

Paper Reference(s)

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London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary/Advanced Level

Unit 1 – The Accounting System and Costing

Thursday 10 January 2008 – Morning

**Source booklet for use with Questions
1 to 7.**

**This source booklet is NOT to be
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SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

1. Meera and Nigel were in partnership sharing profits and losses equally. On 1 January 2007 they admitted Pauline as a partner and she paid £20 000 into the business as capital. Goodwill at that date was valued at £80 000, but it was agreed that this would not be retained in the books of the new partnership.

The partnership has completed its first year of trading, sharing profits and losses in the ratio 2:2:1 respectively. Interest is paid on capital at the rate of 5% per annum. No interest is paid on drawings. Salaries are paid at the rate of £8 000 each per annum to Nigel and Pauline; no salary is paid to Meera.

On 31 December 2007, the following balances were extracted from the partnership books after the preparation of the trading account.

	£
Gross profit	150 000
Stock	18 000
Ⓜ Rent receivable	3 500
Wages	42 000
Office staff salaries	30 700
Salary – Pauline	5 000
Ⓜ Light and power	9 750
Ⓜ Marketing	15 000
Administration costs	7 950
Ⓜ Equipment (cost £60 000)	12 000
Creditors	24 850
Debtors	40 000
Ⓜ Provision for doubtful debts	1 600
Drawings:	
Meera	7 000
Nigel	8 000
Pauline	6 000
Current accounts: 1 January 2007	
Meera	6 500 CR
Nigel	3 500 DR
Capital accounts:	
Meera	17 000
Nigel	10 000
Pauline	4 000

Additional information at 31 December 2007:

- (i) Rent receivable was due to the partnership. Premises had been rented out at the rate of £400 per month for the year.
- (ii) Marketing expenses of £3 000 were prepaid.
- (iii) Light and power is owing £650.
- (iv) Provision for doubtful debts is to be maintained at the level of 4% for debts less than 3 months and 6% for debts over 3 months. Three quarters of the debts are less than 3 months.
- (v) Depreciation on equipment has been charged at the rate of 10% using the straight line method. The equipment has a residual value of £8 000.

Required:

(a) Prepare for the year ended 31 December 2007:

- capital accounts of the partners recording the entry of Pauline
- profit and loss account
- appropriation account
- current accounts of the partners.

(15)

The partnership values stock on the First In First Out (F.I.F.O) periodic method each quarter year, but is considering a transfer to the Last In First Out (L.I.F.O) method. The stock records for the year 2007 show:

Opening balance 700 @ £18 each.	Receipts	Issues
Jan – March	500 @ £20 each	600
April – June	400 @ £24 each	300
July – September	400 @ £27 each	500
October – December	600 @ £30 each	600

- (b) • Calculate the value of the closing balance of stock using the L.I.F.O method.
- Explain the effect on the net profit if the partnership changes to the L.I.F.O method.

(7)

(c) One of the partners, Pauline, said.

“When we provide for depreciation on the equipment, this means that we will have the cash to replace the equipment at the end of its life.”

Evaluate this statement.

(4)

(Total 26 marks)

Answer space for question 1 is on pages 2 to 6 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 2

2. Sportex manufactures and retails two products: sports bags and golf bags.

The following balances were extracted from the books on 31 December 2007.

	£
Stock at 1 January 2007:	
raw materials	50 000
work in progress: sports bags	9 500
golf bags	33 000
finished goods: sports bags	15 000
golf bags	9 600
Purchases of raw materials	225 000
Production wages	180 000
Management salaries	98 000
Administration salaries	76 500
Rent and insurance	105 000
Light and power	56 000
Marketing	50 000
Plant and equipment at cost	400 000
Plant and equipment – provision for depreciation	100 000
Office fixtures at cost	78 000
Office fixtures – provision for depreciation	35 100
Sales:	
sports bags	480 000
golf bags	350 000

Additional information:

- (i) Stock at 31 December 2007:
- | | |
|-------------------------------|--------|
| raw material | 55 000 |
| work in progress: sports bags | 43 500 |
| golf bags | 26 000 |
| finished goods: sports bags | 26 500 |
| golf bags | 18 200 |
- (ii) Raw materials records show that £100 000 of raw material was used in the manufacture of the sports bags, and the remainder of raw material was used in the manufacture of the golf bags.
- (iii) Production workers work 40 hours per week for 50 weeks per year. There are 10 production workers producing the sports bags being paid £5 per hour; and 10 production workers producing the golf bags being paid £4 per hour.
- (iv) During the year, 20 000 sports bags and 8 000 golf bags were manufactured and transferred to the finished goods warehouse.
- (v) During the year 18 000 sports bags and 7 000 golf bags were sold by Sportex.
- (vi) Depreciation is charged on plant and equipment at the rate of 25% using the diminishing balance method, and on office fixtures at the rate of 15% on cost using the straight line method.

(vii) All factory overheads are to be apportioned between the sports bags and the golf bags using the most appropriate basis from the information detailed below.

	Production of sports bags	Production of golf bags	Administration
Floor area (sq m)	600	400	500
Power usage (kWh)	1 500	2 500	3 000
Plant and equipment (value £)	240 000	160 000	–
Number of employees	10	10	8

Required:

(a) Prepare, for the year ended 31 December 2007, the:

- manufacturing account (in columnar format), showing the **prime cost** and **production cost** of manufacturing sports bags and golf bags
- trading and profit and loss account, showing the **gross profit** for both the sports bags and the golf bags and the total **net profit** for the business.

(18)

(b) Calculate the production cost of manufacturing:

- **one** sports bag
- **one** golf bag.

(2)

Sportex has been experiencing difficulties in selling both the sports bags and the golf bags due to increased competition. An overseas supplier has offered to supply Sportex with the sports bags for £15 each and the golf bags for £30 each. If Sportex accepted the offer it would cease production of its own bags.

(c) Calculate what the **net profit** of Sportex would be if the offer was accepted and production of the bags ceased.

(2)

(d) Evaluate whether Sportex should purchase the sports bag and golf bag from an overseas supplier, considering both the financial and social accounting aspects.

(4)

(Total 26 marks)

Answer space for question 2 is on pages 7 to 10 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. Sonex is a business manufacturing and retailing wind turbines for the home generation of electricity. The owners of Sonex are considering expansion by the purchase of another business and have a choice of two businesses which are for sale: Wavepower and Solargain.

The owners of Sonex only have the funds to purchase one business and have the following information relating to the two businesses for the year ended 31 December 2007:

	Wavepower £	Solargain £
Sales	400 000	400 000
Cost of sales	140 000	120 000
Production wages	165 000	110 000
Other expenses and salaries	85 000	90 000
Fixed assets	170 000	210 000
Stock	75 000	90 000
Debtors and prepayments	30 000	15 000
Cash and bank	25 000	5 000
Creditors and accruals	50 000	60 000
Long term loans	–	50 000

Required:

- (a) Distinguish between the terms **profitability** and **liquidity**. (4)
- (b) Calculate, for Wavepower and for Solargain, from the balances given:
- net profit as a percentage of sales
 - return on capital employed
 - current ratio
 - liquid (acid test) ratio.
- (8)
- (c) Comment upon the ratios calculated in (b). (5)

If the owners of Sonex decide to buy one of the businesses, the following actions will be taken:

Purchase of Wavepower

The business employs 12 production workers. Each is paid for 50 hours per week, 50 weeks per year at an hourly rate of £5.50. The payment system for the production workers would be changed to a group piecework scheme paying £25 for each unit of the 5 000 units produced.

Purchase of Solargain

Stock will be reduced by £30 000. Creditors will be reduced by £20 000. The long term loan will be repaid.

Required:

(d) Calculate for Wavepower and Solargain the revised:

- return on capital employed
- liquid (acid test) ratio.

(5)

(e) Evaluate whether the owners of Sonex should purchase Wavepower or Solargain.

(4)

(Total 26 marks)

Answer space for question 3 is on pages 11 to 15 of the question paper.

SECTION B

SOURCE MATERIAL FOR USE WITH QUESTION 4

4. Rizan is a sole trader buying and selling goods for cash and on credit. When he commenced business he decided not to keep a formal set of books and all bank transactions are recorded in his personal bank account.

Rizan is now required to file his profit for the year with the government and seeks your help to prepare the return.

In discussion with Rizan the following information is available:

- (i) On 1 January 2007 assets and liabilities were as follows:

Stock	£18 600
– Motor van for business use	£5 900
Debtors	£1 520
Creditors	£810

- (ii) Payments had been received during the year, by cheque, £14 000 for credit sales and a further £1 200 was owed by debtors on 31 December 2007.
- (iii) Rizan banked £13 000 from cash sales after he had paid for the following in cash: stock £12 000, petrol and repairs for the motor van £920, a part time assistant £2 400 and personal drawings £9 000.
- (iv) Credit purchases of £21 000 were paid by cheque during the year and £900 was owed to creditors on 31 December 2007.
- (v) The motor van was valued at £4 800 on 31 December 2007.
- (vi) Rizan paid £3 600 by cheque for storage and insurance for the goods.
- (vii) The mark up on goods is 50%.
- (viii) On 28 December 2007, Rizan's storage was broken into and goods were stolen. On 31 December 2007, Rizan carried out a stocktake of the goods remaining and valued the stock at £12 240. Rizan will make an insurance claim for the stolen goods.

Required:

(a) Calculate for the year ended 31 December 2007, the value of:

- sales
- purchases.

(6)

(b) Prepare for the year ended 31 December 2007:

- the trading account
- a calculation of the stock stolen
- the profit and loss account.

(6)

(c) Identify and explain which accounting concept has been broken by Rizan's failure to maintain a separate bank account for the business.

(2)

(d) Evaluate Rizan's decision to not maintain a formal set of accounts.

(2)

(Total 16 marks)

Answer space for question 4 is on pages 16 to 19 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 5

5. Ahmed is in business operating a garage repairing cars for customers.

The following information is available:

- (i) He rents the garage premises for £750 per month.
- (ii) Heat, light and power costs average £500 per quarter year.
- (iii) Licensing and sundry expenses cost £3 100 per annum.
- (iv) Equipment cost £15 000 and has a life of 10 years, with no residual value.
- (v) A bookkeeper is employed for 10 hours per week for 48 weeks per year at a rate of £5 per hour.
- (vi) Ahmed needs to earn £1 500 per month to meet his personal needs.
- (vii) The garage is open for 50 hours per week for 48 weeks per year.
- (viii) It is estimated that Ahmed spends 75% of his time undertaking repair work which will be charged to customers.
- (ix) When providing quotations to customers, Ahmed works on the basis of achieving a 25% profit margin as the total cost of the job.

Required:

(a) Calculate the hourly cost of Ahmed's repair service. **(6)**

(b) Prepare a quotation for a customer's vehicle repair, where the vehicle parts cost £70 and the repair will take 7 hours to complete. **(4)**

Ahmed is considering the purchase of new 'hi tech' electronic analysing equipment at a cost of £36 000. The equipment will have a life of 3 years and no residual value. If purchased, the number of hours that Ahmed will be able to charge customers will be reduced to a total of 1 600 hours per annum.

(c) Calculate the revised hourly cost of Ahmed's repair service, if the 'hi tech' electronic analysing equipment is purchased. **(4)**

(d) Evaluate whether Ahmed should purchase the 'hi tech' electronic analysing equipment. **(2)**

(Total 16 marks)

Answer space for question 5 is on pages 20 to 22 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 6

6. Yousuf, a sole trader, who has not had any formal accounting training, prepared the following trading and profit and loss account for the year ended 31 December 2007.

	£
(i) Sales	40 000
(i) Cost of sales	<u>24 500</u>
Gross profit	15 500
Rent of shop	2 000
(ii) Telephone and internet	712
(ii) Depreciation of fixtures	50
(iv) Staff wages and costs	8 500
(v) Drawings	<u>5 000</u>
Net loss	(762)

The following information is available:

- (i) A customer had said that he may buy some goods, but no order has been received. The trading account includes goods which cost £1 200 and have a sales value of £1 800 relating to this 'transaction'.
- (ii) The telephone and internet relates to the actual payments made and does not include an estimated £48 telephone bill owing and a £20 advance payment for the internet.
- (iii) The fixtures cost £24 000, will have a life of 15 years and no residual value. Yousuf planned to depreciate them evenly over the life but only allowed £50 depreciation in the current year because he said that the fixtures still look new.
- (iv) Included in the staff wages and costs is a sum of £1 000 relating to the increased skill of the sales assistant obtained after completing one year in the job.
- (v) Yousuf took drawings of £5 000 in the year. This has been recorded as an expense of the business.

Required:

- (a) Explain, for each of (i) to (v), the accepted accounting concept or convention, **other than prudence**, which should have been complied with. (5)
- (b) Prepare a revised trading and profit and loss account for the year ended 31 December 2007 which complies with accepted accounting concepts and conventions. (5)
- (c) Discuss the role played in accounting by accepted accounting concepts and conventions. (4)
- (d) Evaluate a circumstance in which it could be appropriate for a business to account for the increased skill of staff. (2)

(Total 16 marks)

Answer space for question 6 is on pages 23 to 25 of the question paper.

SOURCE MATERIAL FOR USE WITH QUESTION 7

7. The following trial balance, which failed to agree, was prepared by the business of Jerome on 30 November 2007.

	Debit £	Credit £
Capital		5 000
Debtors	8 640	
Creditors		6 100
Stock	7 900	
Bank	850	
Rent	1 000	
Fixtures and fittings	10 000	
Gross profit		9 380
General expenses	4 410	
Wages	10 740	
Commission receivable		14 960
Drawings	<u>7 400</u>	
	<u>50 940</u>	<u>35 440</u>

The following errors were found in the books:

- (i) Debtors includes the account of J. Williams, whose debt of £450 became a bad debt on 1 August 2007. On 26 September 2007 a cheque was received in final settlement for £0.40 in the £. No entries had been made in the accounts to record the bad debt or the cheque receipt.
- (ii) Jerome paid rent of £500 per quarter year in advance, commencing on 1 January 2007. The third quarter rent had been credited to both the rent and bank accounts.
- (iii) Drawings by Jerome of £1 600 had been recorded in the wages account.
- (iv) Commission receivable is received twice yearly. On 30 March 2007, £16,500 had been received and correctly entered in the bank account, but no entry had been made in the commission receivable account.

On 30 September 2007, a cheque for commission receivable had been received which had been miscalculated in Jerome's favour by £630. A cheque was drawn to refund the overpayment.

Required:

(a) Prepare for Jerome:

- journal entries to correct the errors. (narrations not required)
- the suspense account showing clearly the opening balance.

(8)

(b) Prepare the following ledger accounts for the year:

- rent account
- commission receivable account.

(6)

(c) Evaluate the role of a trial balance in ensuring the accuracy of ledger accounts.

(2)

(Total 16 marks)

Answer space for question 7 is on pages 26 to 28 of the question paper.

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