

UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary and Advanced Level

MARK SCHEME for the November 2005 question paper**9706 ACCOUNTING****9706/04****Paper 4, maximum mark 120**

This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which Examiners were initially instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began. Any substantial changes to the mark scheme that arose from these discussions will be recorded in the published *Report on the Examination*.

All Examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes must be read in conjunction with the question papers and the *Report on the Examination*.

The minimum marks in these components needed for various grades were previously published with these mark schemes, but are now instead included in the Report on the Examination for this session.

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1 (a)

Harmonica Ltd

Balance Sheet at 1 October 2004
after acquisition of Suck and Blow

	Cost \$000	Depn. \$000	N.B.V. \$000	
<u>Fixed assets</u>				
Intangible: Goodwill	<u>100</u>	-	<u>100</u>	(2)
Tangible				
Freehold premises	1 200	200	1 000	(1)
Plant and machinery	560	300	260	(1)
Motor vehicles	248	170	78	(1)
Office equipment	<u>105</u>	<u>60</u>	<u>45</u>	(1)
	<u>2 113</u>	<u>730</u>	<u>1 383</u>	
<u>Total fixed assets</u>	<u>2 213</u>	<u>730</u>	1 483	
<u>Current assets</u>				
Stock		118		(1)
Debtors		140		(1)
Bank		<u>60</u>		(1)
		318		
<u>Current liabilities</u>				
Creditors		<u>185</u>	<u>133</u>	(1of)
			1 616	
<u>Long term liabilities</u>				
8% debentures			<u>75</u>	(2)
			<u>1 541</u>	
<u>Share capital and reserves</u>				
Ordinary shares of \$1			1 200	(1)
Share Premium account			65	(2)
General reserve			200	
Retained profit			<u>76</u>	
			<u>1 541</u>	(1)

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(b) Profit and Loss Account for the year ended 31 July 2005

	\$000	\$000
Turnover: Continuing operations	1 300 (2)	
Acquisitions	<u>217 (2)</u>	
	1 517	
Discontinued operations	<u>80 (2)</u>	1 597
Cost of sales		<u>925 (1)</u>
Gross profit (1)		672 (2)
Distribution costs	140 (1)	
Administration expenses	<u>180 (1)</u>	<u>320 (1)</u>
Operating profit		352 (1)

Continuing operations	500
Acquisitions	<u>60</u>
	560
Discontinued operations	(108)

Profit on disposal of discontinued operations	<u>24 (1)</u>
Profit on ordinary activities before interest	376
Interest on debentures (10 months)	<u>5 (1) 8%(1)x 75(1)x 10/12(1)</u>
Profit before taxation	371 (1 of)

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(c) Four exceptional items:

- (i) Reorganisation expenses due to the acquisition of a new business (1)
- (ii) Reorganisation due to the disposal of business segments (1)
- (iii) Profit on sale of discontinued operation (1)
- (iv) Expenses of discharging personnel on reorganisation due to acquisitions/disposals (1) [4]

2 (a) The proposal for a scheme of capital reduction.

The directors have to inform you of certain matters that have now become apparent and require our urgent attention. They are as follows:

- (1) The company's premises have developed a structural defect that has severely reduced their value by \$225 000.
 - (2) Stock with a value of \$20 000 has become damaged by flooding and must now be written off as unsalvageable.
 - (3) A major debtor owing \$30 000 is in financial difficulties and is unlikely to be able to pay.
 - (4) The directors are of the opinion that Goodwill shown in the Balance Sheet is of no value now and, in accordance with accounting standards, must be written off.
- } max 2 marks

As a consequence of the above, the directors propose a scheme of capital reduction which, if carried out with your consent, will not result in any reduction in the number of shares you hold, (1) but will result in a reduction in the nominal value of each share. (1)

	\$	
Goodwill	50 000	} 1 mark for any pair; max 2 marks
Premises	225 000	
Stock	20 000	
Bad debt	30 000	
Debit balance on Profit and Loss Account	<u>425 000 (1)</u>	
Total reduction	<u>750 000 (1 of)</u>	

For 2.5 million shares (1) this is equivalent to a reduction of \$0.30 on each share. (1 of)

The proposal, then, is to exchange your current share certificates for new certificates showing that the shares you currently hold will have a nominal value of \$0.70 each. (1 of)

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The benefits of this scheme, if implemented, are as follow:

- (1) The company has secured some profitable new contracts which we confidently expect to produce annual profits of \$70 000. **(1)**
- (2) The directors will propose to recommence an annual distribution of \$50 000 as ordinary dividend. **(1)**
- (3) The dividend will represent an annual yield of 2.85 per cent on your shares. **(4)** The average rate of return on money invested outside the company is currently 2.80 per cent. **(1)**
- (4) If your consent is not given to this scheme, it could be a number of years before the company could re-commence the payment of dividends. **(1)**

You will be invited to attend a meeting of the company at which you will be able to vote on a special resolution to empower the directors to implement the scheme of capital reduction. **(1)**

	\$000	\$000	
(b)			[maximum 12]
Goodwill	50 - 50	-	
Tangible fixed assets	1 300 - 225	1 075 (1)	
Net current assets	<u>725</u> - 20 (1) - 30 (1)	<u>675</u> (2)	
	<u>2 075</u>	<u>1 750</u> (1 of)	
2 500 000 (1) ordinary shares of \$0.70 (1)		<u>1 750</u> (1 of)	
			[7]
(c)	\$000	\$000	
Tangible fixed assets	1 075 (of) + 230 (1) - 50 (1) - 30 (1) - 280 (1)	945 (of)	
Net current assets	<u>675</u> (of) + 173 (1) - 16 (1) + 20 (1) + 13 (1) - 50 (1)	<u>815</u> (of)	
	<u>1 750</u>	<u>1 760</u>	
Ordinary shares of \$0.70	1 750	1 750	
Profit and Loss Account	60 (1) - 50 (dividend) (1of)	<u>10</u>	
		<u>1 760</u>	[11]

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(d) Matters for inclusion in the Directors Report.

1. A review of the business during the year and its position at the end of the year. **(1)**
The Profit and Loss Account and Balance Sheet do not provide information which cannot be expressed in monetary terms (concept of money measurement). (1)
2. The principal activities carried on by the company during the year and significant changes in those activities. **(1)** *The accounting statements cannot explain the activities carried on by the company/FRS 3 does not give adequate information about new and discontinued activities. (1)*
3. Particulars of important events that have occurred after the end of the financial year and which affect the company.**(1)** *Post Balance Sheet events occur after the directors have approved the financial statements and may affect the Balance Sheet or Profit and Loss Account (adjusting events) or may affect the business after the Balance Sheet date (non-adjusting events). (1)*
4. Recommended dividends. **(1)** *These must be approved by the members of the company at the annual general meeting. (1)*
5. Names of directors of the company and their interests in shares or debentures of the company.**(1)** *Shareholders are entitled to know who have been stewards of their interests during the year and the extent of each director's commitment to the company as share or debenture holders.(1)*
6. Donations to political parties or charities during the year.**(1)** *Shareholders may not wish their money to be used for political purposes, or may wish that some of the profits be used for charitable purposes. (1) .*
7. Arrangements for promoting the health, safety and welfare at work of the employees **(1)** *Shareholders are entitled to be re-assured that the company is abiding by current legislation concerning health and safety and that it is concerned with the welfare of its employess (good labour relations). (1)*
8. Information about research and development being carried on by the company. **(1)** *This helps to assess the future prospects of the company. (1)*
9. An indication of the future developments in the company's business. **(1)** *An indication of likely future growth (1) and/or diversification (1) or disposing of non-core activities. (1)*
10. Significant changes in fixed assets during the financial year. **(1)** *Shareholders are informed of any material differences between the Balance Sheet values of fixed assets and their current market values.(1)*

(1 mark for each matter and one for each comment on its significance. Maximum 10 marks.)
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(a)	Process 1		
	\$		\$
	Direct materials	12 000 (1)	Finished production transferred
	Direct labour (2 000 (1) X 3.5 (1) X \$8 (1))	56 000	to process 2
	Variable costs (2 000 X \$5 (1) X 3.5 (1))	35 000	152 000 (1 of)
	Fixed overhead (2 000 x \$7 (1) X 3.5 (1))	<u>49 000</u>	
		<u>152 000</u>	<u>152 000</u>

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(b)	Process 2		
	\$		\$
	Materials transferred from process 1	152 000 (1 of)	Finished production transferred
	Added materials		to process 3
	(2 000 (1) X 5 (1) X \$3 (1))	30 000(1)	137 200 (7 of)
	Direct labour (3 850 (1) X 10 (1))	38 500(1)	Work in progress carried
	Variable costs (3 850 (1 of) X \$3 (1))	11 550(1)	forward
	Fixed costs (3 850 (1 of) X \$8 (1))	<u>30 800(1)</u>	125 650 (2 of)
		<u>262 850</u>	<u>262 850</u>

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Finished production: 1 000 (1) X (76 (1) + 15 (1) + 22 (1) + 6.6 (1) + 17.6 (1)) = \$137 200 (1)	
Work in progress: Direct materials 1 000 (1) X (76 (1) + 15 (1)) = \$91 000	
Direct labour 750 X \$22 =	16 500 (1)
Variable costs 750 X \$6.6	4 950 (1)
Fixed overheads 750 X \$17.6	<u>13 200 (1)</u>
	<u>125 650 (1)</u>
Direct labour: 1 000 X \$22 = \$22 000	
750 X \$22 = <u>16 500</u>	\$38 500
1 000 X 2.2 hours = 2 200	
750 X 2.2 hours = <u>1 650</u>	3 850 hours

(c)	Process 3		
	\$		\$
	Materials transferred from process 3	137 200 (1 of)	Product X (630 units)
	Added materials	13 600 (1)	Product Y (270 units)
	Direct labour	14 000 (1)	59 040 (1 of)
	Variable costs	10 000 (1)	
	Fixed overheads	<u>22 000 (1)</u>	
		<u>196 800</u>	<u>196 800</u>

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