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.

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UNIVERSITY of CAMBRIDGE International Examinations

[Turn over

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 depreciation	NBV
	$	$	$
Fixed assets			
Intangible fixed asset			
Goodwill	110 000		110 000
Tangible fixed assets			
Freehold land	80 000		80 000
Premises	310 000	50 000	260 000
Vehicles	220 000	160 000	60 000
	720 000	210 000	510 000
Investments at cost			210 000
Current assets			
Stock		40 000	
Trade debtors		56 000	
Cash		4 000	
		100 000	
Creditors: amounts falling due within one year			
Trade creditors	80 000		
Bank overdraft	100 000	180 000	
Net current liabilities			(80 000)
			640 000
Creditors: amounts falling due after more than one year			
8% Debenture (2021) (secured on the freehold land)			100 000
			540 000
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			(410 000)
			540 000
Authorised share capital			
1 000 000 ordinary shares of $1 each			1 000 000
500 000 8% preference shares of $1 each			500 000

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

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]