

Series 3 Examination 2011

CERTIFICATE IN ACCOUNTING (IAS)

Level 3

Friday 3 June

Subject Code: 3902

Time allowed: **3 hours**

INSTRUCTIONS FOR CANDIDATES

- Answer **any 4** questions. There are no compulsory questions.
- All questions carry equal marks.
- Study the “**REQUIRED**” section of each question carefully and extract the data required for your answers from the information supplied.
- Write your answers in blue or black ink/ballpoint. You can only use pencil for graphs, charts, diagrams etc.
- Begin your answer to each question on a new page.
- All answers must be correctly numbered, but need not be in numerical order.
- Workings must be shown.
- You may use a calculator, provided the calculator gives no printout, has no word display facilities, is silent and cordless. The provision of batteries and their condition is your responsibility.
- Marks may be lost through lack of neatness and poor presentation.

QUESTION 1

Towe is the manager of Nesco superstore in Brigg. Nesco has two hundred superstores in the country and expects managers to achieve results on its two main product lines as follows:

Electrical goods	-	50% mark up on cost
Food	-	12% gross profit on sales

Sales of electrical goods at the Brigg superstore for the six months ended 31 December 2010 were 20% above the budget of \$140,000. However, on 31 December 2010, there was a burglary and all the electrical goods were stolen.

Towe was able to provide the following information in respect of electrical goods:

- (1) 1 July 2010, inventory at cost was \$20,700 and payables were owed \$17,200
- (2) during the six months to 31 December 2010, payables were paid \$105,400
- (3) 31 December 2010 payables were owed \$21,700.

REQUIRED

- (a) Calculate the cost of the electrical goods stolen, assuming that the 50% mark up on cost had been achieved. (9 marks)

Figures for the sale of food at the Brigg superstore, for the six months ended 31 December 2010, were as follows:

- (1) 1 July, inventory at cost was \$18,000 and at 31 December, inventory at cost was 25% higher in value than it had been at 1 July
- (2) inventory turnover ratio, based on the average cost of the opening inventory and the closing inventory, was 26 times
- (3) actual gross profit on sales was 10%, as opposed to the expected 12%.

REQUIRED

- (b) Calculate the total gross profit, as would appear in the Income Statement for food, in respect of the six months ended 31 December 2010. (6 marks)
- (c) Calculate the difference between the actual gross profit on food and the expected gross profit on food, based on the sales figure from (b) above, for the six months ended 31 December 2010. (2 marks)

On 1 January 2011 Towe was dismissed. She intends to claim compensation from Nesco for unfair dismissal, and provides the following information to her lawyer:

- (i) Because of the burglary it was not possible to accurately assess the performance of the electrical goods department
- (ii) The burglary took place while she was on annual leave. Closed circuit television showed that the security guards, recruited by her, were asleep when the burglary took place
- (iii) Bad weather, and fear that supplies would run out, had led to the panic buying of food in December. Towe had reduced the prices in order to reassure buyers
- (iv) Head office, without consulting Towe, had sent 5,000 frozen carp (a fish which they had imported) to be sold at the Brigg superstore. Local fishermen, who are not allowed to catch carp, organised a boycott of food sales at the superstore until the carp were withdrawn from sale.

QUESTION 1 CONTINUED

REQUIRED

- (d) Discuss, whether or not, **each** of the four pieces of information provided by Towe will assist her compensation claim.

(8 marks)

(Total 25 marks)

QUESTION 2

The following information has been extracted from Volga, a private company's, Balance Sheet at 31 December 2010:

	\$
Ordinary shares of \$0.50 each	400,000
10% Preferred shares of \$1.00 each	50,000
Share premium	70,000
Accumulated profits	130,000

Volga has a substantial bank balance at 31 December 2010, and the directors are uncertain as to how it should be used.

Two suggestions have been put forward:

- A - Purchase 160,000 of Volga's own \$0.50 ordinary shares, at a premium of \$0.20 per share
- B - Purchase a new machine for \$112,000. This would increase profits by \$25,000 in 2011, and by \$28,000 in 2012, both calculated before deducting depreciation on the machine, to be provided on a reducing balance basis at 30%, per year.

Volga's accountant, had budgeted that profits, after providing for depreciation but excluding profit from the new machine, will be \$90,000 for 2011 and \$100,000 for 2012. It is company policy to pay total dividends equal to 40% of net profit each year.

REQUIRED

- (a) Prepare Journal entries (without narratives) to record the necessary transactions if Suggestion A is adopted. (7 marks)
- (b) Calculate, to **three** decimal places, the earnings per ordinary share for **each** of 2011 and 2012, assuming **alternatively**:
 - (i) Suggestion A is adopted
 - (ii) Suggestion B is adopted. (8 marks)
- (c) Calculate to **three** decimal places, the dividend payable per ordinary share for **each** of 2011 and 2012, assuming **alternatively**:
 - (i) Suggestion A is adopted
 - (ii) Suggestion B is adopted. (6 marks)

Volga's accountant has argued that, instead of either of Suggestions A and B, the company should pay a one-off (special) dividend to the ordinary shareholders. The directors have two objections to this:

- (i) if this dividend is paid, it will raise the expectations of ordinary shareholders in respect of dividends in future years
- (ii) the preferred shareholders will not receive any benefit.

REQUIRED

- (d) Briefly discuss whether or not either objection of the directors is valid. (4 marks)

(Total 25 marks)

QUESTION 3

Three techniques used for evaluating investment projects are:

- (1) payback period
- (2) accounting rate of return
- (3) net present value.

REQUIRED

- (a) State which technique takes into consideration the time value of money (1 mark)
- (b) State which two techniques use cash flows in their calculation. (2 marks)

Swale, who runs a small supermarket, is considering buying a delivery van for \$26,000. The running costs of the van are estimated to be \$6,000 per year (excluding depreciation) but Swale would save \$10,000 per year in distribution costs. The van would be sold for \$8,000 after 5 years' use and be depreciated on a straight line basis.

Discount factors at 12% (Swale's cost of capital) are as follows:

Year 1	0.893
Year 2	0.797
Year 3	0.712
Year 4	0.636
Year 5	0.567

REQUIRED

- (c) Calculate the following in respect of Swale's van: (16 marks)
- (i) payback period
 - (ii) accounting rate of return
 - (iii) net present value.

Swale's manager believes that the payback period should be used when deciding whether or not to buy the van. If the van doesn't pay back it shouldn't be purchased, if it does pay back it should be purchased.

Swale's chief salesman believes that additional data should be included in the decision making process, like the sales value of the goods delivered. Swale's accountant agrees to some extent but believes that the additional data should be the profit made on the goods delivered.

REQUIRED

- (d) Assess the argument put forward by Swale's manager. (3 marks)
- (e) Discuss the views of Swale's chief salesman and Swale's accountant, and give a conclusion. (3 marks)

(Total 25 marks)

QUESTION 4

Ruhr, a public company, was formed on 1 January 2008. It decided on the following depreciation policies:

Buildings	2% per year on cost
Plant and machinery	30% per year on cost
Fixtures and fittings	20% per year on a reducing balance basis
Motor vehicles	sum of the years digits basis over 5 years assuming a zero residual value

Ruhr did not purchase or sell any non-current assets during the two years ended 31 December 2009 at which date the net book values of the non-current assets, purchased on 1 January 2008, were as follows:

	\$
Land and buildings (including land \$300,000)	588,000
Plant and machinery	120,000
Fixtures and fittings	80,000
Motor vehicles	240,000

REQUIRED

- (a) Calculate for Ruhr, the total depreciation charge for **each** of the years 2008 and 2009.

(14 marks)

On 30 June 2010, Ruhr's land and buildings were valued at \$700,000, of this figure \$360,000 related to buildings. It was decided to incorporate the new value in the accounts, on 1 July 2010. The total life of the buildings from 1 January 2008 (implied by the depreciation policy) remained unchanged. The revalued amount was to be written off evenly over the remaining life.

REQUIRED

- (b) Calculate, to the nearest \$, the depreciation charge for Ruhr's buildings for 2010.

(3 marks)

- (c) Calculate, the surplus on revaluation of land and buildings on 1 July 2010, and explain how this surplus should be treated in Ruhr's accounts.

(3 marks)

Two directors are concerned about the revaluation and its effects:

- (1) the Marketing Director argues that if one class of assets is revalued then all the other non-current assets must be revalued
- (2) the Production Director is concerned that the increase in depreciation expense each year will reduce profits and distributable reserves.

REQUIRED

- (d) Comment briefly on the views of **each** of the two directors.

(5 marks)

(Total 25 marks)

QUESTION 5

Nile, a public company, has two subsidiaries; Blue, a private company, and White, a private company, both of which were acquired several years ago. Details of the acquisitions are as follows:

- (1) Nile paid \$700,000 to acquire 80% of the 100,000 \$1 ordinary shares in Blue. At the date of acquisition Blue had a share premium of \$60,000 and accumulated profits of \$80,000. At that date the fair values of Blue's assets and liabilities were equal to their book values, except for property which originally cost \$80,000 (book value \$30,000), which had a fair value of \$100,000.
- (2) Nile paid \$800,000 to acquire 70% of the 300,000 \$0.50 ordinary shares in White. At the date of acquisition White had a revaluation reserve of \$40,000 and accumulated profits of \$70,000. At that date the fair values of White's assets and liabilities were equal to their book values in all cases.

Blue depreciated property at 2% per year on cost. It is Nile group policy to depreciate all property at 5% per year on cost.

REQUIRED

Calculate the following amounts:

- (a) the total of the goodwill arising on the acquisitions of Blue and White. (7 marks)
- (b) the increase in the annual depreciation charge on Blue's property since the acquisition by Nile. (2 marks)
- (c) the amount of extra annual depreciation charged to the minority interest in Blue. (1 mark)

In most acquisitions of subsidiaries, fair value adjustments are likely to be necessary in respect of non-current assets. Adjustments are less likely in respect of current assets, and even less likely in respect of liabilities.

REQUIRED

- (d) Discuss the validity or otherwise of the above statement. (6 marks)

At 31 December 2010, the group's year end, the current accounts in which the intercompany debts are recorded did not agree. On investigation the following matters were discovered:

- (1) Nile sold goods costing \$20,000 to Blue, on 15 December 2010, for \$60,000. Half the value of these goods had been included in Blue's inventory at 31 December 2010 (as they remained unsold) valued at their cost to Blue. However, although the sale had been recorded in Nile's books, the purchase had not been recorded in Blue's books.
- (2) White sold goods costing \$50,000 to Nile, on 18 December, at a mark up of 30%. A quarter of the value of these goods had been included in Nile's inventory at 31 December 2010 (as they remained unsold) valued at their cost to Nile. However, although the sale was correctly recorded in White's books, the purchase had not been recorded in Nile's books.

QUESTION 5 CONTINUED

REQUIRED

(e) Prepare Journal entries (**with narratives**) to account for the unrecorded purchases in the books of:

- (i) Blue
- (ii) Nile.

(5 marks)

(f) Calculate the decrease, caused by the need to provide for unrealised profit, in:

- (i) consolidated accumulated profits
- (ii) minority interest.

(4 marks)

(Total 25 marks)