Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

ACCOUNTING **9706/42**

Paper 4 Problem Solving (Supplementary Topics) **October/November 2014**

2 hours

No Additional Materials are required.

8201703774

READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

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.

The number of marks is given in brackets [ ] at the end of each question or part question.

IB14 11_9706_42/7RP

CAMBRIDGE International Examinations

1 The directors of Aston plc provided the following financial information at 1 June 2013.

	$000
Ordinary share capital ($1 shares)	25 000
Share premium	5 000
Revaluation reserve	1 000
Retained earnings	2 950
Land	6 000

On 1 July 2013 $1 800 000 8% debentures were issued.
For the year ended 31 May 2014 profit from operations was $3 752 000.
The tax charge for the year was 25% of the profit before taxation.

REQUIRED

(a) Prepare the income statement for the year ended 31 May 2014. [6]

Additional information

On 1 September 2013 a final dividend relating to the previous year of $0.04 per ordinary share was paid.

On 1 October 2013, 5 000 000 ordinary shares of $1 each were issued at a premium of $0.10 per share.

On 1 November 2013 a rights issue was made of 1 ordinary share for every 5 ordinary shares owned at $1 per share. This was fully subscribed.

On 1 February 2014 land was revalued at $7 500 000.

On 1 February 2014 an interim dividend of $0.03 per ordinary share was paid.

On 1 March 2014 a transfer of $500 000 was made from retained earnings to a newly formed general reserve.

On 1 April 2014 the directors proposed a final dividend for the year 50% higher per share than the previous year.

REQUIRED

(b) Copy the following table into your answer booklet and prepare a statement of changes in equity for the year ended 31 May 2014.

Statement of changes in equity

	Share capital $000	Share premium $000	Revaluation reserve $000	General reserves $000	Retained earnings $000	Total $000
Balance at 1 June 2013						
Balance at 31 May 2014						

[20]

(c) Explain the treatment of the final dividend proposed on 1 April 2014. [4]

Additional information

The directors are hoping to expand the business. They are planning a bonus issue of 1 new ordinary share for every 5 ordinary shares held on 31 May 2014.

REQUIRED

(d) Explain what is meant by a bonus issue and also explain whether it would help the expansion plans for the business. [4]

Additional information

In July 2014, the directors carried out impairment review of their plant and equipment.

The data for this review is shown below:

Asset	Carrying value $	Net selling price $	Value in use $
1	1870	1560	1362
2	2423	2514	2625
3	1368	1287	1313

REQUIRED

(e) (i) Explain what is meant by impairment. [2]

(ii) Calculate the total impairment loss that would be recognised in the income statement for the year ending 31 May 2015 in accordance with IAS 36, Impairment of assets. [4]

[Total: 40]

2 The directors of Ragley Limited are considering a new business opportunity. This involves the purchase of machinery costing $600 000.

Units produced by the machine are expected to have a selling price of $50 each and the variable costs of production are expected to be $31.10 per unit. Fixed costs are expected to be $120 000 per annum excluding depreciation.

The machinery is expected to lose its value evenly over four years and then be scrapped.

The directors expect to produce and sell 20 000 units a year.

REQUIRED

(a) Calculate the following expected **annual** values. Label each answer.
(i) Total contribution
(ii) Net cash flow
(iii) Profit [6]

(b) Calculate the expected **annual** breakeven level of production, both in units and sales revenue. [5]

Additional information

Ragley Limited has a cost of capital of 10%. Discount factors are as follows.

Year 1	0.909
Year 2	0.826
Year 3	0.751
Year 4	0.683
	3.169

The directors provide the following incorrect net present value calculation as an aid to decision making.

Annual surplus	$108 000
x Discount factor for four years	3.169
Net present value	$342 252

REQUIRED

(c) Explain why the directors' net present value calculation is incorrect. [4]

(d) Calculate the correct net present value of the machinery. [6]

(e) Calculate the sensitivity of the project to changes in the cost of the machinery. [4]

(f) Calculate the sensitivity of the project to changes in the selling price. [9]

(g) State the IAS which deals with property, plant and equipment and identify **five** items which a company can add to the cost price of an asset. [6]

[Total: 40]

3 The directors of Drosnan Retail Limited provide the following budgeted information.

	Revenue	Purchases	Monthly depreciation	Administration costs
2014	$	$	$	$
November	24 000	14 000	120	6 300
December	26 000	17 000	120	6 200
2015				
January	30 000	18 000	120	6 200
February	26 000	15 000	120	6 800
March	28 000	19 000	150	7 100
April	32 000	13 000	150	6 700

Other information is as follows.

1. 10% of all revenue are cash sales.
2. 50% of credit customers pay in the month following the sale and receive a 4% cash discount. Remaining trade receivables pay in the second month following the sale.
3. All purchases are on credit and are paid for in the month following purchase, after deducting a 5% early settlement discount.
4. The business rent is $9000 a year. This is paid in two equal instalments on 1 February and 1 August each year.
5. A dividend of $3100 is expected to be paid on 19 January 2015.
6. Administration costs are paid in the month after the one in which they are incurred.
7. The company expects to take out a bank loan of $10 000 with an interest rate of 7.8% per annum on 1 March 2015. This is to help finance the purchase of a new vehicle in March which is expected to cost $12 000. The loan is to be repaid in full together with the interest after one year.
8. The company directors intend to sell an old vehicle in April 2015. This originally cost $7200 and by the date of disposal will have accumulated depreciation of $5100. The sales proceeds are anticipated to be $1100.
9. Inventory on 1 January 2015 is expected to have a value of $2100. Inventory on 30 April 2015 is expected to be valued at $3800.
10. It is expected that there will be a bank overdraft of $1303 on 1 January 2015.

REQUIRED

(a) Prepare a cash budget for **each** of the four months January to April 2015. [15]

(b) Prepare a budgeted income statement for the four month period ending 30 April 2015. [14]

(c) Explain **two** reasons why the change in the bank balance calculated in **(a)** is different from the profit figure in **(b)**. [4]

(d) State **two** reasons why management prepares a cash budget. [2]

Additional information

Drosnan Retail Limited has a financial year end of 31 July 2015.
40% of its annual profit is expected to arise in the four month period ending 30 April. The dividend in January will be the interim dividend; the final dividend is expected to be double the interim dividend.

REQUIRED

(e) Calculate the expected dividend cover for the year ending 31 July 2015. [5]

[Total: 40]

BLANK PAGE