Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

ACCOUNTING **9706/42**

Paper 4 Problem Solving (Supplementary Topics) **May/June 2014**

2 hours

Additional Materials: Answer Booklet/Paper

1625116244

READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use an HB pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, glue or correction fluid.

Answer **all** questions.
All accounting statements are to be presented in good style.
International accounting terms and formats should be used as appropriate.
Workings should be shown.
You may use a calculator.

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **8** printed pages.

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1 Ann, Jan and Tan are in partnership sharing profits and losses equally. They provide the following information.

1 Statement of financial position at 1 January 2013.

Assets	$	$
Non-current assets		
Land and buildings		130 000
Motor vehicles		25 000
		155 000
Current assets		
Inventory	15 000	
Trade receivables	30 000	
		45 000
Total assets		200 000
Capital and liabilities		
Capital accounts: Ann	40 000	
Jan	40 000	
Tan	30 000	
		110 000
Current accounts: Ann	5 000	
Jan	2 000	
Tan	(4 000)	
		3 000
Non-current liabilities		
Loan: Tan		50 000
Current liabilities		
Trade payables	25 000	
Bank overdraft	12 000	
		37 000
Total liabilities		200 000

2 Summary of the business bank account for the year ended 31 December 2013.

Bank account

	$		$
Receipts from customers	85 000	Payments to suppliers	55 000
		Payments for business expenses	20 500
		Drawings – Ann	5 000
		– Jan	8 000
		– Tan	2 000

3 At 31 December 2013 amounts outstanding from credit customers were $20 000 and amounts due to credit suppliers were $30 000.

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4 The partners were unable to value their inventory at 31 December 2013. However, products are sold at a uniform gross profit margin of 40%.

5 The partnership agreement stated that there were to be no partners' salaries, interest on capital or interest on drawings. However, Tan is paid interest on his loan at 4% per annum.

REQUIRED

(a) Prepare the income statement for the year ended 31 December 2013. [9]

(b) Prepare Tan's current account at 31 December 2013. [4]

Additional information

On 1 January 2014 Tan retired from the partnership. It was agreed that Tan would take a motor vehicle at a value of $5000. He agreed to leave $20 000 of his loan in the partnership with any money owed to him being paid from the business bank account. At that date land and buildings were revalued at $160 000. Goodwill was valued at £18 000 but would not be retained in the books of account.

Ann and Jan would now share profits and losses in the ratio of 2:1.

REQUIRED

(c) Prepare the partners' capital accounts to record all of these adjustments and Tan's retirement from the partnership. [11]

Additional information

Tan is considering how to invest the money he received when he retired from the partnership. He has three options.

Option 1
Purchase ordinary shares in XY Limited. The shares have a nominal value of $1 and a current market value of $2.

The total share capital of XY Limited is 100 000 ordinary shares. For the last financial year the company made a profit for the year of $24 000 and paid a dividend of 8%.

Option 2
Start a new business as a sole trader. He believes that in the first year of trading he will break even, in year two he will earn a profit for the year of $2000, and in year three a profit for the year of $10 000.

Option 3
Invest the money in a bank earning interest of 5% per annum.

REQUIRED

(d) Calculate the dividend yield for XY Limited. [4]

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(e) Calculate the dividend cover for XY Limited. [3]

(f) Discuss the advantages and disadvantages of each of the three options, and advise Tan which option he should choose. [9]

[Total: 40]

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2 Bridlington plc prepares accounts annually to 30 September. The directors provide the following information.

Trial Balance
at 30 September 2013

	Debit $	Credit $
Revenue		936 011
Purchases	479 352	
Distribution costs	108 376	
Administrative expenses	236 758	
Ordinary share capital		400 000
Share premium		40 000
Retained earnings		57 386
Land and buildings		
Cost	380 000	
Accumulated depreciation		78 400
Plant and machinery		
Cost	105 000	
Accumulated depreciation		66 500
Motor vehicles		
Cost	65 000	
Accumulated depreciation		37 578
Loss on disposal of motor vehicle	850	
Inventory at 1 October 2012	177 838	
Provision for doubtful receivables		6 834
Trade receivables	138 450	
Trade payables		51 243
Cash and cash equivalents		17 672
	1 691 624	1 691 624

Additional information

1 Land, which cost $100 000, is not to be depreciated.

2 Depreciation is to be provided as follows:

buildings	4% on cost,
plant and machinery	10% on cost,
motor vehicles	25% reducing balance.

A full year's depreciation is charged in the year of acquisition and none in the year of disposal.

The charge is split in the ratio 3:1 between administrative expenses and distribution costs.

Plant and machinery costing $10 000 was acquired on 1 April 2013.

A motor vehicle which had been purchased on 1 February 2011 for $16 000 was sold on 1 June 2013 for $8 150.

3 The inventory at 30 September 2013 was valued as follows:

Net realisable value	$212 653,
Cost	$172 927.

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[Turn over

4 The provision for doubtful receivables is to be provided at 4% of the trade receivables and the movement is to be treated as an administrative expense.

5 An invoice for an administrative expense of $4 525 remained unpaid at 30 September 2013.

6 There was a prepayment for a distribution cost at 30 September 2013 of $2 760.

7 The tax charge for the year is estimated to be $16 730.

REQUIRED

(a) Prepare an income statement for the year ended 30 September 2013. [16]

(b) Prepare a schedule of property, plant and equipment at 30 September 2013 suitable to be used as a note to the accounts. [10]

(c) Prepare a statement of financial position at 30 September 2013. [8]

Additional information

During October 2013 the following transactions took place.

6 October	A rights issue of 1 share for each 8 held was made at $1.50 per share. The rights were fully taken up. Nominal value of each share is $1.00.
15 October	A bonus issue of 1 share for every 10 held was made. The company maintains its reserves in the most flexible manner.
31 October	Land was revalued at $200 000.

Profit for the month of October was $2615.

REQUIRED

(d) Prepare the equity section of the statement of financial position at 31 October 2013. [6]

[Total: 40]

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3 The directors of Drake plc wish to invest in a new production plant, and must choose between Project Utopia and Project Sylvania.

In each case the investment will be financed with a bank loan for the full amount. This will be received in full on the day the plant is purchased. The loan will be repaid in full in a single payment at the end of year five, however interest is payable throughout the useful life of the plant at 10% per annum.

The useful life of the plant will be 5 years, and it will then be scrapped with no sale proceeds.

The following information is available for Project Utopia:

Cost of production plant	$200 000
Cost of capital	10%
Depreciation rate	30% reducing balance
Revenue in year 1	$110 000
Direct costs in year 1	$40 000

Revenue each year will be 5% higher than the year before.
Costs each year will be 3% higher than the year before.

Discount factors showing net present value of $1

Year	10%	40%
1	0.909	0.714
2	0.826	0.510
3	0.751	0.364
4	0.683	0.260
5	0.621	0.186

Copy the following table into your answer booklet.

Year	Revenue	Costs	Interest	Net cash flow
	$	$	$	$
0				
1				
2				
3				
4				
5				
Total				

REQUIRED

(a) Complete the table from the information given to calculate the net cash flow for **each** year and in total for Project Utopia. [7]

(b) Calculate the net present value for Project Utopia. [7]

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(c) Calculate the accounting rate of return (ARR). [5]

(d) Calculate the internal rate of return (IRR). [7]

Additional information

The following information has also been calculated for Project Sylvania.

Net present value	$41 680
Accounting rate of return (ARR)	19.48%
Internal rate of return (IRR)	17.29%

REQUIRED

(e) State, with reasons, in which project the directors of Drake plc should invest. [4]

Additional information

The directors of Drake plc could finance the new project by issuing new ordinary shares and not using a bank loan.

REQUIRED

(f) Explain how financing the new project from the proceeds of issuing new ordinary shares would affect the accounting rate of return (ARR). [6]

(g) State and explain **two** other sources of finance for the project. [4]

[Total: 40]

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