Paper Reference(s)

6001

London Examinations GCE

Accounting (Modular Syllabus)

Advanced Subsidiary Level

Unit 1 – The Accounting System
and Costing

Monday 16 January 2006 – Afternoon

Time: 3 hours

Materials required for examination	**Items included with question papers**
Answer book (AB16)	Accounting paper (AB34)

Instructions to Candidates

Answer FIVE questions, choosing TWO from Section A and THREE from Section B.
All calculations must be shown.
In the boxes on the answer book, write the name of the examining body (London Examinations), your centre number, candidate number, the subject title (Accounting), the paper reference (6001), your surname and other name(s), and signature.
Answer your questions in the answer book.
Ensure that your answers to parts of questions are clearly numbered.
Use additional answer sheets if necessary.
If the accounting paper provided does not allow you to set out your answer in the way you wish, rule up a page of your answer book to suit your requirements.

Information for Candidates

The total mark for this paper is 100.
The marks for individual questions and parts of questions are shown in round brackets: e.g. **(2)**.
This paper has seven questions. All blank pages are indicated.
Calculators may be used.

Advice to Candidates

Write your answers neatly and in good English.

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SECTION A

Answer TWO questions from this section

1. Bright Ideas Ltd manufactures two wooden products – desks and chairs. A third product, bookcases, are purchased by the business as a finished good. All three products are stored in the warehouse until they are sold. The following information relates to Bright Ideas Ltd for the year ended 31 December 2005.

(i) Balances extracted from the books at 31 December 2005.

		£
Stocks at 1 January 2005:		
Raw materials		10 000
Work in progress:	desk	19 000
	chair	14 700
Finished goods:	desk	12 000
	chair	11 000
	bookcase	8 700
Purchases:		
Raw materials		57 000
Finished goods	bookcase	97 100
Direct wages:	desk	46 000
	chair	36 000
Fuel and power:	factory	8 400
	administration	3 200
Direct expenses royalties		1 500
Supervision and management:	factory	28 000
	administration	30 000
General expenses:	factory	15 400
	administration	4 600
Marketing costs		25 000
Factory machinery (at cost)		140 000
Factory machinery provision for depreciation		77 000
Office equipment (at cost)		16 000
Provision for depreciation on office equipment		6 000
Sales:		
	desk	135 000
	chair	120 000
	bookcase	120 000
Debtors		97 000
Provision for doubtful debts		4 000

(ii) Stocks at 31 December 2005:

Raw materials		12 000
Work in progress:	desk	19 400
	chair	15 000
Finished goods:	desk	24 000
	chair	5 000
	bookcase	9 800

(iii) During the year, 1 000 desks and 1 500 chairs were manufactured and transferred to the warehouse. A total of 1 200 bookcases were purchased.

(iv) Raw materials stock records show that £34 000 worth of raw material was used in the manufacture of desks, and the balance was used in the manufacture of chairs.

(v) Direct expenses royalties are paid to the designer at the rate of £2 per chair. Payment is due on completion of the manufacturing process.

(vi) All factory overheads are to be apportioned between desks and chairs in the ratio of 4:3.

(vii) Depreciation is to be charged on factory machinery at the rate of 30% using the reducing balance method and is to be charged on office equipment at the rate of 20% using the straight line method.

(viii) A sum of £3 000 included in the debtors is to be written off as a bad debt. The provision for doubtful debts is to be maintained at 5% of the remaining debtors.

Required:

(a) Prepare, for the year ending 31 December 2005, the:

(i) manufacturing account (in columnar format), showing clearly the **prime cost** and **production cost** of manufacturing desks and chairs;

(11)

(ii) trading and profit and loss account, showing the gross profit for each product (desks, chairs and bookcases) and the total net profit for the business.

(9)

(b) Calculate the production cost of manufacturing:

- **one** desk
- **one** chair.

(2)

(c) Another manufacturer of chairs has offered to supply Bright Ideas Ltd with an identical chair for £2 less than the current production cost.

Evaluate whether Bright Ideas Ltd should cease the production of chairs and accept the offer made by the other manufacturer.

(4)

(Total 26 marks)

2. Lee Kwan is a general trader buying and selling computer components on credit. The provisional accounts for the year ended 31 December 2005 have been prepared. Lee is concerned that the level of creditors has increased significantly over the year and that some of those creditors are now refusing to supply goods to him on credit, until he makes payment.

Lee Kwan – Balance Sheet (Extracts) as at 31 December 2005

		2004		**2005**
		£000		**£000**
Current Assets				
Stock		40 000		58 500
Debtors	30 000		40 000	
Less provision for doubtful debts	1 500		2 000	
		28 500		38 000
Bank		12 500		-
		81 000		96 500
less				
Current Liabilities				
Creditors		45 000		80 000
Bank overdraft		-		8 500
		45 000		88 500
Working Capital		36 000		8 000

Additional information at 31 December 2005:

(i) Included within the stock are components valued at £3 500, which were returned to the supplier on 30 December 2005 but which have not yet been recorded in the books.

(ii) Included within the debtors are two debts for which payment in full will not be received. Both debtors have now ceased trading and the following final payments have been received.

	Debt owed	Payment awarded
Salamandar & Co	£5 000	£0.60 in the £
Vickrum	£1 000	£0.40 in the £

(iii) The provision for doubtful debts is to be maintained at 5% of remaining debtors.

(iv) The value of stock as at 1 January 2004 was £30 000.

(v) Lee Kwan uses a 50% ‘mark up’.

(vi) Sales for 2004 were £420 000 and for 2005 were £855 000.

Required:

"Although businesses will need to consider their liquidity from time to time, it is more important that those businesses maintain their profitability at all times."

(a) (i) Distinguish between **liquidity** and **profitability**.

(ii) To what extent would you agree or disagree with the above statement?

(5)

(b) Prepare for the year ending 31 December 2005:

(i) bad debts account;

(ii) provision for doubtful debts account.

(5)

(c) Redraft the balance sheet (extract) as at 31 December 2005, after adjusting for items (i) to (iii) in the additional information on the opposite page.

(6)

(d) Calculate for each of the years ended 31 December 2004 and 31 December 2005:

(i) rate of stock turnover;

(ii) current ratio;

(iii) liquid (acid test) ratio.

(6)

(e) Evaluate the liquidity position of the business of Lee Kwan.

(4)

(Total 26 marks)

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3. Kuamar manufactures products made to customers' special requirements using a system of job costing. The business has two production departments: machining and finishing, supported by two service departments: stores and administration. Kuamar has in previous years calculated a single overhead absorption rate for the business as a whole, but now wishes to calculate separate rates for each production department.

Cost centre expenses of the business have been budgeted as follows:

	Machining	Finishing	Stores	Administration
	£	£	£	£
Allocated costs:				
Indirect costs	1 100	3 500	1 500	1 500
Indirect wages	-	-	11 000	20 000

	Total
	£
Unallocated costs:	
Supervision	30 000
Rent and rates	12 000
Insurance	6 000

The following additional information is available:

	Machining	Finishing	Stores	Administration
Floor area occupied (sq m)	200	250	50	100
Number of employees	5	4	1	2
Plant value (£000)	25	15	5	15
Machine hours	7 100	-		
Direct labour hours	-	8 000		
Direct labour rate (£ per hour)	£8	£7		
Number of stores requisitions (per year)	700	400		
Use of administration services (%)	40	60		

Required:

(a) Apportion the unallocated costs between the departments using the basis of apportionment that is most appropriate from the information provided. Determine the total overhead cost for each department.

(7)

(b) Re-allocate the costs of the service departments (stores and administration) and calculate the overhead absorption rates for each of the production departments (machining and finishing), using the most appropriate basis of recovery in each case.

(5)

(c) (i) Define **over absorption of overhead**.

(2)

(ii) Evaluate the usefulness of calculating departmental overhead absorption rates as an alternative to calculating a single overhead absorption rate for the business as a whole.

(4)

(d) Kuamar has been requested by a customer to provide a quotation.

(i) Prepare the quotation for job H190 from the following information, calculating the price to be charged to the customer.

- Raw materials cost £520
- Labour: 20 hours of machining and 16 hours of finishing
- Overheads: 20 hours of machining and 16 hours of finishing
- All jobs are required to achieve a profit margin of 20%

(4)

(ii) Job H190 is completed with the following costs:

- raw materials cost £401
- labour: 16 hours of machining and 18 hours of finishing
- overheads: 16 hours of machining and 18 hours of finishing

Calculate for job H190 the:

- **under or over recovery** of overheads
- **actual profit margin.**

(4)

(Total 26 marks)

TOTAL FOR SECTION A: 52 MARKS

SECTION B

Answer THREE questions from this section

4. The following information relates to Jafri Holdings' fixed assets of computer equipment.

(i) Account balances at 1 January 2005:

	£
• computer equipment account	120 000
• computer equipment provision for depreciation account	40 000

(ii) Purchases and sales of computer equipment in 2005.

- On 31 March 2005 computer equipment purchased on 1 January 2004 for £16 000 was sold on credit for £11 500
- On 1 July 2005 new computer equipment was purchased on credit at a cost of £10 000

(iii) The policy of Jafri Holdings is to charge depreciation at the rate of 25% on cost using the straight line method. In the year of purchase a full year's depreciation will be charged. In the year of sale, depreciation will be charged on the proportion of the year for which the asset had been owned.

Required:

(a) Prepare, for the year ended 31 December 2005, the:

(i) computer equipment account;

(ii) computer equipment provision for depreciation account;

(iii) disposal account;

(iv) profit and loss account (extract).

(Clearly show all calculations and workings.)

(9)

(b) (i) Distinguish between **capital expenditure** and **revenue expenditure**.

(2)

(ii) Explain how the accounting concept of **materiality** assists in determining whether expenditure is classified as capital expenditure or revenue expenditure.

(3)

(iii) Evaluate whether it would be prudent to consider **training costs** for staff to use new equipment as capital expenditure or revenue expenditure.

(2)

(Total 16 marks)

5. A team of 8 workers produces a total of 400 items in an 8 hour day, for which each member is paid £5 per hour. The business is attempting to improve its labour productivity over the 8 hour day and has received the following three proposals:

(i) reduce the team to 6 members, changing working practices, resulting in a total output of 320 items per day;

(ii) increase the team to 10 members resulting in a total output of 450 items per day;

(iii) maintain the team at 8 members, but pay a bonus of £0.20 per item to be shared equally by the team, resulting in an output of 420 items per day.

Required:

(a) (i) Calculate the original unit labour cost per item.

(ii) For each of the 3 proposals above, calculate the unit labour cost per item and state what effect each proposal would have upon productivity.

(iii) The business produces and sells 2 000 items in each of the 48 weeks that it operates. Calculate the **annual cost saving** that the business will achieve by implementing the most productive proposal.

(10)

(b) "Labour productivity can only be improved if the total output of the business is increasing."

(i) Define **labour productivity**.

(2)

(ii) Describe **two** ways in which labour productivity might be improved **without** an increase in total output.

(2)

(iii) Evaluate the role of bonus schemes in improving productivity in a business where quality of the product is essential.

(2)

(Total 16 marks)

6. Pareet and Hitish are in partnership sharing profits and losses in the ratio 2:1. Interest is paid on capital at the rate of 4% per annum and charged on the closing balance of drawings at the rate of 5% per annum. A salary of £7 500 per annum is paid to Hitish.

On 31 December 2005 the following balances were extracted from the partnership books after the preparation of the trading and profit and loss accounts.

	£	
Net profit	41 150	
Rent and rates	1 400	Dr
Telephone charges	300	Cr
Debtors	21 200	
Creditors	15 900	
Equipment (at cost)	60 000	
Provision for depreciation on equipment	16 000	
Capital accounts:		
Pareet	50 000	
Hitish	50 000	
Current accounts:		
Pareet	500	Dr
Hitish	1 200	Cr
Drawings:		
Pareet	15 000	
Hitish	22 000	
Goodwill	30 000	
Stock at 31 December 2005	25 500	
Bank overdraft	1 050	

Additional information:

- The partners have agreed that goodwill will be removed from the books at 31 December 2005.

Required:

(a) Prepare for Pareet and Hitish the:

(i) profit and loss appropriation account for the year ended 31 December 2005;

(ii) balance sheet as at 31 December 2005.

(11)

(b) Explain the provisions of the Partnership Act 1890 in determining how profits would be appropriated in the absence of a Partnership Agreement.

(3)

(c) Evaluate the validity of removing goodwill from the books of the business.

(2)

(Total 16 marks)

7. At the end of the accounting period, a business prepared a trial balance which failed to balance. The difference was entered into a suspense account. The trial balance was used to prepare the trading and profit and loss account, which recorded a net profit of £23 800. The following errors were later discovered in the books:

(i) a purchase of goods for resale, costing £340, had been recorded in the office fixtures account;

(ii) rent received £2 500 had been correctly entered in the bank account but debited to the rent receivable account;

(iii) a cheque sent to a creditor for £850, was correctly entered in the cash book but was entered as £580 in the creditor's account, P Beese;

(iv) depreciation on motor vehicles had been charged for the year at £900. Motor vehicles cost £15 000, the depreciation policy is to charge depreciation at the rate of 20% on cost;

(v) a payment of £80 wages by cheque, had been debited to the wages account as £18 and credited to the bank account as £180.

Required:

(a) Prepare the:

(i) journal entries recording the correction of errors (i) to (v) above (narratives are not required);

(ii) suspense account, showing the original balance.

(8)

(b) Calculate the revised net profit following the correction of all errors.

(4)

(c) (i) Distinguish between **errors of commission** and **errors of principle**.

(2)

(ii) Evaluate the role of the suspense account in correcting errors contained within the books of double entry.

(2)

(Total 16 marks)

TOTAL FOR SECTION B: 48 MARKS

TOTAL FOR PAPER: 100 MARKS

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