LCCI International Qualifications

Accounting (IAS)
Level 3

International
Qualifications from EDI

Model Answers
Series 4 2012 (3902)

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Accounting (IAS) Level 3
Series 4 2012

How to use this booklet

Model Answers have been developed by EDI to offer additional information and guidance to Centres, teachers and candidates as they prepare for LCCI International Qualifications. The contents of this booklet are divided into 3 elements:

(1)	Questions	–	reproduced from the printed examination paper
(2)	Model Answers	–	summary of the main points that the Chief Examiner expected to see in the answers to each question in the examination paper, plus a fully worked example or sample answer (where applicable)
(3)	Helpful Hints	–	where appropriate, additional guidance relating to individual questions or to examination technique

Teachers and candidates should find this booklet an invaluable teaching tool and an aid to success.

EDI provides Model Answers to help candidates gain a general understanding of the standard required. The general standard of model answers is one that would achieve a Distinction grade. EDI accepts that candidates may offer other answers that could be equally valid.

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Question 1

The Treasurer of the Hill Social Club has, in error, paid an electricity bill for $710, twice. This payment was also entered in the books twice. The bill was in respect of consumption for the three month period ending on 31 May 2012.

The electricity supplier has acknowledged the double payment and it has been agreed that it will be offset against future bills. At 30 June 2012, the club's year end, it was estimated that $300 worth of electricity had been consumed since 31 May 2012.

Required

(a) Prepare, for the Treasurer of the Hill Social Club, a journal entry enabling the correct charge for electricity to be shown in the Income and Expenditure Account for the year ended 30 June 2012. A narrative is required.

(3 marks)

For several years (including the year ended 30 June 2011) the restaurant of the Social Club had a gross profit to revenue ratio of around 40%. For the year ended 30 June 2012 it was only 28.75%. Extracts from the restaurant Income Statement for that year are as follows

		$	$
Revenue			80,000
Cost of goods sold:	Opening inventory	7,000	
	Purchases	60,000	
		67,000	
	Closing inventory	10,000	57,000
Gross profit			23,000

The Treasurer, who suspects goods may have been stolen, has asked the Restaurant Manager to explain the reduction in gross profit to revenue ratio. The Restaurant Manager has made the following suggestions:

(i) there has been a change in revenue mix: more low margin biscuits have been sold and fewer high margin cakes have been sold.

(ii) the opening inventory may have been over valued as the inventory count was not supervised last year.

Required

(b) Calculate the cost of the goods which may have been stolen during the year ended 30 June 2012, on the assumption that the gross profit to revenue ratio should have been 40%.

(3 marks)

(c) Calculate the selling price of the goods which may have been stolen during the year ended 30 June 2012, on the assumption that the gross profit to revenue ratio should have been 40%.

(2 marks)

(d) Assess whether or not **each** of the Restaurant Manager's suggestions could provide an explanation for the fall in the gross profit to revenue ratio.

(4 marks)

(e) List **three** possible explanations for the fall in gross profit to revenue ratio, other than theft and the suggestions of the Restaurant Manger.

(3 marks)

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Question 1 continued

Dock, Road and Beach have been in partnership, without a partnership agreement, for two years with fixed capitals of $8,000, $10,000 and $12,000 respectively. A partnership agreement was drawn up for year three, under which annual profits were to be divided as follows:

(1) Dock to receive an annual salary of $3,000
(2) Interest on fixed capitals to be allowed at 5% per year
(3) Residual profit to be divided between Dock, Road and Beach in the ratio of 1:2:2 respectively.

Net profit for Year 3 is expected to be $45,000.

Required

(f) Calculate the gain or loss to each partner in Year 3, from having no agreement to having an agreement.

(6 marks)

Dock suggests that his salary should be increased to $7,500 per year.

(g) Calculate the gain or loss Dock will make if this suggestion is included in a revised partnership agreement, as compared with **each** of the following:

(i) having no partnership agreement
(ii) accepting the terms of the original partnership agreement.

(4 marks)

(Total 25 marks)

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Model Answer to Question 1
Syllabus Topic 1: Levels 1 and 2 revisited

(a) **Journal entry**

	$ Dr		$ Cr	
Other receivables (710 – 300)	410	1		
Electricity expense			410	1
To recognise the payment in advance for electricity				1

(3 marks)

(b) **Cost of goods stolen**

	$	
Expected gross profit (80,000 x .40)	32,000	2
Actual gross profit	23,000	1
Cost of goods stolen	9,000	

(3 marks)

(c) **Sales value of goods stolen**

Cost of goods stolen x mark-up
9,000 x 100/60 = $15,000
1of 1

(2 marks)

(d) **Restaurant Manager's suggestions**

(i) The change from a high margin product to a low margin product would lower the average gross profit to revenue percentage. However as cakes and biscuits are likely to be only a small part of the restaurant sales, such a change is unlikely to explain such a large fall.
2

(ii) The absence of supervision at inventory count, causing the opening inventory to be over valued, would reduce the year's gross profit to revenue percentage. However, this would also increase the previous year's gross profit to revenue percentage. As the previous year's percentage was around the normal 40%, this explanation is also unlikely.
2

(4 marks)

(e) **Possible additional explanations**

- Expenses paid out of takings but not recorded
- Purchases paid for but not delivered
- Customers being undercharged or limited to cash sales customers
- Inventory sold on credit not recorded

Any 3 x 1

(3 marks)

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Model Answer to Question 1 continued

(f) **Gain or loss for each partner**

	$	$	Dock $		Road $	Beach $	
No agreement 45,000 (1:1:1)			15,000		15,000	15,000	1½
	$	$	$		$	$	
Agreement:		45,000					
Salary: Dock	3,000		3,000				½
Interest 5% : Dock	400		400				½
Road	500				500		½
Beach	600					600	½
		(4,500)					
Residual profit (1:2:2)		40,500	8,100		16,200	16,200	1½
			11,500		16,700	16,800	
			$		$	$	
Gain/(Loss)			(3,500)		1,700	1,800	1of

(6 marks)

(g) **Gain or loss for Dock**

	$	$	Dock $		Road $	Beach $
Revised agreement :		45,000				
Salary: Dock	7,500		7,500	½		
Interest 5%	1,500		400	½	500	600
		(9,000)				
Residual profit (1:2:2)		36,000	7,200	1	14,400	14,400
			15,100		14,900	15,000

(i) Compared with no agreement (15,100 – 15,000) $100 gain 1of

(ii) Compared with original agreement (15,100 – 11,500) $3,600 gain 1of

(4 marks)

(Total 25 marks)

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Question 2

Pier, a limited company, has provided the following (correctly calculated) information for its Statement of Cash Flows for the eleven months ended 31 May 2012:

	$000	$000
Operating profit before working capital changes		170
Decrease in inventories		20
Decrease in trade receivables		10
Increase in trade payables		5
Cash generated from operations		205
Debenture interest		(10)
Net cash flow from operating activities		195
Cash flows from investing activities		
Cash paid for non-current assets	(40)	
Net cash used in investing activities		(40)
Cash flows from financing activities		
Issue of debentures	50	
Dividends paid	(20)	
Net cash used in financing activities		30
Net increase in cash and cash equivalents		185

In the month ended 30 June 2012 the following occurred:

(1) Sales of $100,000. Pier achieved a **net operating profit** of 10% of revenue, before taking into consideration any of the matters mentioned in (2) – (7) below.

(2) Non-current assets were purchased for $70,000. Non-current assets, with a carrying amount of $30,000, were disposed of at a loss of $3,000.

(3) Depreciation was provided at 10%, on a reducing balance basis, on all non-current assets held at the end of the year. The net book value of non-current assets at 1 July 2011 was $160,000.

(4) An interim dividend of $10,000 was paid.

(5) An issue of 200,000 $0.50 ordinary shares was made at a premium of 10%. $20,000 of debentures were redeemed at par.

(6) Debenture interest of $10,000 was paid.

(7) Inventory increased by $2,000, before a provision for obsolete inventory of $3,000 was made. Trade receivables decreased by $3,000, before writing off bad debts of $1,000 and making an allowance for doubtful debts of $2,000. Trade payables increased by $1,000.

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Question 2 continued

Required

(a) Calculate the net operating profit for the year ended 30 June 2012.

(8 marks)

(b) Prepare the Statement of Cash Flows, in accordance with IAS 7, for the year ended 30 June 2012

(17 marks)

(Total 25 marks)

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Model Answer to Question 2
Syllabus Topic: 7 Cash Flow Statements

(a) **Profit of Pier year ended 30 June 2012**

	$000	
Profit to 31 May 2012	170	½
Profit for June 2012 (100 x 10%)	10	1
Loss on disposal	(3)	1
Depreciation for year [(160 + 40 + 70 – 30) x 10%]	(24)	2½
Provision for obsolete inventory	(3)	1
Bad debts	(1)	1
Allowance for doubtful debts	(2)	1
	147	

(8 marks)

Pier
Statement of Cash Flows for the year ended 30 June 2012

(b)

	$000	$000	
Profit for the year		147	½of
Adjustments for			
Loss on disposal		3	1
Depreciation		24	1of
Operating profit before working capital changes		174	
Decrease in inventories (20 - 2 + 3)		21	1½
Decrease in trade receivables (10 + 3 + 1 + 2)		16	2
Increase in trade payables (5 + 1)		6	1
Cash generated from operations		217	½of
Debenture interest (10 + 10)		(20)	1½
Net cash flow from operating activities		197	
Cash flows from investing activities			
Cash paid for non-current assets (40 + 70)	(110)		1½
Cash received from sale of non-current assets (30 - 3)	27		1½
Net cash used in investing activities		(83)	
Cash flows from financing activities			
Dividends paid (20 + 10)	(30)		1½
Issue of debentures	50		½
Redemption of debentures	(20)		1
Proceeds from issue of shares (200,000 x 0.50 x 1.10)	110		1½
Net cash used in financing activities		110	
Net increase in cash and cash equivalences		224	½of

(17 marks)

(Total 25 marks)

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Question 3

On 1 January 2009 Platt, a private company, purchased twenty machines for $9,000 each. Depreciation on them was charged at 15% per year, using the reducing balance method. Platt charges depreciation on a monthly basis.

On 30 June 2010 four of the machines were destroyed in a fire and replaced, on 1 July 2010, with four machines costing $9,900 each. Platt received $27,000 from its insurance company on 1 September 2010.

On 1 January 2011 it was decided to change to the straight line method of depreciation. It was estimated that all machines would have a useful life of ten years from their date of purchase and a scrap value of $450 each. The change in depreciation method was not expected to materially distort future results.

Required

(a) Prepare the following Accounts for **each** of the three years ended 31 December 2009, 2010 and 2011:

(i) machinery at cost
(ii) accumulated depreciation on machinery
(iii) machinery disposal.

Note: Make all calculations to the nearest $1.

(19 marks)

During the year ended 30 June 2012 Cyres, a baker, purchased the following:

		$
(1)	Land	80,000
(2)	Stationery	1,200
(3)	Goods for resale	91,300
(4)	Second hand car	3,100
(5)	Office building	104,100
(6)	Goodwill	71,100

Required

(b) Classify **each** of the above items as either capital expenditure or revenue expenditure.

For any item classified as capital expenditure state whether it is tangible or intangible.

(6 marks)

(Total 25 marks)

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Model Answer to Question 3
Syllabus Topic: 3 Valuation of non-current assets

(a)

Machinery at Cost Account

			$			$	
2009	Bank (20 x 9,000)	1	180,000	2009	Balance c/d	180,000	
2010	Balance b/d		180,000	2010	Disposal (4 x 9,000)	36,000	1
	Bank (4 x 9,900)	1	39,600		Balance c/d	183,600	
			219,600			219,600	
2011	Balance b/d		183,600	2011	Balance c/d	183,600	

Accumulated Depreciation on Machinery Account

			$			$	
2009	Balance c/d		27,000	2009	Income Statement (.15 x 180,000)	27,000	1
2010	Disposal (W2)	<2>	7,695	2010	Balance b/d	27,000	
	Balance c/d		42,930		Income Statement (W1)	23,625	<4>
			50,625			50,625	
2011	Balance c/d		58,701	2011	Balance b/d	42,930	
					Income Statement (W3)	15,771	<6>
			58,701			58,701	

Machinery Disposal Account

			$			$	
2010	Machinery at cost	½of	36,000	2010	Acc. depr. on mach.	7,695	½of
					Bank	27,000	1
					Income Statement	1,305	1
			36,000			36,000	

(19 marks)

W1	16 machines	9,000 x 16 x .85 x .15	18,360	1
	4 machines	9,000 x 4 x .85 x .15 x .5	2,295	1
	4 machines	9,900 x 4 x .15 x .5	2,970	1
			23,625	1of
				<4>

W2	4 machines destroyed:	2009	9,000 x 4 x .15	5,400	1½
		2010	as W1	2,295	½of
				7,695	
					<2>

W3	16 machines: carrying amount	9,000 x 16 x .85 x .85		104,040	1
	scrap value	16 x 450		7,200	1
			8 years	96,840	1of
			∴1 year	12,105	
	4 new machines: carrying amount	9,900 x 4 (1 - .075)		36,630	1
	scrap value	x4 x 450		1,800	1
			9.5 years	34,830	1of
			∴1 year	3,666	
	Depreciation 2011 (12,105 + 3,666)			15,771	<6>

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Model Answer to Question 3 continued

(b) **Classification of purchases**

(1)	capital (tangible)	1
(2)	revenue	1
(3)	revenue	1
(4)	capital (tangible)	1
(5)	capital (tangible)	1
(6)	capital (intangible)	1

(6 marks)

(Total 25 marks)

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Question 4

Golf, a public company, acquired 180,000 of the 300,000 $1 ordinary shares of Club, a private company, on 1 January 2008, at a cost of $4,000,000. At that date the credit balance on Club's Retained Earnings Account (the only reserve) was $3,000,000.

Required

(a) Calculate the goodwill arising on the acquisition of Club.

(3 marks)

During the year ended 31 December 2011, Club sold goods to Golf for $207,000, which included a mark up of 15%. Half of the value of these goods remained in Golf's inventory at 31 December 2011. The values of the inventory in the Statement of Financial Positions of Golf and Club at that date were $370,000 and $210,000 respectively.

Required

(b) Calculate the value of inventory that would appear in the Consolidated Statement of Financial Position (formally the Balance Sheet) of Golf and Club at 31 December 2011.

(3 marks)

At 31 December 2011 the capital and reserves section of the Statement of Financial Position of each company was as follows:

	Golf	**Club**
	$	**$**
Ordinary share capital	700,000	300,000
Retained earnings	2,100,000	4,800,000

Required

(c) Calculate the consolidated retained earnings of Golf and Club at 31 December 2011. Assume that goodwill has been impaired by 40% at 31 December 2011 and that the Non Controlling Interest (formally Minority Interest) is to be charged with its share of unrealised profit in inventory.

(4 marks)

Main, a public company, has acquired over 50 subsidiary companies in the last few years. Summarised financial information for three of them in respect of 2011 is given below:

	Soken	**Arden**	**Chase**
	$000	**$000**	**$000**
Revenue	7,000	19,200	253
Cost of sales	2,340	17,640	182
Average inventory	2	300	25
Average trade receivables	583	100	8

Cost of sales (in accordance with group policy) consists of direct labour cost and material cost. Inventory is valued at material cost only.

Direct labour costs for the year were as follows:

	$
Soken	2,336,000
Arden	2,000,000
Chase	30,000

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Question 4 continued

Required

(d) Calculate, for **each** company the inventory turnover ratio (in days) and **two** other ratios which will assist in the analysis of their performance. All ratios should be calculated to one decimal point.

(6 marks)

Soken, Arden and Chase operate in three different business areas: a small antiques shop, the provision of accounting services and a supermarket chain.

Required

(e) State, giving **two** reasons in **each** case, which company is in which business.

(9 marks)

(Total 25 marks)

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Model Answer to Question 4
Syllabus Topic: 6 Accounting for groups of companies
Syllabus Topic: 8 Accounting ratios

(a) **Goodwill on consolidation**

		$		$	
Cost				4,000,000	½
Less: Share capital		300,000	½		
Retained earnings		3,000,000	½		
	60% x	3,300,000	½	1,980,000	
				2,020,000	1F

(3 marks)

(b) **Value of consolidated inventory**

	$	
Golf	370,000	½
Club	210,000	½
Unrealised profit (207,000 x .50 x 15/115)	(13,500)	2
	566,500	

(3 marks)

(c) **Consolidated retained earnings**

	$		$	
Golf			2,100,000	½
Club [(4,800,000 – 3,000,000) x 60%]			1,080,000	1½
			3,180,000	
Less: Goodwill impaired (2,020,000 x 40%)	808,000	1of		
Unrealised profit in inventory (13,500 x 60%)	8,100	1of	816,100	
			2,363,900	

(4 marks)

(d)

	Soken	**Arden**	**Chase**
Inventory turnover	2 / (2,340 – 2,336) x 365 = 182.5 days 1	300 / (17,640 – 2,000) x 365 = 7.0 days ½	25 / (182 – 30) x 365 = 60.0 days ½
Gross profit to revenue	(7,000 – 2,340) / 7,000 x 100 = 66.6% 1	(19,200 – 17,640) / 19,200 x 100 = 8.1% ½	(253- 182) / 253 x 100 = 28.1% ½
Trade receivables collection period	583 / 7,000 x 365 = 30.4 days 1	100 / 19,200 x 365 = 1.9 days ½	8 / 253 x 365 = 11.5 days ½

(6 marks)

(e) **Business areas**

(i) **Soken** - provision of accounting services 1

- cost of sales is nearly all direct labour
- very little inventory
- high gross profit to revenue margin
- clients on average pay monthly

any 2 x 1

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Model Answer to Question 4 continued

(ii) **Arden** - supermarket chain 1

- high level of sales
- very few receivables
- very short receivable's payment period
- low gross profit to revenue margin
- rapid inventory turnover

any 2 x 1

(iii) **Chase** - small antiques shop 1

- low level of sales
- relatively high inventory
- relatively high receivables
- relatively high profit to revenue margin

any 2 x 1

(9 marks)

(Total 25 marks)

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Question 5

The budgeted Cash Account of Guise, a limited company, for the month ending 31 December 2012 is as follows:

	$		$
Opening balance	32,000	Cash purchases	5,000
Cash sales	15,000	Trade payables (one month's credit)	40,000
Trade receivables (one month's credit)	60,000	Trade payables (two month's credit)	22,000
Trade receivables (two month's credit)	45,000	General expenses	11,000
Sale of non-current assets	6,000	Ordinary dividend	5,000
		Purchase of non-current assets	2,000
		Closing balance	73,000
	158,000		158,000

Extracts from Guise's Statement of Financial Position (formerly Balance Sheet) at 30 September 2012 (the company's year end) are as follows:

	$
Non-current assets (net book value)	200,000
Inventory	31,000
Share premium	48,000
Retained earnings	45,000

Further information is given below:

(1) 20% of each month's sales are for cash; 50% of each month's sales are expected to be received in the month after sale; the remaining sales are expected to be received in the second month after sale.

(2) The non-current assets budgeted to be sold in December originally cost $20,000 and had been depreciated by $12,000. No depreciation is charged in the quarter in which a non current asset is sold.

(3) 10% of each month's purchases are for cash; 50% of each month's purchases are expected to be paid in the month after purchase; the remaining purchases are expected to be paid in the second month after purchase.

(4) General expenses, which are always paid in cash, are expected to be 10% higher in December than in November, and were 25% higher in November than in October.

(5) The non-current assets budgeted to be purchased in December are to be paid for in twelve equal monthly instalments.

(6) The dividend to be paid on 15 December is at the rate of $0.05 per $1 share and is the only dividend to be paid in the October to December quarter.

(7) A bonus (capitalisation) issue, of one new ordinary share for every two held will be made on 22 December 2012. This will make the maximum use of the non-distributable reserve.

(8) Inventory at 31 December 2012 is budgeted to be $40,000.

(9) No non-current assets are budgeted to be purchased or sold in October and November 2012. Depreciation is to be provided at 5% per quarter on the net book value of non-current assets held at 31 December 2012. A full quarter's depreciation is charged in the quarter in which an asset is purchased.

Required

Prepare the budgeted Income Statement for the three months (quarter) ending 31 December 2012 and the budgeted Statement of Financial Position at that date.

(Total 25 marks)

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Model Answer to Question 5
Syllabus Topic 9: Budgetary control and appropriation

Guise
Budgeted Income Statement for three months ending 31 December 2012

	$	$	$	
Revenue - October (45,000 x 100/30)			150,000	1
November (60,000 x 100/50)			120,000	1
December (15,000 x 100/20)			75,000	1
			345,000	
Less : Cost of goods sold :				
Opening inventory		31,000		½
Purchases - October (22,000 x 100/40)	55,000			1
November (40,000 x 100/50)	80,000			1
December (5,000 x 100/10)	50,000	185,000		1
		216,000		
Less : Closing inventory		40,000		
			176,000	½
Gross profit			169,000	
Less : General expenses – December	11,000			1
November (11,000 / 110%)	10,000			1
October (10,000 / 125%)	8,000	29,000		½
Loss on disposal of non-current assets [(20,000 – 12,000) – 6,000]		2,000		1
Depreciation {[200,000 + (2,000 x 12) – 8,000] x 5%}		10,800	41,800	2
Net profit			127,200	

Guise
Budgeted Statement of Financial Position at 31 December 2012

	$	$	$	
Non-current Assets			205,200	2
[200,000 + (2,000 x 12) – 8,000 – 10,800]				
Current Assets				
Inventory		40,000		½
Trade receivables - November (120,000 x 0.30)	36,000			1
December (75,000 x 0.80)	60,000	96,000		1
Bank		73,000		½
			209,000	
Total assets			414,200	
Equity and liabilities				
Capital and reserves				
Ordinary share capital (5,000 x 100/5 = 100,000 + 50,000)			150,000	1½
Share premium (48,000 – 48,000)			-	½
Retained earnings (45,000 + 127,200 – 5,000 – 5,000 + 48,000)			165,200	2½
			315,200	
Current liabilities				
Trade payables – November (80,000 x 0.4)		32,000		1
– December (50,000 x 0.9)		45,000		1
		77,000		
Trade payables – non-current assets (2,00 x 11)		22,000	99,000	1
Total equity and liabilities			414,200	

(Total 25 marks)

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