UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

ACCOUNTING **9706/04**

Paper 4 Problem Solving (Supplementary Topics)

October/November 2005

2 hours

Additional Materials: Answer Booklet/Paper

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 on both sides of the paper.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.
At the end of the examination, fasten all your work securely together.
The questions in this paper carry equal marks.
All accounting statements are to be presented in good style. Workings should be shown.
You may use a calculator.
The number of marks is given in brackets [ ] at the end of each question or part question.

SP (NH) T08260/4

UNIVERSITY *of* CAMBRIDGE
International Examinations

1 Suck and Blow were in partnership and decided to retire and sell the business to Harmonica Ltd on 1 October 2004. The partnership Balance Sheet at 30 September 2004 was as follows:

	Cost	Depreciation	Net Book Value
	$000	$000	$000
Fixed assets			
Freehold premises	400	300	100
Plant and machinery	270	190	80
Motor vehicles	100	76	24
Office equipment	60	50	10
	830	616	214
Current assets			
Stock		55	
Debtors		61	
Bank		28	
		144	
Current liabilities			
Creditors		73	71
			285
Long term liability			
Loan from Suck at 12% per annum			50
			235
Partners' capital accounts			235

The assets and liabilities were valued as follows for the sale:

	$000	$000
Freehold premises		200
Plant and machinery		60
Motor vehicles		18
Office equipment		5
		283
Stock	40	
Debtors	50	
	90	
Creditors	73	17
		300

Harmonica Ltd did not take over the partnership bank account.

The consideration for the purchase of the partnership was $400 000 and was satisfied as follows:

1 The issue to Suck of an amount of 8% debentures which would ensure that he would continue to receive the same amount of interest as he had received from the partnership.
2 A cash payment of $60 000.
3 200 000 ordinary shares in Harmonica Ltd for the balance of the purchase consideration.

Harmonica Ltd's Balance Sheet at 30 September 2004 was as follows:

	Cost $000	Depn. $000	N.B.V. $000
Fixed assets			
Freehold premises	1000	200	800
Plant and machinery	500	300	200
Motor vehicles	230	170	60
Office equipment	100	60	40
	1830	730	1100
Current assets			
Stock		78	
Debtors		90	
Bank		120	
		288	
Current liabilities			
Creditors		112	176
			1276
Share capital and reserves			
Ordinary shares of $1			1000
General reserve			200
Retained profit			76
			1276

REQUIRED

(a) Prepare Harmonica Ltd's Balance Sheet at 1 October 2005 after the acquisition of the partnership business and before any other transactions had occurred. [17]

During the year ended 31 July 2005 Harmonica Ltd, in addition to the acquisition of the partnership business of Suck and Blow, disposed of another of its operations. An extract from the company's trial balance at 31 July 2005 was as follows:

	$000	$000
Turnover: continuing operations		1300
acquisition		217
discontinued operation		80
Cost of sales	925	
Distribution costs	140	
Administration expenses	180	
Profit on sale of discontinued operation		24

The operating profits/(losses) were as follows:

	$000
Continuing operations	500
Acquisition	60
Discontinued operation	(108)

REQUIRED

(b) Prepare Harmonica Ltd's published Profit and Loss Account for the year ended 31 July 2005 to show the profit before taxation and in the form required by current standards. [19]

(c) State **four** exceptional items that should be included in Harmonica Ltd's Profit and Loss Account for the year ended 31 July 2005. [4]

[Total: 40]

2 The chairman of Kalamitty Ltd needs to obtain the consent of the shareholders to a reduction of capital.

The summarised Balance Sheet of Kalamitty Ltd at 30 September 2005 was as follows:

	$000
Goodwill	50
Tangible fixed assets	1 300
Net current assets	725
	2 075
Ordinary shares of $1	2 500
Profit and Loss Account	(425)
	2 075

Further information:

The company has not paid a dividend for the past few years.

The directors are aware of the following matters:

1. Goodwill is now valueless.
2. The freehold premises have developed a structural fault and must now be written down by $225 000.
3. Stock has been damaged by flooding and must be written down by $20 000.
4. A major debtor owing $30 000 is in financial difficulties and is unlikely to pay.

The company has secured a number of new, long-term profitable contracts and the directors are confident that in future the company will make annual profits of at least $70 000.

The directors propose a scheme of capital reconstruction which will enable them to write off the debit balance on the Profit and Loss Account and adjust the accounts for items numbered 1 to 4 above. The scheme will not result in a change in the number of shares that have been issued.

The directors are confident that the capital reconstruction will enable them to commence paying annual dividends of $50 000 in the year ending 30 September 2006. The current rate of interest on money invested outside the business is 2.8%.

REQUIRED

(a) Using the information given above, state the facts which the chairman should include in his letter to the shareholders to obtain their consent to the scheme of capital reduction. [12]

The directors have obtained the necessary consent and the scheme of capital reduction has been implemented.

REQUIRED

(b) Prepare the Balance Sheet as it appears after the scheme of capital reduction has been implemented. [7]

[Turn over

Kalamitty Ltd's accountant has prepared a forecast cash flow statement for the year ending 30 September 2006 as follows:

Cash flow from operating activities	$000	$000
Operating profit		110
Depreciation of fixed assets		280
Loss on sales of fixed assets		30
Stock		16
Debtors		(20)
Creditors		(13)
Cash inflow from operating activities		403
Capital expenditure		
Purchase of fixed assets	(230)	
Disposals of fixed assets	50	(180)
Equity dividends paid		(50)
Increase in cash		173

REQUIRED

(c) Prepare a forecast Balance Sheet at 30 September 2006. [11]

Kalamitty Ltd's published accounts must include a directors report.

REQUIRED

(d) State **five** matters which should be included in the directors report. Give **one** reason why each of the matters you have identified is important. [10]

[Total: 40]

3 Laurus manufactures two products which involve three processes. They pass through processes 1 and 2 as a single product and separate into product X and product Y in process 3.

Laurus uses a standard costing system and the following information has been extracted from the standard cost records:

	Process 1	*Process 2*
Materials per unit	4 litres	5 litres
Cost of material per litre	$1.50	$3
Cost of materials used in process 1	$12 000	–
Cost of materials used in process 2	–	to be calculated
Direct labour hours per unit	3.5	2.2
Hourly labour cost	$8	$10
Variable overhead per unit	$5 per direct labour hour	$3 per direct labour hour
Fixed overhead absorption rate	$7 per direct labour hour	$8 per direct labour hour
Opening stock of work in progress	nil	nil
Closing stock of work in progress	nil	1000 units

The closing stock of work in progress in process 2 is complete as to 100 per cent materials and 75% labour.

REQUIRED

(a) Prepare the ledger account for process 1. [9]

(b) Prepare the ledger account for process 2. [23]

The completed units in process 2 are transferred to process 3 where they separate into joint products, X and Y.

70% of the finished units are X and 30% are Y.

The costs in process 3 are as follows:

Added materials: 2 kilos per unit at $6.80 per kilo
Direct labour: 2 hours per unit at $7 per hour
Variable overheads: $5 per direct labour hour
Fixed overhead absorption rate: $11 per direct labour rate.

10% of the production in process 3 was spoiled.

REQUIRED

(c) Prepare the ledger account for process 3. [8]

[Total: 40]

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