were as follows:

	Bangla Homes Furnishings plc £m		Red Sun Department Stores plc £m	
ASSETS				
Non-current Assets				
Buildings	22		25	
Fixtures and fittings	5		6	
Computer systems	3		4	
Vehicles	1		1	
		31		36
Current Assets				
Inventories	12		14	
Trade receivables	4		5	
Bank	2		-	
Cash	1		1	
		19		20
Total Assets		**50**		**56**
EQUITY AND LIABILITIES				
Equity				
Ordinary shares of £1 each	20		28	
Share premium	12		14	
Retained earnings	5		1	
		37		43
Non-current Liabilities				
Bank loan	8		5	
		8		5
Current Liabilities				
Trade payables	5		4	
Overdraft	-		4	
		5		8
Total Equity and Liabilities		**50**		**56**

Style plc is to settle the purchase consideration by issuing to the shareholders of Bangla Homes Furnishings plc and Red Sun Department Stores plc, ordinary shares of £1 in Style plc, at a value of £1.40 each.

Style plc is to take over all the assets and liabilities at book value, with the following exceptions:

- The buildings were revalued at:
  Bangla Homes Furnishings plc £27m
  Red Sun Department Stores plc £30m.
- The fixtures and fittings were revalued at:
  Bangla Homes Furnishings plc £4m
  Red Sun Department Stores plc £5m.
- The computer systems were revalued at:
  Bangla Homes Furnishings plc £2m
  Red Sun Department Stores plc £2m.
- The inventories of Red Sun Department Stores plc were revalued at £11m.
- The following trade receivables were written off as bad debts:
  Bangla Homes Furnishings plc £1m
  Red Sun Department Stores plc £2m.
- Goodwill was valued at:
  Bangla Homes Furnishings plc £3m
  Red Sun Department Stores plc £2m.
- The purchase price of Red Sun Department Stores plc was £42m.

Required:

(a) (i) Calculate the purchase price of Bangla Homes Furnishings plc.

(7)

(ii) Calculate the total number of shares in Style plc that the shareholders of Bangla Homes Furnishings plc will receive.

(4)

(b) Prepare in the books of Bangla Homes Furnishings plc the:

(i) Realisation Account

(8)

(ii) Sundry Shareholders Account.

(7)

You have been asked to speak at an Extraordinary General Meeting of the shareholders of Bangla Homes Furnishings plc, who are considering the merger with Red Sun Department Stores plc.

Required:

(c) Evaluate the merger on behalf of the shareholders of Bangla Homes Furnishings plc.

(12)

The merger goes ahead and you are appointed as the Finance Director of Style plc.

Required:

(d) Prepare the Statement of Financial Position of Style plc at 1 April 2016.

(14)

(Total for Question 2 = 52 marks)

Answer space for Question 2 is on pages 9 to 14 of the question paper.

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QUESTION 3 BEGINS ON THE NEXT PAGE

SOURCE MATERIAL FOR USE WITH QUESTION 3

3 Mashariki Railways plc was formed to build and run a high-speed railway between two large cities. Since the railway opened, the line has been run at an operating profit. However, a high level of borrowing, has meant that Mashariki Railways plc has not been able to make a profit after interest payments.

The Equity and Liabilities section of the Statement of Financial Position of Mashariki Railways plc at 1 April 2015, the start of the financial year, is shown below.

Equity and Liabilities

Equity	**£m**	**£m**
Ordinary shares of £1	600	
Share Premium reserve	150	
Retained earnings	(120)	
General reserve	20	
		650
Non-current Liabilities		
8% Debenture 2022	500	
11% Debenture 2024	400	
9% Bank loan	100	
		1 000

The directors decided to raise another £200 million by an issue of shares.

On 1 May 2015, the company offered 160 million £1 ordinary shares at a price of £1.25 on the following terms:

- £0.60 on application
- £0.30 on allotment (including the 25p premium)
- £0.35 first and final call.

On 10 June 2015 applications for 185 million shares had been received. The directors rejected applications for 5 million shares and allotted shares to the remaining applicants on the basis of 8 shares for every 9 applied for.

On 20 June 2015 monies were returned to the unsuccessful applicants of the 5 million shares.

The balances due on allotment were fully received on 30 July 2015.

The first and final call was made on 1 December 2015 and the amounts were fully received on 30 December 2015.

Required:

(a) Prepare the following ledger accounts to record the transactions from May to December 2015:

- Ordinary Share Capital Account
- Share Premium Account
- Application and Allotment Account
- First and Final Call Account.

You must show the following where possible:

- dates
- opening balances at the start of the year
- closure of any relevant accounts during the year
- closing balances at the end of the year.

(20)

For the financial year ended 31 March 2016, Mashariki Railways plc made an Operating Profit Before Interest of £43 million.

Required:

(b) Calculate the Profit After Interest for Mashariki Railways plc for the financial year ended 31 March 2016.

(5)

Mashariki Railways plc has found it very difficult to meet the interest payments on debt. The directors of Mashariki Railways plc persuaded the holders of the 8% Debenture to convert the Debenture into Ordinary Shares of £1, on 1 April 2016.

Required:

(c) Prepare the Journal entry to show the conversion of the Debenture into Ordinary Shares.

(5)

(d) Calculate the gearing ratio on 1 April 2016, **after** the conversion of the Debenture into £1 Ordinary Shares, clearly stating the formula used.

(10)

(e) Evaluate the decision to convert the 8% Debenture into £1 Ordinary Shares from the viewpoint of the directors of Mashariki Railways plc.

(12)

(Total for Question 3 = 52 marks)

Answer space for Question 3 is on pages 15 to 20 of the question paper.

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4 Silverseal plc is a new company that produces batteries for smartphones. Silverseal plc has a four year contract to supply a major smartphone producer, Voyager plc, with 500 000 batteries per year.

The following information is available for the year ended 31 March 2016:

Opening inventory	Nil
Production	520 000 batteries
Semi-variable costs	£7 800 per month plus £0.45 per battery
Fixed overheads	£26 000 per month
Direct materials	£1.85 per battery
Direct labour	20 minutes work per battery at a wage rate of £5.40 per hour
Selling price	£5.95 per unit
Closing inventory	20 000 units

Required:

(a) Prepare, for management, a Statement of Comprehensive Income for the year ended 31 March 2016. Closing inventory is to be valued using **absorption costing**.

(12)

On 1 April 2016, Konichiwa plc, a large smartphone producer, requested Silverseal plc to supply 50 000 batteries during April at a price of £4.75 per battery.

Required:

(b) Advise management whether they should sell the 20 000 batteries in the inventory to Konichiwa plc at a price of £4.75 per battery, to meet part of the order.

(6)

If Silverseal plc decides to sell the inventory of 20 000 batteries to Konichiwa plc, the company has two options to supply the remainder of the order.

Option 1
Silverseal plc will produce 30 000 extra batteries to fulfil the order. This would require workers to work overtime at a wage rate of £6.60 an hour. Other costs remain the same.

Option 2
Silverseal plc can buy the 30 000 extra batteries at a price of £4.60 from another firm.

Required:

(c) Using **marginal costing**, advise, stating your reasons, which of the following courses of action Silverseal plc should select:

- Option 1
- Option 2
- reject the order.

(6)

(d) Evaluate the use of marginal costing in decision making.

(8)

(Total for Question 4 = 32 marks)

Answer space for Question 4 is on pages 21 to 24 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 5

5 Yasmin had some surplus funds, which she decided to invest in a public limited company quoted on the Stock Exchange. Yasmin did some research and decided to buy shares in Dubarab Shipping plc on 1 April 2015.

Information concerning Dubarab Shipping plc for the financial year ended 31 March 2016 is shown below:

Authorised share capital	100 000 000 x £1.25 Ordinary shares
Issued share capital	84 000 000 x £1.25 Ordinary shares
Reserves	£27 000 000
Net profit before interest and tax	£5 160 000
Net profit after interest and tax	£3 360 000
Non-current liabilities	£40 000 000
Interim ordinary dividend paid September 2015	£672 000
Final ordinary dividend paid March 2016	£1 953 000
Share price on 1 April 2015	£1.20
Share price on 31 March 2016	£1.32

Required:

(a) Calculate the profit **percentage** made by Yasmin due to the rise in the share price of Dubarab Shipping plc for the financial year ended 31 March 2016.

(3)

(b) Calculate the following ratios for Dubarab Shipping plc for the year ended 31 March 2016:

(i) Return on capital employed

(4)

(ii) Earnings per ordinary share

(3)

(iii) Price/earnings ratio at 31 March 2016

(3)

(iv) Dividend paid per share

(4)

(v) Dividend cover

(3)

(vi) Dividend yield.

(4)

On 1 April 2016, Yasmin has more funds, which she wants to invest in shares. She has decided to choose between two possible options:

(i) Option 1 – make her own selection of the companies in which she will buy shares

(ii) Option 2 – visit a stockbroker and invest in shares the stockbroker recommends.

The following information concerns the All Share Index of the Stock Exchange.
The figures given are an average for all companies quoted on the Stock Exchange, for the year ended 31 March 2016.

Rise in share price	7%
Return on capital employed	5%
Dividend cover	2 times
Dividend yield	5.6%

Yasmin is not sure whether she is good at selecting shares in which to invest.

She needs to compare the performance of Dubarab Shipping plc shares with the All Share Index of the Stock Exchange.

Required:

(c) Evaluate whether Yasmin should select her own shares, or invest in the shares recommended by a stockbroker.

(8)

(Total for Question 5 = 32 marks)

Answer space for Question 5 is on pages 25 to 27 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 6

6 You are the Cost Accountant at Sliema Domestics Limited, which produces steel radiators and uses a standard costing system. You have been working on the management accounts for May 2016 and the report is partly completed and shown below.

	BUDGET £	ACTUAL £	VARIANCE £
Revenue	76 800	A	1 500 ADV
Less			
Material Costs	8 928	B	C
Labour Costs	10 120	D	88 ADV
Variable Overheads	3 080	E	156 FAV
= Cost of Sales	22 128	F	G
Gross Profit	54 672	H	I
Less Fixed Overheads	17 575	J	195 FAV
Net Profit	37 097	K	L

The following information is also available for May 2016:

- A budgeted production of 1 600 radiators for May 2016 was achieved
- There was no opening inventory of steel on 1 May 2016
- During the month of May, Sliema Domestics Limited purchased 14 550 kilograms of steel at a price of £0.60 per kilogram
- The closing inventory of steel was 70 kilograms at 31 May 2016
- Each radiator was budgeted to use 9 kilograms of steel at a price of £0.62 per kilogram
- The budgeted sales figure of 1 600 radiators was achieved.

Required:

(a) Complete the spaces in the columns in the question paper, showing figures for A to L.

(12)

(b) Calculate for the month of May 2016 the:

(i) material usage variance

(5)

(ii) material price variance

(5)

(iii) total material cost variance.

(2)

At a meeting, the Sales Director stated “There is an adverse variance, comparing budgeted sales to actual sales, but this is not necessarily bad for the company”.

Required:

(c) Evaluate the statement made by the Sales Director from the point of view of Sliema Domestics Limited.

(8)

(Total for Question 6 = 32 marks)

Answer space for Question 6 is on pages 28 to 32 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 7

7 Suntours plc are considering building a hotel in the seaside resort of Komos. The initial cost of building the hotel will be £2 000 000.

The following budgeted information is available:

Year	Room occupancy	Charge per room per week	Running costs per room (including depreciation)
1	60%	£225	£135
2	80%	£230	£135
3	80%	£230	£140
4	90%	£235	£140
5	90%	£235	£145

- The hotel has 5 floors with 16 rooms on each floor
- Depreciation will be £250 000 per year
- Assume 52 weeks in a year
- It is company policy to have a positive net present value on projects within five years
- The cost of capital for the company is 8%.

A table showing the discount factors is given below.

Year	8%
1	0.926
2	0.857
3	0.794
4	0.735
5	0.681

Required:

(a) Calculate the net present value of the project at the end of Year 5.

(24)

(b) Evaluate the project for Suntours plc, using calculations made in (a) and considering any other relevant factors.

(8)

(Total for Question 7 = 32 marks)

Answer space for Question 7 is on pages 33 to 36 of the question paper.