CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Advanced Level

MARK SCHEME for the October/November 2014 series

9706 ACCOUNTING

9706/43 Paper 4 (Problem Solving – Supplement), maximum raw mark 120

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CAMBRIDGE
International Examinations

1 **(a)** Finance costs = 75 000
5625 **(1)** × 8% **(1)** × 2/12 **(1)** = 75 **[3]**

(b) Profit before tax = 3296 – 75 = 3221 **(1)OF**
Profit attributable to equity holders = 3221 – 782 = 2439 **(1)OF** **[2]**

(c)

Profit from operations	3296	**(1)**
Depreciation	2050	**(1)**
Gain on disposal	(395)	**(1)**
Dividends received	(750)	**(1)**
Increase in inventories	(389)	**(1)**
Increase in trade receivables	(404)	**(1)**
Increase in trade payables	939	**(1)**
	4347	
Interest paid	(75)	**(1)OF**
Tax paid	(579)	**(3)**
Net cash from operating activities	3693	**(1)OF**

609 * + 782 (**1) –** 812 * **1 both** = 579 **(1) of**

[12]

(d) Statement of cash flows for year ended 30 June 2014

	$		$	
Cash flow from operating activities			3693	**(1)OF**
Cash flows from investing activities				
Purchase of property, plant and equipment (W1)	(11 401)	**(4)**		
Proceeds from property, plant and equipment	520	**(1)**		
Dividends received	750	**(1)**		
Net cash used in investing activities			(10 131)	**(1)OF**
Cash flows from financing activities				
Proceeds from share issue	1500	**(1)**		
Proceeds from issue of debentures	5625	**(1)**		
Dividends paid	(150)	**(1)**		
Net cash from financing activities			6975	**(1)OF**
Net increase in cash and cash equivalents			537	**(1)OF**
Cash and cash equivalents at start of year			(83)	**(1)**
Cash and cash equivalents at end of year			454	**(1)OF**
W1				**(+1)CF**
Purchase of property, plant and equipment				
Property, plant and equipment at start of period	10 509	**(1)**		
Depreciation	(2050)	**(1)**		
NBV of disposed property, plant and equipment	(125)	**(1)**		
Property, plant and equipment at end of period	(19 735)	**(1 both)**		
Property, plant and equipment additions	(11 401)	**(1)OF**		

[16]

(e) **(i)** Non-adjusting.**(1)** Note to the accounts. **(1)**

(ii) Adjusting. **(1)** Write off in the accounts. **(1)**

(iii) Non-adjusting. **(1)** The dividend of $120 000 **(1)** should be treated as a note to the accounts. **(1)** **[7]**

[Total: 40]

2 **(a)** Budgeted income statement for year ended 30 June 2015

	$	$	
Revenue ($3 000 000 × 1.6 × 1.1)		5 280 000	**(1)**
Cost of goods sold (60% of sales)		3 168 000	**(1)OF**
Gross profit (40% of sales		2 112 000	**(2)OF**
Less: Operating expenses			
Administrative salaries ($700 000 × 1.05)	735 000		**(1)**
Heating and lighting ($98 000 × 1.05)	102 900		
Rent and rates ($340 000 × 1.05)	357 000		**(1)**
Sundry expenses ($72 000 × 1.05)	75 600		
Depreciation:			
Plant and machinery ($300 000 + $220 000) × 20%	104 000		**(1)**
Motor vehicles ($240 000 + $130 000) × 20%	74 000		**(1)**
Provision for doubtful debt ($5 280 000 / 12) **(1)** × 2% **(1)**	8800		
Salaries to salesmen	123 000		**(1)**
Commission to salesmen (5 280 000 × 3%)	158 400		**(1)OF**
Loan interest $100 000 × 10%	10 000		**(1)**
	1 748 700		
Bonus ($2 112 000 – $1 748 700) **(1)** × (5 / 105) **(1)**	17 300	1 766 000	
Budgeted net profit for the year		346 000	**(1)OF**

[16]

Gross profit for 2014 is 45% ($1 350 000 / $3 000 000). It will be reduced by 5% in 2015, which is 40% (45% – 5%).

(b) Bank account (for the year 2015)

	$			$	
Balance b/d	86 000		Plant & machinery	220 000	**(1)**
Trade receivables ($5 280 000 × 11/12) **(1)OF** + $245 000 **(1)**	5 085 000		Motor vehicles	130 000	
			Trade payables		
Loan	100 000	**(1)**	($3 228 000 × 10 / 12) **(1)OF** + $186 000) **(1)**	2 876 000	
Share capital	250 000		Administrative salaries ($735 000 + $9 000)	744 000	**(1)**
			Heating and lighting	102 900	
			Rent and rates	357 000	
			Sundry expenses	75 600	
			Salaries to salesmen	123 000	
			Balance c/d	892 500	**(1)OF**
	5 521 000			5 521 000	

Calculation of purchases:

Given that opening inventory $120 000; closing inventory $180 000 and cost of goods sold $3 168 000, purchases for the year is:

$3 168 000 + $180 000 – $120 000 = $3 228 000 **[8]**

(c) Budgeted statement of financial position at 30 June 2015

Assets	$000		$000	
Non-current assets				
Plant and machinery	520	**(1)**		
Accumulated provision for depreciation	264	**(1)OF**	256	
Motor vehicles	370	**(1)**		
Accumulated provision for depreciation	224	**(1)OF**	146	
			402	
Current assets				
Inventory	180			
Trade receivables	431.2	**(1)OF**		
Cash and cash equivalent	892.5	**(1)OF**	1503.7	
Total assets			1905.7	
Equity and liabilities				
Equity				
Ordinary shares			450	
Retained earnings ($286 + $346)			632	**(1)OF**
			1082	
Non-current liabilities				
Loan			100	**(1)**
Current liabilities				
Trade payables	538	**(1)OF**		
Accrued commission	158.4	**(1)OF**		
Accrued bonus	17.3	**(1)OF**		
Accrued interest	10	**(1)OF**	723.7	
Total equity and liabilities			1905.7	

[12]

(d) **1** For planning purpose – a budget serves as a blueprint; it sets the direction / target for the business to achieve

2 For controlling purpose – a budget serves as a yardstick; it sets the standard / frame and the managers are aware that the actual expenditure will not exceed the budgeted expenditure.

3 For performance evaluating purpose – the actual result is compared to the budgeted; the managers are accountable to any departure from the budget (i.e. actual expenditure in excess of the budgeted expenditure). **[4]**

Any 2 points, 2 marks each

[Total: 40]

3 **(a)** Annual profit = [6 000 000 – 5 600 000 – 300 000] = $100 000 **(1)**

Years to clear loss (2014, 2015, 2016, 2017) = 4 **(1)**

First year for dividend 2018 **(1)** **[3]**

(b) Capital reduction scheme **(1)**. Face value of each share is <u>reduced</u> **(1)** to eliminate the debit balance on retained earnings **(1)**.
Face value = 1.6m / 2m = $0.80 **(2)** **[5]**

(c)

Year	Cash flows $000	Discount factor	Net cash flow $000	
0 (2014)	(400) **(1)**	1	(400.00)	**(1)OF**
1 (2015)	500 – 300 **(1)** = 200 **(1)**	0.909	181.80	**(1)OF**
2 (2016)	700 – 490 **(1)** = 210 **(1)**	0.826	173.46	**(1)OF**
3 (2017)	1100 – 740 **(1)** = 360 **(1)**	0.751	270.36	**(1)OF**
4 (2018)	300 – 610 **(1)** = (310) **(1)**	0.683	(211.73)	**(1)OF**
			13.89	**(1)OF**

[15]

(d)

IRR = 10% **(1)** + 5% **(1)** $\left(\dfrac{13\,890 \textbf{ (1)OF}}{13\,890 + 7\,830 \textbf{ (1)OF}} \right)$

= 13.2% **(1)OF**

[5]

(e) Average profit = $\dfrac{(200 + 210 + 360 - 310) \textbf{ (1)OF} - 400 \textbf{ (1)}}{4 \textbf{ (1)}}$

= 15 000 per annum **(1)OF**

Average capital = 200 **(1)**

ARR = 15 / 200 = 7.5% **(1)OF** **[6]**

(f) The directors should purchase the machinery **(1)**. NPV is positive **(1)**. IRR is greater than cost of capital **(1)**.
Directors might consider stopping project at the end of year 3 **(1)** to avoid the loss making year **(1)**. Stopping early might mean there is a second hand value to the machinery **(1)**.

[6]

[Total: 40]