Accounting
Level 3

LCCI

International Qualifications from EDI

Model Answers
Series 4 2012 (3012)

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Accounting 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 sales ratio of around 40%. For the year ended 30 June 2012 it was only 28.75%. The restaurant Trading Account for that year is as follows:

		£	£
Sales			80,000
Cost of goods sold:	Opening stock	7,000	
	Purchases	60,000	
		67,000	
	Closing stock	10,000	57,000
Gross profit			23,000

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

(i) there has been a change in sales mix: more low margin biscuits have been sold and fewer high margin cakes have been sold.
(ii) the opening stock may have been over valued as the stocktaking 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 sales ratio should have been 40%.

(3 marks)

(c) Calculate the sales value of the goods which may have been stolen during the year ended 30 June 2012, on the assumption that the gross profit to sales 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 sales ratio.

(4 marks)

(e) Briefly give **three** possible explanations, for the fall in gross profit to sales ratio, other than theft and the suggestions of the Restaurant Manager.

(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	
Prepayment (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 sales 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 stocktaking, causing the opening stock to be over valued, would reduce the year's gross profit to sales percentage. However, this would also increase the previous year's gross profit to sales 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 not paying
- Unrecorded debtors

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 Ltd has provided the following (correctly calculated) information for its Cash Flow Statement for the eleven months ended 31 May 2012:

Reconciliation of operating profit to net cash inflow from operations

	£000
Operating profit	170
Decrease in stock	20
Decrease in debtors	10
Increase in creditors	5
	205

Cash flow statement for the eleven months ended 31 May 2012

	£000
Net cash inflow from operating activities	205
Returns on investment and servicing of finance	
Debenture interest	(10)
Capital expenditure and financial investment	
Purchase of fixed assets	(40)
Equity dividends paid	(20)
Net cash flow before financing	135
Financing	
Issue of debentures	50
Increase in cash and cash equivalents	185

In the month ended 30 June 2012 the following occurred:

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

(2) Fixed assets were purchased for £70,000. Fixed assets, with a net book value 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 fixed assets held at the end of the year. The net book value of fixed 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) Stock increased by £2,000, before a provision for obsolete stock of £3,000 was made. Debtors decreased by £3,000, before writing off bad debts of £1,000 and making a provision for bad debts of £2,000. Creditors increased by £1,000.

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Question 2 Continued

Required

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

(8 marks)

(b) Reconcile the operating profit to the net cash flow from operating activities for the year ended 30 June 2012.

(7 marks)

(c) Prepare the Cash Flow Statement, in accordance with FRS1 (revised), for the year ended 30 June 2012.

(10 marks)

(Total 25 marks)

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

(a) **Operating profit of Pier Ltd year ended 30 June 2012**

	£000	
Operating 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 stock	(3)	1
Bad debts	(1)	1
Provision for bad debts	(2)	1
	147	

(8 marks)

(b) **Reconciliation of operating profit to net cash flow from operating activities**

	£000	
Operating profit (from (a) above)	147	½of
Loss on disposal	3	1
Depreciation	24	1of
Decrease in stock (20 – 2 + 3)	21	1½
Decrease in debtors (10 + 3 + 1 + 2)	16	2
Increase in creditors (5 + 1)	6	1
	217	

(7 marks)

(c) **Pier Ltd Cash Flow Statement year ended 30 June 2012**

	£000	£000	
Cash flow from operating activities		217	½
Returns on investment and servicing of finance			
Debenture interest (10 + 10)		(20)	1½
Capital expenditure and financial investment			
Purchase of fixed assets (40 + 70)	(110)		1½
Sale of fixed assets (30 – 3)	27	(83)	1½
Equity dividends paid (20 + 10)		(30)	1½
Net cash flow before financing		84	
Financing			
Issue of debentures	50		½
Redemption of debentures	(20)		1
Issue of ordinary shares (200,000 x 0.50 x 1.10)	110	140	1½
Increase in cash and cash equivalents		224	½of

(10 marks)

(Total 25 marks)

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Question 3

On 1 January 2009 Platt Ltd purchased twenty machines for £9,000 each. Depreciation on them was charged at 15% per year, using the reducing balance method. For parts of years the annual amount was calculated, then reduced proportionately.

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 Ltd 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 effect of the change in depreciation method was not expected to distort future results to any material degree.

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 fixed 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	Profit and Loss	27,000	1
					(.15 x 180,000)		
2010	Disposal (W2)	<2>	7,695	2010	Balance b/d	27,000	
	Balance c/d		42,930		Profit and Loss (W1)	23,625	<4>
			50,625			50,625	
2011	Balance c/d		58,701	2011	Balance b/d	42,930	
					Profit and Loss (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
					Profit and Loss	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: book value	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: book value	9,900 x 4 (1 - .075)		36,630	1
	scrap value	4 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 plc acquired 180,000 of the 300,000 £1 ordinary shares of Club Ltd on 1 January 2008, at a cost of £4,000,000. At that date the credit balance on Club Ltd's Retained Earnings Account (the only reserve) was £3,000,000.

Required

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

(3 marks)

During the year ended 31 December 2011, Club Ltd sold goods to Golf plc for £207,000, which included a mark up of 15%. Half of the value of these goods remained in Golf plc's stock at 31 December 2011. The values of the stock in the Balance Sheets of Golf plc and Club Ltd at that date were £370,000 and £210,000 respectively.

Required

(b) Calculate the value of stock that would appear in the Consolidated Balance Sheet of Golf plc and Club Ltd at 31 December 2011.

(3 marks)

At 31 December 2011 the capital and reserves section of the Balance Sheet of each company was as follows:

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

Required

(c) Calculate the consolidated retained earnings of Golf plc and Club Ltd at 31 December 2011. Assume that goodwill is being written off evenly over ten years and that the minority interest is to be charged with its share of unrealised profit in stock.

(4 marks)

Main plc 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 Ltd	**Arden Ltd**	**Chase Ltd**
	£000	**£000**	**£000**
Sales	7,000	19,200	253
Cost of sales	2,340	17,640	182
Average stock	2	300	25
Average debtors	583	100	8

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

Direct labour costs for the year were as follows:

	£
Soken Ltd	2,336,000
Arden Ltd	2,000,000
Chase Ltd	30,000

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Question 4 Continued

Required

(d) Calculate, for **each** company the stock 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 Ltd, Arden Ltd and Chase Ltd 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 stock**

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

(3 marks)

(c) **Consolidated retained earnings**

	£		£	
Golf plc			2,100,000	½
Club Ltd [(4,800,000 – 3,000,000) x 60%]			1,080,000	1½
			3,180,000	
Less: Goodwill amortisation (2,020,000 x 10% x 4)	808,000	1of		
Unrealised profit in stock (13,500 x 60%)	8,100	1of	816,100	
			2,363,900	

(4 marks)

(d)

	Soken Ltd	Arden Ltd	Chase Ltd
Stock turnover	$\frac{2}{2,340 - 2,336} \times 365 = 182.5$ days 1	$\frac{300}{17,640 - 2,000} \times 365 = 7.0$ days ½	$\frac{25}{182 - 30} \times 365 = 60.0$ days ½
Gross profit to sales	$\frac{(7,000 - 2,340)}{7,000} \times 100 = 66.6\%$ 1	$\frac{(19,200 - 17,640)}{19,200} \times 100 = 8.1\%$ ½	$\frac{(253 - 182)}{253} \times 100 = 28.1\%$ ½
Debtor's collection period	$\frac{583}{7,000} \times 365 = 30.4$ days 1	$\frac{100}{19,200} \times 365 = 1.9$ days ½	$\frac{8}{253} \times 365 = 11.5$ days ½

(6 marks)

(e) **Business areas**

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

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

any 2 x 1

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Model Answer to Question 4 continued

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

- high level of sales
- very few debtors
- very short debtors payment period
- low gross profit margin
- rapid stock turnover

any 2 x 1

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

- low level of sales
- relatively high stock
- relatively high debtors
- relatively high profit margin

any 2 x 1

(9 marks)

(Total 25 marks)

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Question 5

The budgeted Cash Account of Guise Ltd for the month ending 31 December 2012 is as follows:

	£		£
Opening balance	32,000	Cash purchases	5,000
Cash sales	15,000	Creditors (one month's credit)	40,000
Debtors (one month's credit)	60,000	Creditors (two month's credit)	22,000
Debtors (two month's credit)	45,000	General expenses	11,000
Sale of fixed assets	6,000	Ordinary dividend	5,000
		Purchase of fixed assets	2,000
		Closing balance	73,000
	158,000		158,000

Extracts from Guise Ltd's Balance Sheet at 30 September 2012 (the company's year end) are as follows:

	£
Fixed assets (net book value)	200,000
Stock	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 fixed 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 fixed 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's than in October.

(5) The fixed 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) Stock at 31 December 2012 is budgeted to be £40,000.

(9) No fixed 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 fixed assets held at 31 December 2012. A full quarters depreciation is charged in the quarter in which an asset is purchased.

Required

Prepare the budgeted Profit and Loss, and Appropriation Account for the three months (quarter) ending 31 December 2012 and the budgeted Balance Sheet at that date.

(Total 25 marks)

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

Guise Ltd

Budgeted Profit and Loss Account and Appropriation for three months ending 31 December 2012

			£	£	£	
Sales -	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 stock			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 stock				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 fixed 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	
Less: Dividend					5,000	1
Retained profit					122,200	

Guise Ltd

Budgeted Balance Sheet at 31 December 2012

		£	£	£	
Fixed Assets				205,200	2
[200,000 + (2,000 x 12) – 8,000 – 10,800]					
Current Assets					
Stock			40,000		½
Debtors -	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		
Less:**Current Liabilities**					
Creditors -	November (80,000 x 0.40)	32,000			1
	December (50,000 x 0.90)	45,000			1
		77,000			
Creditors -	fixed assets (2,000 x 11)	22,000	99,000		1
Net Current Assets				110,000	
				315,200	

Capital and Reserves	£	
Ordinary share capital (5,000 x 100/5 = 100,000 + 50,000)	150,000	1½
Share premium (48,000 – 48,000)	-	
Retained earnings(45,000 + 122,200 – 50,000 + 48,000)	165,200	2
	315,200	

(Total 25 marks)

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