UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

ACCOUNTING **9706/04**

Paper 4 Problem Solving (Supplementary Topics) **May/June 2007**

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.

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

UNIVERSITY *of* CAMBRIDGE International Examinations

[Turn over

1 Amandeep, Bruce and Chetan have been in partnership trading as Abcan. They share profits and losses in the ratio 3 : 2 : 1 respectively. Gurpreet and Hibo have been in partnership trading as Gurbo. They share profits and losses equally.

At 31 March 2007 the summarised balance sheets of both businesses were as follows:

		Abcan	Gurbo
		$	$
Premises		100 000	70 000
Machinery		35 000	13 000
Vehicles		78 000	-
Investments at cost		12 000	-
Stock		10 000	5 000
Debtors		14 000	9 000
Balance at bank		8 500	4 000
		257 500	101 000
Less Creditors		7 500	6 000
		250 000	95 000
Less 8 % Loan from Chetan		30 000	
		220 000	
Capital accounts -	Amandeep	100 000	
	Bruce	70 000	
	Chetan	50 000	
	Gurpreet		50 000
	Hibo		45 000
		220 000	95 000

The partners agreed to form a limited company, ABCOGH Ltd, to take over both businesses.

All Abcan's assets were transferred to ABCOGH Ltd with the exception of three vehicles, investments, debtors and balance at bank.

The agreed values of assets taken over by the company are:

	Abcan	Gurbo
	$	$
Premises	170 000	100 000
Machinery	30 000	10 000
The remaining vehicles	40 000	-
Stock	9 000	5 000

The purchase consideration for Abcan was $240 000 as follows:

1 57 000 7 % preference shares of $1 each to be distributed in profit sharing ratios;

2 sufficient 6 % debenture stock to give Chetan the same return as he had received on his loan to the partnership;

3 the balance as ordinary shares of $1 at a premium of $0.30 per share distributed to the partners in proportion to their capital account balances at 31 March 2007.

Abcan collected $12 900 cash from debtors. Creditors accepted $7100 in full settlement of amounts due to them.

The three vehicles which have been used by the partners were taken over by them as follows:

Partner	Agreed takeover price
	$
Amandeep	10 000
Bruce	7 500
Chetan	7 800

The investments at cost were purchased by Bruce at an agreed value of $13 400.

The purchase consideration for Gurbo was $134 000 as follows:

1 43 000 7 % preference shares of $1 each to be distributed in profit sharing ratios;

2 the balance as ordinary shares to be shared equally.

Costs involved in dissolving the Abcan partnership amounted to $6400; costs to dissolve the Gurbo partnership were $3100.

Gurbo collected $7000 cash from debtors. Creditors were paid the amounts due to them.

REQUIRED

(a) Prepare partnership capital accounts at 31 March 2007 for **both** businesses to show the closing entries in both sets of partnership books of account. [27]

It was agreed that the issued ordinary share capital would be held as follows:

Amandeep	30 %
Bruce	10 %
Chetan	20 %
Gurpreet	20 %
Hibo	20 %

It was further agreed that the transfer price of any ordinary shares would be $1.30 per share.

REQUIRED

(b) Calculate the number of ordinary shares received by each partner. [3]

(c) Calculate the amounts of cash payable or receivable by each shareholder to achieve the required shareholding. [3]

(d) Prepare a balance sheet for ABCOGH Ltd at 31 March 2007 immediately after incorporation. [5]

(e) Explain briefly **one** possible reason why the partners decided to change their business into a limited company. [2]

[Total: 40]

2 The following information relates to the business of Lopez Ltd for the year ended 31 March 2007:

Rate of stock turnover (calculated using average stock)	20 days
Gross margin	50 %
Net margin	15 %
Dividend paid as percentage of net profit	25 %
Creditors' payment period	32 days
Debtors' collection period	28 days
Current ratio	3 : 1

Issued share capital 500 000 ordinary shares of $0.50 each.

Profit and loss account balance at 1 April 2006 was $73 424.

Stock at 1 April 2006 was valued at $10 000.

Stock at 31 March 2007 was valued at $14 000.

The market price of an ordinary share in Lopez Ltd at 31 March 2007 was $0.80.

REQUIRED

Note: work to the nearest $

(a) Prepare a trading and profit and loss account for the year ended 31 March 2007 in as much detail as possible. [8]

(b) Prepare a balance sheet at 31 March 2007 in as much detail as possible. (Fixed assets and balance at bank are balancing figures.) [9]

The following statistics have been prepared by a local bank. They relate to similar businesses in the same district as Lopez Ltd.

Dividend yield	5.6 %
Dividend cover	3 times
Dividend per share	10.7 cents
Earnings per share (EPS)	32 cents
Price earnings ratio	5.9

REQUIRED

(c) Explain what **each** of the **five** ratios indicates. [5]

(d) Calculate the same **five** ratios for Lopez Ltd. Show the formulae that you have used. [10]

(e) Discuss the **five** ratios calculated for Lopez Ltd and comment on what they show about the company. [8]

[Total: 40]

3 Tesda plc is a supermarket chain. They have been offered the choice of two five-year leases on supermarkets abroad. Lack of finance means that they can choose only **one** of them.

The directors have projected the following forecasts:

The lease on supermarket A will cost $5m.

The lease on supermarket B will cost $8m.

They expect cash receipts and payments to be as follows:

	Without leasing either new supermarket	With supermarket A	With supermarket B
Year	$	$	$
Total receipts			
1	61 m	63.6 m	63.9 m
2	64 m	67.7 m	69.4 m
3	67 m	71.2 m	73.3 m
4	71 m	75.5 m	77.9 m
5	75 m	80.1 m	83.4 m
Total payments			
1	20 m	21.8 m	21.8 m
2	23 m	25.0 m	25.7 m
3	27 m	29.2 m	30.3 m
4	32 m	34.4 m	35.9 m
5	38 m	40.6 m	42.7 m

Assume all receipts and payments occur at the end of the respective year.

Additional information:

Estimated additional costs	Supermarket A	Supermarket B
Additional working capital required at start of lease	$0.6 m	$1 m
Improvements end of year 2	-	$1.8 m
Improvements end of year 3	$2.9 m	-
Improvements end of year 4	-	$1 m
Depreciation	$0.5 m per annum	$0.7 m per annum

REQUIRED

(a) Calculate the estimated annual net cash flows for

(i) Supermarket A [3]

(ii) Supermarket B [3]

(b) Calculate the accounting rate of return (ARR) for

(i) Supermarket A [7]

(ii) Supermarket B [7]

The following are extracts from present value tables for $1:

Year	8 %	14 %
1	0.926	0.877
2	0.857	0.769
3	0.794	0.675
4	0.735	0.592
5	0.681	0.519

The current cost of capital for Tesda plc is 8 %.

REQUIRED

(c) Calculate the net present value for

(i) Supermarket A [6]

(ii) Supermarket B [6]

(d) Identify the supermarket that Tesda plc should lease. Explain your choice. [3]

The net present value for **each** supermarket using a cost of capital of 14 % is estimated to be:

Supermarket A $1 057 900 negative

Supermarket B $2 127 600 negative

REQUIRED

(e) Calculate the internal rate of return (IRR) for the supermarket chosen in **(d)**. [5]

[Total: 40]

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