# 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 2006

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.

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.

All accounting statements are to be presented in good style. 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.

1 Knotsogood Ltd has been trading unprofitably for the past few years. The court has recently approved a scheme of capital reconstruction.

A Balance Sheet at 31 August 2006 showed the following position.

	Cost	Accumulated	NBV
	\$	depreciation \$	\$
Fixed assets			
Intangible fixed asset Goodwill Tangible fixed assets	110 000		110 000
Freehold land	80 000		80 000
Premises Vehicles	310 000 220 000	50 000 160 000	260 000 _60 000
venicles	720 000 720 000	<u>210 000</u>	510 000
Investments at cost			210 000
Current assets			
Stock		40 000	
Trade debtors Cash		56 000 4 000	
		100 000	
Creditors: amounts falling due within one year			
Trade creditors	80 000	100.000	
Bank overdraft	<u>100 000</u>	<u>180 000</u>	
Net current liabilities			(80 000)
			640 000
Creditors: amounts falling due after more than	-		
8% Debenture (2021) (secured on the freehold I	and)		<u>100 000</u> <u>540 000</u>
			<u> </u>
Capital and reserves Ordinary shares of \$1 each fully paid			500 000
8% preference shares of \$1 each fully paid			200 000
Share premium account			250 000 950 000
Less Profit and loss account			( <u>410 000</u> )
			<u>540 000</u>
Authorised share capital			
1 000 000 ordinary shares of \$1 each 500 000 8% preference shares of \$1 each			1 000 000 500 000
500 000 6 /6 preference shares of \$1 each			300 000

**Note**: The preference shares are cumulative and the dividends on the shares are 3 years in arrears.

The approved scheme for the reduction of capital was implemented as follows:

- (i) The preference shares were reduced to \$0.50 per share.
- (ii) The ordinary shares were reduced to \$0.25 per share.
- (iii) Two new ordinary shares issued for every \$1 of gross preference dividend in arrears. The share premium account was utilised for the issue.
- (iv) Goodwill was written off.

#### In addition:

- (v) Stock costing \$6000 had been included in the final accounts at its selling price of \$10 000.
- (vi) A debt of \$21 000 was written off as bad.
- (vii) The debenture holder took over the freehold land at an agreed valuation of \$125 000. The balance was paid to the company.
- (viii) The investments were sold for \$235 000.

## **REQUIRED**

(a) Prepare a capital reconstruction account.

[8]

- (b) Prepare a balance sheet at 31 August 2006 immediately after the capital reconstruction had taken place. [20]
- (c) Calculate the net asset value of each ordinary share
  - (i) before the implementation of the scheme;
  - (ii) after the implementation of the scheme.

[9]

(d) Identify and explain **one** factor that the court would consider before agreeing to the scheme of reconstruction. [3]

[Total: 40]

2 The managers of Draxian Industries Ltd operate a system of standard costing and budgetary control. The company manufactures components which pass through two departments - machining and finishing. The standard cost and budget information for March 2006 was as follows:

	Machining department	Finishing department
Standard cost per unit		
direct materials	\$4	
direct labour machining (2 hours)	\$14	
direct labour finishing (1½ hours)		\$12
Budgeted output – units	20 000	20 000
Budgeted direct labour hours	40 000	30 000

All output passes through both departments.

#### Additional information:

- 1 The actual production cost and details for March 2006 were as follows:
  - (i) Output passing through each department was 18 000 units and there was no opening or closing work in progress.
  - (ii) Direct materials used at standard prices was \$71 360.
  - (iii) Direct materials used at actual prices was \$73 144.
  - (iv) The direct labour hours used and the direct wages paid for the machining department were:

	hours	\$
Machining department	36 300	263 175

2 Variances for the finishing department have been calculated and are:

Direct labour efficiency variance \$3200 adverse
Direct labour rate variance \$2740 favourable

## **REQUIRED**

- (a) Calculate
  - (i) the total direct material variance for the machining department;
  - (ii) the direct material usage variance for the machining department;
  - (iii) the direct material price variance for the machining department.

[6]

- (b) Calculate
  - (i) the total direct labour variance for the machining department;
  - (ii) the direct labour efficiency variance for the machining department;
  - (iii) the direct labour rate variance for the machining department.

[6]

- (c) Calculate
  - (i) the actual direct labour hours used for the finishing department;
  - (ii) the actual direct wage rate paid per hour for the finishing department;
  - (iii) the total direct labour variance for the finishing department.

[6]

- (d) Identify **one** possible reason for **each** of the following variances calculated in (a) and (b) and also the variances given for the finishing department in (c).
  - (i) the direct material usage variance for the machining department;
  - (ii) the direct material price variance for the machining department;
  - (iii) the direct labour efficiency variance for the machining department;
  - (iv) the direct labour rate variance for the machining department;
  - (v) the direct labour efficiency variance for the finishing department;
  - (vi) the direct labour rate variance for the finishing department.

[12]

**(e)** Discuss possible links between **two pairs** of variances calculated above.

[6]

**(f)** Explain **two** reasons why a system of standard costing might be introduced into a business.

[4]

[Total: 40]

**3** The directors of Hamilton Ltd provide the following balances extracted from the ledgers of the company at 30 September 2006.

	Dr	Cr
	\$000	\$000
Cost of sales and Sales	819	1 626
Operating expenses	672	
Interest paid	12	
600 000 ordinary shares of \$0.50 each	-	300
10 % redeemable preference shares	-	100
8% Debentures (2010)	-	150
Interim preference dividend paid	5	-

# Additional information:

The market price of the ordinary shares on 30 September 2006 was \$1.60.

The directors wish to make provision for:

- (i) Corporation taxation for the year of \$28 000.
- (ii) Final preference dividend.
- (iii) Final ordinary dividend of \$35 000 (no interim dividend was paid).

The corporation tax charge for the year was \$28 000.

## **REQUIRED**

(a) Prepare a Trading, Profit and Loss and Appropriation Account for the year ended 30 September 2006.

[10]

The following information relates to the Profit and Loss and Appropriation Account for the year ended 30 September 2005.

	\$000
Operating profit	120
Debenture interest paid	12
Provision for corporation tax	25
Preference dividends for the year	10
Proposed ordinary dividend (no interim dividend was paid)	20

The market price per share at 30 September 2005 was \$1.35.

The issued ordinary share capital was 600 000 shares of \$0.50 each at both balance sheet dates.

## **REQUIRED**

- **(b)** Calculate the following ratios for **each** of the years ended 30 September 2005 **and** 30 September 2006:
  - (i) interest cover;
  - (ii) earnings per share (EPS);
  - (iii) price earnings ratio (P/E);
  - (iv) dividend yield;
  - (v) dividend cover. [10]
- (c) Comment on the changes in the ratios calculated in (b) over the two years. [10]

The directors of Hamilton Ltd have drawn up the following draft balance sheet at 30 September 2006.

Fixed assets Premises Other fixed assets	\$000	\$000	\$000 460 <u>200</u> 660
Current assets Current assets other than bank Balance at bank		65 <u>91</u> 156	
Creditors: amounts falling due in less than one year Trade creditors Proposed dividends Taxation	18 40 <u>28</u>	<u>86</u>	<u>70</u> 730
<b>Creditors</b> : amounts falling due after more than one year 8% Debentures (2010)			<u>150</u> <u>580</u>
Share Capital and Reserves Ordinary shares of \$0.50 each fully paid 10% redeemable preference shares of \$1 each fully paid Profit and loss account			300 100 <u>180</u> <u>580</u>

Note: Both the debentures and the preference shares were issued in 1996.

The directors have not taken into account the following transactions that took place at the close of business on 30 September 2006:

- (i) the premises were revalued at \$750 000;
- (ii) the preference shares were redeemed at a premium of 10%;
- (iii) a bonus issue of 1 new ordinary share for every 2 held was made;

It is company policy to maintain reserves in their most flexible form.

## **REQUIRED**

(d) An extract showing the share capital and reserves section of the balance sheet of Hamilton Ltd after the items (i) to (iii) have been incorporated. [10]

[Total: 40]

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