UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Level

**ACCOUNTING** **9706/41**

Paper 4 Problem Solving (Supplementary Topics) **May/June 2011**

**2 hours**

Additional Materials: Answer Booklet/Paper

*2206719093*

**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.
International accounting terms and formats should be used as appropriate.
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.

DC (CW) 32111/4


UNIVERSITY *of* CAMBRIDGE
International Examinations

**1** Deed Ltd has a financial year end of 31 December. It is a retail business which has failed to trade successfully for several years. In January 2011 the directors discovered that this was due to the incompetence and dishonesty of the manager who was then dismissed.

A draft statement of financial position (balance sheet) at 31 December 2010 showed the following:

Deed Ltd
Draft statement of financial position (balance sheet) at 31 December 2010

| | $ Cost | $ Depreciation | $ N B V |
|---|---|---|---|
| **Non-current assets** | | | |
| Fixtures and fittings | 52 000 | 25 120 | 26 880 |
| Delivery vehicle | 20 000 | 12 800 | 7 200 |
| | 72 000 | 37 920 | 34 080 |
| **Current assets** | | | |
| Inventory | | 33 995 | |
| Trade receivables | | 18 300 | |
| Cash and cash equivalents | | 7 500 | |
| | | 59 795 | |
| **Current liabilities** | | | |
| Trade payables | 19 195 | | |
| Other payables | 4 200 | 23 395 | |
| | | | 36 400 |
| | | | 70 480 |
| **Equity** | | | |
| 100 000 ordinary shares of $1 each | | | 100 000 |
| Retained earnings | | | (29 520) |
| | | | 70 480 |

Other information is as follows:

1. The bank reconciliation statement at 31 December 2010 showed:

| | $ |
|---|---|
| Bank balance per cash book | 7 500 |
| Outstanding lodgements | (10 000) |
| Unpresented cheques | 7 900 |
| Balance per bank statement | 5 400 |

   Investigation showed that $8000 of the outstanding lodgements had not been paid into the bank and had been stolen by the manager.

2. The company rents its premises. In October 2010 it suffered a fire. No provision had been made as the company had expected the insurance company to pay. It was discovered that the manager had not paid the insurance premium and that Deed Ltd would have to pay $9000 for the repairs.

3. The manager has valued the inventory at cost. The inventory at 31 December 2010 included 1000 damaged items which had cost $3 each, and which were being offered for sale at $2 each.

4. The manager had failed to follow up slow paying credit customers. The trade receivables figure was found to include $1200 of debts which had been outstanding for so long that they were now considered to be irrecoverable.

5 The fixtures and fittings at cost included $2000 of items which had been purchased by Deed Ltd on 1 January 2009. It was discovered that they were in fact delivered to the manager's private address for his own use.
The company policy is to depreciate fixtures and fittings at a rate of 20% a year on the reducing balance basis.

**REQUIRED**

**(a)** Calculate the balance of retained earnings at 31 December 2010 after adjusting for items 1–5. [9]

The directors of Deed Ltd believe that after the departure of the manager the company can return to profitability. The company has been unable to pay a dividend for several years. It now intends to use a capital reduction scheme so that future profits can lead to dividends.

**REQUIRED**

**(b)** Calculate the face value of **each** share after the capital reduction scheme. [5]

**(c)** Prepare a statement of financial position (balance sheet) for Deed Ltd at 31 December 2010 after adjusting for items 1–5 and the capital reduction scheme.
Show the number of issued shares and their face value. [12]

**(d)** Name **three** types of capital reserve. [6]

**(e)** Give **two** characteristics of **each** of the following:

**(i)** revenue reserves;

**(ii)** capital reserves.

[8]

**[Total: 40]**

**2** **A** Ukamaka and Chinedu have been in partnership for some years.

Details of the partnership for the year ended 31 December 2010 are as follows:

| | Ukamaka | Chinedu |
|---|---|---|
| Fixed capitals | $100 000 | $80 000 |
| Profit sharing ratio | 60% | 40% |
| Annual salaries | $12 000 | $6000 |
| Interest on capital | 10% | 10% |
| Annual interest on drawings | $1200 | $900 |

For some years these details have remained unchanged and the partnership has made a profit for the year of $72 000.

Chinedu owns, in a personal capacity, a number of shares in Knopf plc which pay an annual dividend of $0.15 per share. The market value of the shares is $2 each. He also has $25 000 in a personal savings account paying him interest at 4%.

Ukamaka and Chinedu now wish to buy the business premises which they have previously been renting for $8800 a year. The purchase price of the premises is $95 000. They are considering two alternative means of financing this.

Option 1

Chinedu could sell his shares and close his savings account to raise $95 000, paying the proceeds into the partnership bank account. This would increase his fixed capital.

Option 2

The partnership could take out a bank loan of $95 000 with an annual interest rate of 8%.

**REQUIRED**

**(a)** Calculate Chinedu's total annual income under

**(i)** option 1 [8]

**(ii)** option 2. [11]

**(b)** State the advantages of each option and recommend with reasons which Chinedu would prefer. [4]

**B** Adichie plc has the following statement of financial position (balance sheet) at 31 December 2010:

| | $ |
|---|---|
| **Net assets** | 820 000 |
| | |
| **Equity** | |
| 600 000 ordinary shares of $1 each | 600 000 |
| 100 000 redeemable ordinary shares of $0.50 each | 50 000 |
| Share premium | 20 000 |
| Retained earnings | 150 000 |
| | 820 000 |

The directors intend to redeem the redeemable ordinary shares at a premium of $0.05 per share. They had originally been issued at a premium of $0.10 per share.

The directors intend at the same time to issue 20 000 new ordinary shares at an issue price of $1.60.

**REQUIRED**

**(a)** Prepare the statement of financial position (balance sheet) of Adichie plc immediately after these transactions have taken place. [9]

**(b)** Give **one** reason why a company might want to buy its own shares. [3]

**(c)** State by what means a company may purchase its own shares. [3]

**(d)** State **one** similarity and **one** difference between a rights issue and a bonus issue of shares. [2]

**[Total: 40]**

**3** Echoes plc has the following statement of financial position (balance sheet) at 30 April 2011.

| | $000 Cost | $000 Depreciation | $000 N B V |
|---|---|---|---|
| **Non-current assets** | | | |
| Land and buildings | 1200 | 50 | 1150 |
| Equipment | 230 | 90 | 140 |
| Motor vehicles | 210 | 115 | 95 |
| | 1640 | 255 | 1385 |
| **Current assets** | | | |
| Inventory | | 150 | |
| Trade receivables | | 122 | |
| Prepaid rates and insurance | | 8 | |
| | | 280 | |
| **Current liabilities** | | | |
| Trade payables | 75 | | |
| Tax | 30 | | |
| Cash and cash equivalents | 15 | 120 | |
| | | | 160 |
| | | | 1545 |
| **Equity** | | | |
| Ordinary shares of $0.50 each | | | 800 |
| Share premium | | | 100 |
| Retained earnings | | | 645 |
| | | | 1545 |

Sales and purchases budgets have been produced for Echoes plc for the year ending 30 April 2012 as follows:

| | $000 Sales | $000 Purchases |
|---|---|---|
| May to February | 1060 | 560 |
| March | 100 | 60 |
| April | 100 | 60 |
| Total | 1260 | 680 |

Other information is as follows:

1 All sales are on credit.

50% of customers pay in the month after sale and the remaining customers pay in the second month.

On 1 May 2011 the company is introducing a 5% cash discount for customers paying in the month after sale, applicable to sales made on or after that date.
Discount will only be accounted for when funds are received.

2 Purchases accrue evenly over the month. The company pays its suppliers 1½ months after receipt of goods.

3 The company pays rates six months in advance on 1 June and 1 December each year. Each payment amounts to $9000.

4 The company pays an annual premium for insurance, in advance, on 1 October each year. It is expected that in 2011 the premium will be $30 000.

5 All other selling, distribution and administration payments for the year, including wages and salaries, are expected to amount to $184 000.

6 The company plans to modernise its equipment and upgrade its vehicles during the year.

It plans to sell all the vehicles for $80 000 and buy new ones at a total cost of $400 000.

It also plans to sell half the equipment for $75 000 and replace it with new equipment costing $310 000.

7 The cost of land and buildings is split $800 000 for the land and $400 000 for the buildings.

8 The company provides a full year's depreciation on non-current assets purchased during the year but none in the year of disposal. Annual depreciation rates are:

| | |
|---|---|
| Buildings | 2.5% on cost |
| Equipment | 20% on cost |
| Motor vehicles | 30% on net book value |

9 The company plans to issue 100 000 new shares at a price of $1.70 on 1 July 2011 to part fund the purchase of the non-current assets.

It also plans to issue $300 000 6% debentures, redeemable in 2028, on 1 July 2011. The first interest payment on the debentures will be paid on 30 April 2012.

10 Tax is provided for at 20% of profit after finance charges and is paid ten months after the financial year end.

11 Inventory is expected to increase by 10% over the year.

12 The company intends to pay a dividend of $0.03 per share on 30 June 2011.

**REQUIRED**

**(a)** Calculate the bank balance expected on 30 April 2012. [14]

**(b)** Prepare the forecast income statement (profit and loss account) for the year ending 30 April 2012. [12]

**(c)** Prepare the statement of financial position (balance sheet) at 30 April 2012. [14]

**[Total: 40]**

**BLANK PAGE**

 