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RECOGNISING ACHIEVEMENT

ADVANCED GCE UNIT **2503**

ACCOUNTING

Management Accounting 1

FRIDAY 15 JUNE 2007 Morning

Time: 1 hour 30 minutes

Each candidate must be given:
(1) one copy of this question paper, 2503;
(2) one 12-page Answer Booklet.
Item (2) is sent with the stationery parcel.
Candidates may use calculators in this examination.

CUP/T39438

INSTRUCTIONS TO CANDIDATES

- Complete the front page of the Answer Booklet as directed.
- Answer **all** questions.
- You must show the calculations leading to your answers.

INFORMATION FOR CANDIDATES

- The maximum mark for this paper is 100.
- **Continuous prose responses are required to questions in this paper. You will be assessed on your form and style of writing, the clarity and coherence of your organisation of information, your use of specialist accounting vocabulary and conventions, the legibility of text and your spelling, grammar and punctuation.**

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1 Omega Ltd is the manufacturer of a single product.

The standard production costs per unit are:

Materials	4 kg at £12 per kg
Labour	40 minutes at £12 per hour
Variable overheads	40 minutes at £7.50 per hour

Fixed overheads are estimated at £30 000 per month.

In May 2007, budgeted and actual production was 3 600 units.

The cost accountant at Omega Ltd has identified the following variances for the month of May 2007.

	£	
Material price	10 100	favourable
Material usage	2 500	adverse
Labour rate	7 250	adverse
Labour efficiency	950	adverse
Total variable overhead	1 050	favourable
Total fixed overhead	3 040	adverse

REQUIRED

(a) Calculate the budgeted production cost for May 2007. [5]

(b) **(i)** State the formula for calculating a labour rate variance. [2]

(ii) Give possible explanations for the material and labour variances. [8]

(c) A statement reconciling original budgeted production cost with the actual total cost for May 2007. [4]

(d) Explain the stages involved in setting material standards. [6]

Total marks [25]

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2 Whitney plc is considering acquiring one of two businesses in order to diversify its operations.

The options are Cracker Ltd and Musket Ltd which make different products.

Option 1 – Cracker Ltd

Estimated cost of acquisition: £8.6 million

Annual production: 400 000 units

Sales: 75% of production is to be sold under an existing fixed price contract which has a further four years to run at £20 per unit. The remaining 25% will be sold at the following prices:

Year	1	2	3	4
Selling price per unit:	£18	£18.50	£20	£21

Operating costs (including depreciation) are estimated at £4 million in each of years 1 and 2 and £4.4 million in each of years 3 and 4. Depreciation is estimated at £500 000 per annum.

Option 2 – Musket Ltd

Estimated cost of acquisition: £6.8 million

Annual production: 250 000 units

Sales: A contract already exists covering the next four years under which the entire product will be sold at a price of £16 per unit for years 1 and 2, and £18 per unit in years 3 and 4.

Operating costs (including depreciation) are estimated at £0.9 million in year 1, £1.0 million in year 2, and £1.2 million in each of years 3 and 4. Depreciation is estimated at £300 000 per annum.

Whichever option is chosen, the estimated cost of acquisition would be payable immediately. All other receipts and payments take place at the end of each year. The cost of capital for Whitney plc is 10%.

Extract from present value tables at 10%:

Year 1	0.909
Year 2	0.826
Year 3	0.751
Year 4	0.683

REQUIRED

(a) The net present value of each of the two options. [14]

(b) Evaluate **each** option and recommend which, if either, Whitney plc should choose. [6]

(c) **(i)** Identify **two** other methods of capital investment appraisal. [2]

(ii) Discuss the advantages and disadvantages of each of these methods. [8]

Total marks [30]

3 Susan Lee is planning to start trading on 1 July 2007 with £25 000 of her own savings and a £15 000 bank loan to the business. Both of these amounts will be paid into the business bank account on 1 July 2007. Susan has also arranged a £5 000 bank overdraft facility.

Susan has already prepared budgets for her sales and purchases for the first six months of trading. These are as follows:

	July	Aug	Sep	Oct	Nov	Dec
Sales (£)	12 500	22 500	32 500	25 000	22 500	30 000
Purchases (£)	40 000	17 500	25 000	15 000	22 500	17 500

Additional information

1. 40% of sales will be for cash, for which a 2% discount will be allowed. The remainder are on two months credit.

2. Purchases for July 2007 will be paid for immediately in cash. From August 2007 Susan has arranged credit terms and will pay in the month after purchase.

3. Equipment is to be purchased for £16 000 on 1 July 2007. Payment is to be made in four equal monthly instalments starting in October 2007.

4. The equipment is to be depreciated at 20% per annum using the straight line method, the rate applying for each month of ownership.

5. Susan intends to take cash drawings of £2 000 per month in July, August and September 2007 and £2 500 in October, November and December 2007.

6. The bank loan is repayable in 2010 and interest at an annual rate of 8% is payable at the end of each quarter. The first payment is to be made on 30 September 2007.

7. Other expenses (excluding depreciation) of £2 400 are to be paid monthly commencing in July 2007.

8. Closing stock at 31 December 2007 is estimated at £21 500 at cost.

REQUIRED

(a) The Cash Budget for the six months ending 31 December 2007. [20]

(b) The Budgeted Trading and Profit and Loss account for the six months ending 31 December 2007. [8]

(c) The Budgeted Balance Sheet as at 31 December 2007. [11]

(d) Evaluate Susan's cash management for her first six months of trading. [6]

Total marks [45]

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