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 2008**

2 hours

Additional Materials: Answer Booklet/Paper

1071140321

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.

This document consists of **7** printed pages and **1** blank page.

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UNIVERSITY of CAMBRIDGE International Examinations

1 Wong was a sole trader. Gruber and Gupta were in partnership and did not have a partnership agreement.

Both of the businesses had been experiencing falling profits for a number of years due to large supermarkets opening in their town. They agreed that GWG Ltd be formed on 1 April 2008 to take over both businesses in order that they could better compete with larger businesses.

The new company has an authorised share capital of 500 000 ordinary shares of $1 each.

The summarised balance sheets of Wong and Gruber and Gupta at 31 March 2008 are shown.

	Wong		Gruber and Gupta	
	$	$	$	$
Fixed assets				
Net book value - premises		16 000		50 000
equipment		20 000		30 000
		36 000		80 000
Current assets				
Stock	6 000		15 000	
Trade debtors	3 000		11 000	
Bank balance	1 000		-	
	10 000		26 000	
Current liabilities				
Trade creditors	4 000		2 000	
Bank overdraft	-	6 000	5 000	19 000
		42 000		99 000
Capital accounts – Wong		42 000		
Gruber				40 000
Gupta				60 000
Current accounts – Gruber				500
Gupta				(1500)
				99 000

Profits earned over the past 5 years were:

Year ended 31 March	Wong	Gruber and Gupta
	$	$
2004	29 000	55 000
2005	25 000	49 000
2006	17 000	42 000
2007	13 000	25 000
2008	11 000	19 000

The purchase consideration had been agreed at 3 times the average profits for the past five years. The purchase consideration was settled by **each** of Wong, Gruber and Gupta receiving:

$25 000 7 % debentures (2028) issued at par, and
24 000 ordinary shares of $1 each in GWG Ltd.

Additional information:

1 Debtors and creditors were not taken over by GWG Ltd. Wong and Gruber and Gupta each undertook to collect their own debtors and pay their own creditors.

2 Wong's debtors paid $2800 in full settlement and Gruber and Gupta collected $10 000 from their debtors.

3 Wong paid his creditors $3600 while Gruber and Gupta paid their creditors in full.

4 Wong sold his equipment for $18 000 cash.

5 Costs of dissolution for Wong's business were $700 and for Gruber and Gupta $2100.

6 The remaining assets were taken over by GWG Ltd at the following agreed values:

	Wong	Gruber and Gupta
	$	$
Fixed assets – premises	50 000	80 000
equipment	-	20 000
Stock	5 000	14 500

7 Gruber and Gupta each have enough personal cash resources to make up any deficit which may arise on their capital accounts.

REQUIRED

(a) Prepare a realisation account, a bank account and a capital account to close Wong's books of account. [17]

(b) Prepare a realisation account, a bank account and capital accounts to close the partnership books of account. [17]

(c) Prepare the balance sheet of GWG Ltd at 1 April 2008 immediately after the formation of the company and before any other transactions had taken place. [6]

[Total: 40]

2 The directors of Khan plc provided the following information:

Balance sheets at	30 June 2007		30 June 2008	
	$000	$000	$000	$000
Tangible fixed assets				
Freehold land and buildings (note 1)		960		1225
Plant and machinery (note 2)		490		652
Vehicles (note 3)		265		239
Investments		90		120
		1805		2236
Current assets				
Stock	453		597	
Trade debtors	181		165	
Bank balance	46		-	
	680		762	
Creditors: amounts falling due in less than one year				
Trade creditors	(203)		(186)	
Bank overdraft	-		(39)	
Proposed ordinary dividend	(45)		(52)	
Proposed preference dividend	(24)		-	
Taxation	(220)	188	(60)	425
		1993		2661
Creditors: amounts falling due in more than one year				
8 % debentures (2008) (note 4)		(450)		-
9 % debentures (2033)		-		(500)
		1543		2161
Share capital and reserves				
Ordinary shares of $0.50 each fully paid (note 5)		650		950
6 % redeemable preference shares (note 6)		400		-
Share premium account		300		580
Revaluation reserve		-		290
Profit and loss account		193		341
		1543		2161

Notes to the balance sheet

Note 1

	30 June 2007	30 June 2008
Freehold land and buildings	$000	$000
Cost	1200	-
Valuation	-	1250
Accumulated depreciation	240	25
Net book value	960	1225

During the year ended 30 June 2008 the freehold land and buildings were revalued at $1 250 000. There were no disposals of freehold land or buildings during the year.

Note 2

Plant and machinery	30 June 2007 $000	30 June 2008 $000
Cost	769	981
Depreciation	279	329
Net book value	490	652

There were no disposals of plant or machinery during the year.

Note 3

Vehicles	30 June 2007 $000	30 June 2008 $000
Cost	425	?
Depreciation	160	?
Net book value	265	239

During the year ended 30 June 2008 vehicles costing $124 000 were sold for $18 000. The accumulated depreciation on these vehicles to 30 June 2007 amounted to $110 000. Vehicles costing $218 000 were purchased during the year.

Note 4

The 8 % debentures (2008) were redeemed on 30 June 2008. They had originally been issued on 1 July 1993. An issue of $500 000 9 % debentures was made on 1 July 2007.

Note 5

600 000 ordinary shares of $0.50 each were issued at $1 each on 16 June 2008; all monies due were received by 30 June 2008.

Note 6

The proceeds of the ordinary share issue were used to redeem the redeemable preference shares on 30 June 2008 at a premium of $0.05. The preference shares were originally issued at $1.10 each. A final dividend of $24 000 on the preference shares was paid on that date.

Additional information:

An interim ordinary dividend of $34 000 was paid on 11 February 2008.

REQUIRED

(a) Calculate the company's trading profit before interest and tax for the year ended 30 June 2008. [9]

(b) Prepare a cash flow statement for the year ended 30 June 2008 in accordance with current accounting practice. [29]

(c) State **one** reason why the directors of a limited company would prepare a cash flow statement. [2]

[Total: 40]

3 The managers of Namllih Ltd planned to produce and sell 1500 briefcases in August 2008. They actually produced and sold 1125 briefcases.

The following information is available.

The standard costs for producing 1500 briefcases were:

Direct materials	1400 m^2 at a cost of \$2.10 per m^2
Direct labour	2460 hours at \$4.20 per hour

The actual costs were:

Direct materials	1210 m^2 at \$2.05 per m^2
Direct labour	1800 hours at \$4.10 per hour

REQUIRED

(a) Calculate:

(i) material price variance

(ii) material usage variance

(iii) total materials variance

(iv) labour rate variance

(v) labour efficiency variance

(vi) total labour variance [12]

(b) Explain how any **two** of the variances calculated in **(a)** may be connected. [2]

The managers of Namllih Ltd believe that demand for their product will fall over the next few months if they do not lower the selling price of each briefcase. They intend to purchase a machine that will cut and prepare the leather used to make the briefcases at a lower cost.

There are currently two machines on the market capable of doing exactly what the company requires. Each machine will be used for 4 years, after which it will be scrapped. Machine A is made locally and costs \$40 000. Machine B is manufactured in Indonesia and costs \$44 000.

Whichever machine is purchased output will increase by 875 briefcases per month and the directors are confident that they could all be sold for \$13.50 each.

The total annual costs of producing the extra 875 briefcases using machine A will be \$120 000 in the first year of use and these costs will rise by 5 % each year thereafter.

The annual costs of producing the extra 875 briefcases using machine B in the first year will also be \$120 000 but costs are expected to rise by \$5000 each year thereafter.

The current cost of capital for Namllih Ltd is 7 %.

The present value of $1 is shown.

	7 %	14 %
Year 1	0.935	0.877
Year 2	0.873	0.770
Year 3	0.816	0.675
Year 4	0.763	0.592

The net present value of machine A using a discount rate of 14 % is negative $740.68.

The net present value of machine B using a discount rate of 7 % is $5697.25.

Using 14 % as the discount rate the net present value of machine B is negative $100.50.

REQUIRED

(c) Calculate the net present value for machine A at 7 % cost of capital. [12]

(d) Advise the directors of Namllih Ltd which machine they should purchase. Give reasons for your advice. [8]

(e) Calculate the internal rate of return for your chosen machine. Show your workings. [6]

[Total: 40]

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