

# ACCOUNTING

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## GCE Advanced Level and GCE Advanced Subsidiary Level

<b>Paper 9706/01</b>
<b>Multiple Choice (Core)</b>

<i>Question Number</i>	<i>Key</i>	<i>Question Number</i>	<i>Key</i>
1	<b>B</b>	16	<b>D</b>
2	<b>D</b>	17	<b>D</b>
3	<b>B</b>	18	<b>A</b>
4	<b>B</b>	19	<b>A</b>
5	<b>A</b>	20	<b>D</b>
6	<b>D</b>	21	<b>A</b>
7	<b>A</b>	22	<b>B</b>
8	<b>B</b>	23	<b>D</b>
9	<b>C</b>	24	<b>C</b>
10	<b>C</b>	25	<b>C</b>
11	<b>C</b>	26	<b>C</b>
12	<b>A</b>	27	<b>B</b>
13	<b>A</b>	28	<b>B</b>
14	<b>D</b>	29	<b>A</b>
15	<b>C</b>	30	<b>B</b>

### General comments

4097 candidates took this paper. The mean score was 16.7 out of 30 and the standard deviation was 4.8.

All items were within the scope of the syllabus.

Three items (**5**, **12** and **23**) were too easy. Two items (**19** and **20**) fell below the design limit of 25% and were therefore found to be too difficult.

### Comments on specific items

#### **Item 4**

Only 26% of candidates correctly chose **B** while 41% chose **C**. The discrimination index was 0.18 (design limit 0.25). This indicates the insecurity of many candidates when reconciling a cash book when the bank is in overdraft. Candidates failed to note the significance of the credit balance in the cash book. More pre-examination practice is required on cash book reconciliation when the account is overdrawn.

#### **Item 19**

22% of candidates correctly chose **A** while 53% chose **C**. The discrimination index was 0.08. If unsure about which is the correct key, it takes little time (well within the two minutes available for the item) to make up a simple working capital statement and adjust it for stock bought on credit to see what happens to the ratios.

### Item 20

Only 15% chose the correct key while 55% chose **B**. The discrimination index was 0.21. Altogether, a surprising 67% showed that they do not understand gross profit percentage. A margin of 40% results from a mark up of 66.7%. Mark up is constant regardless of the amount of sales revenue and the gross profit percentage consequently remains unchanged.

### Item 26

41% correctly identified the key and the discrimination index was 0.21. 30% selected **B**. Perhaps this is not altogether surprising as it is evident from written papers that too many candidates do not properly understand overhead over/under absorption. This is generally a result of not understanding how overhead absorption rates are calculated. More attention should be given to overhead absorption and under/over-recovery.

### Item 30

33% chose the correct key but 38% chose **C**. The discrimination index was 0.17. Most candidates successfully calculated the equivalent units of production but failed to include the sale of waste in their calculations.

### Conclusion

Areas of the syllabus showing particular weakness were Interpretation and Analysis (Section H) and Overhead Absorption (Section J).

<p><b>Paper 9706/02</b> <b>Structured Questions</b></p>
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### General comments

Generally a good response, though it was obvious that some candidates had not understood areas of the syllabus, such as FIFO, LIFO and AVCO, but had learned how to apply them by rote learning. And the practical side of **Question 3** tended to be either very well or very badly attempted, suggesting that some candidates had been well taught in this area, whilst for others it had been completely ignored.

Overall, a well-answered paper which awarded marks to those deserving of them.

### Comments on specific questions

#### Question 1

Part (a) was generally correct, with the occasional minor errors of:

- placing the proposed dividend *after* the Net profit brought forward;
- including both provision for depreciation figures.

Part (b) was also correct for the most part, with the following occasional minor errors:

- both depreciation figures included in Fixed Assets;
- proposed dividends in the Financed By section;
- Working Capital (net Current Assets) not named or Net Assets figure given as Working Capital;
- Overdraft shown as a Long Term Liability.

Part (c) often included much relevant information, but not quite what was asked for, i.e. Four trends, that is movements *in one direction* over the three-year period, to be Identified and Commented upon. Fluctuations are not trends.

## Question 2

Parts (a), (b) and (c), were answered correctly up to and including the closing stock valuation, but a large minority stopped there, possibly because they had been taught by rote and did not know how to continue to work out the profit in each case. Marks are of course awarded for work done, but nevertheless some easily gained marks were lost here.

Part (d) gave marks to most candidates, but more than half calculated the new sales value at 7½% of the old sales figure, not taking into account the 10% reduction in price. Also many ignored the request for ratios.

In part (e) a common problem was that of misreading the question, and assuming that the new figures were merely an alteration of the old figures, *for the same year*, to show a better profit. The concepts of Consistency or Prudence were named by many, but not often expanded upon. Where three marks are offered, it is usually expected that three individual comments or points will be made.

## Question 3

In parts (a) and (b) common errors were

- showing the Material Cost figure as Sales;
- adding all of the variable costs together then *deducting* fixed costs and giving the answer as total costs.

Some attempted to work out the answer using unit costs, but few – certainly none seen by the Principal Examiner – succeeded.

In part (c) marks were of course awarded where candidates took wrong figures from part (a) but used the correct methods, yet again some attempted this using unit costs, unsuccessfully. The formulae of Contribution = Sales – Variable Costs or Profit + Fixed Costs were not, apparently, known by a small minority of candidates.

For part (d) the main advantages of Cost or Price were rarely mentioned, nor the advantage of Control not being lost to debenture holders, and many, indeed most answers gave as an advantage that more funds would be available. As this was the object of the exercise, it was not considered a worthy answer.

<b>Paper 9706/03</b>
<b>Multiple Choice (Extension)</b>

<i>Question Number</i>	<i>Key</i>	<i>Question Number</i>	<i>Key</i>
1	<b>C</b>	16	<b>A</b>
2	<b>A</b>	17	<b>C</b>
3	<b>C</b>	18	<b>C</b>
4	<b>A</b>	19	<b>B</b>
5	<b>B</b>	20	<b>A</b>
6	<b>A</b>	21	<b>B</b>
7	<b>A</b>	22	<b>A</b>
8	<b>B</b>	23	<b>B</b>
9	<b>C</b>	24	<b>A</b>
10	<b>C</b>	25	<b>A</b>
11	<b>C</b>	26	<b>C</b>
12	<b>C</b>	27	<b>D</b>
13	<b>B</b>	28	<b>B</b>
14	<b>A</b>	29	<b>A</b>
15	<b>A</b>	30	<b>C</b>

## **General comments**

4598 candidates took this paper. The mean score was 13.4 out of 30 and the standard deviation was 5.2. All items were within the scope of the syllabus.

Two items (**10** and **13**) fell below the facility design limit of 0.25 and were therefore found to be too difficult. Otherwise there were no areas of the syllabus showing particular strengths or weaknesses on the part of the candidates. Nevertheless, some other items call for special comment below.

## **Comments on specific items**

### **Item 3**

Only 29% of candidates selected the key. The discrimination index was 0.9 (design limit 0.25). 32% chose **A** and 25% chose **D** indicating that there was much guessing among the better candidates. As the shares were not redeemed out of a new issue, the premium on redemption could not be charged to Share Premium account. The Capital Redemption Reserve should equal the nominal value of the shares redeemed. This topic needs more attention.

### **Item 8**

34% selected the key. 60% guessed either **A** or **D** indicating that little attention had been given to this topic in the study of published company accounts. More attention should be given to this topic and, if possible, candidates should be given the opportunity to see actual published accounts.

### **Item 9**

34% selected the key. 52% guessed either **A** or **D**. This again indicated lack of knowledge about published company accounts.

### **Item 10**

Apparently only 23% had been told the reason for the introduction of Accounting Standards. Up to the end of the 1960s there were no recognised standards which companies followed to record certain transactions. This led to confusion and uncertainty when interpreting their financial statements. Accounting Standards were introduced to counter this situation. It is not surprising that 69% selected **D** because they recognised accounting bases as a subject of one of the standards.

### **Item 13**

23% selected the key. 32% did not know that loan stock is not part of shareholders' funds and chose **A**. 37% failed to deduct interest on the loan stock from operating profit. This topic would repay more attention. More emphasis should be given to the distinction between profit before interest and earnings (after interest, tax and preference dividend) on ordinary shares.

### **Item 15**

29% selected the key, 27% selected **B**, 23% selected **C** and 22% selected **D**. There was clearly much guessing here and certainly obvious inability to calculate earnings and dividend. Dividend cover is not understood by many candidates. This item has identified weaknesses which require a little more attention in preparation for the A2 syllabus. Better preparation is required on this topic.

### **Item 19**

49% correctly selected the key. 23% selected **C** which would increase the creditors shown in the Balance Sheet. This could hardly be described as "window dressing". Window dressing should be explained more clearly to candidates especially as it is very topical just now as one cause of the global stock markets being in turmoil.

## Item 21

28% selected the key, but 34% selected **A** and 28% selected **C**. There may have been a lot of guessing here, but the topic of maximising profit when there are limiting factors such as shortage of material or labour obviously needs more attention. It is a regular examination topic at this level.

<p><b>Paper 9706/04</b> <b>Problem Solving (Extension)</b></p>
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### General comments

This was the first Problem Solving paper set under the new syllabus. All the questions were within the syllabus and the required depth of responses was appropriate to A level.

Although a specimen paper had been issued with the new syllabus many candidates were no doubt unfamiliar with the new format. This, together with the absence of past Problem Solving papers on which to practice, may have accounted to some extent for the generally disappointing standard of many entries. That apart, there was plenty of evidence that candidates had been inadequately prepared on the topics in the A level syllabus. Possibly some candidates had experienced difficulty in preparing to take the AS and A levels together instead of taking them in separate diets.

This report attempts to identify the weaknesses in candidates' knowledge and skills and will repay close attention in the preparation of future candidates.

### Comments on specific questions

#### Question 1

(a) Candidates were required to calculate six common investment ratios. Many candidates did not know how to calculate the ratios or to present the answers. The principal errors were

- wrong models used for the ratios
- preference dividend not deducted from profit before calculating dividend cover
- the \$ sign omitted from the earnings per share
- omission of the % sign from the dividend yield
- failure to calculate and take debenture interest into account in gearing.

(b) Very few candidates offered any helpful explanations on the importance of the ratios to investors. It was common to find that candidates did little more than repeat the models for calculating the ratios they had already demonstrated in (a). Candidates should be advised that if in this type of question they make a statement which invites the question 'how?' or 'why?', they have not given a satisfactorily complete explanation and are not likely to gain marks. Thus the statement that 'this ratio is useful to shareholders or investors to see how efficiently the company is performing' is not sufficient. Reference should have been made to risk, confidence and other relevant factors. Questions testing knowledge with understanding require A level candidates to show more depth in their responses; this does not necessarily mean longer answers. Typical errors were:

- interest cover shows how many times the interest covers the profit. (Inversion)
- interest cover shows whether the company can pay the interest (confusion of profitability with liquidity).
- dividend cover shows how many times the dividend covers the profit. (Inversion)

- failure to distinguish between operating profit (for interest cover) and earnings (for dividend cover)
  - failure to recognise the risk to shareholders imposed by low interest and dividend covers
  - failure to recognise that the price/earnings ratio is a measure of investors' confidence in the future performance of the company
  - no explanation of why high gearing poses risk to shareholders.
- (c)** Candidates did little more than repeat the ratios for 2001 and 2002 or, worse, say that the ratios went 'up' or 'down'. Comments in this type of question should be supported with relevant figures. In some cases, candidates failed to read the question carefully and took the 2001 ratios as occurring after those of 2002 so that their answers were nonsensical. There was little attempt to interpret the ratios in the light of explanations in **(b)** mainly because the responses to **(b)** had been so weak.
- (d)** There was a very disappointing tendency for candidates to grasp at isolated accounting ratios from the AS syllabus. Gross profit percentage, net profit percentage, current ratio and the acid test in isolation cannot help candidates assess the future performance of Oitar plc. Such ratios were only acceptable if mentioned in the context of trend analysis and/or inter firm comparison. Rarely did candidates want to see directors' and auditors' reports for vital information that might be contained in them. In short, candidates showed little imagination in this part. A very few commendably referred to external factors such as economic and market conditions, the existence of competition, or to labour relations, skills and training within Oitar plc.

## Question 2

- (a)(i)** This was generally well done and candidates boosted their marks with their responses to this question. However, common errors were
- retention of goodwill in the Balance Sheet after it had been written off
  - an increase in the bank balance following the exchange of the old shares for the new shares
  - the retention of the old \$1 shares in the Balance Sheet together with the new \$0.55 shares
  - a balance remaining on the Profit and Loss Account
- (ii)** Most candidates merely repeated the information given in the question concerning the elimination of Goodwill, the writing down of other assets and the elimination of the debit balance on Profit and Loss account. There can be no marks for repeating the question. A common error was to attribute the improved profitability to these Balance Sheet adjustments; the improved profitability was going to be achieved anyway. Few candidates recognised that the Balance Sheet value of the shares had already declined to \$0.55. Some recognised that unless the Profit and Loss Account loss was written off and the assets reduced in value, even with the improved profitability shareholders could not expect any dividend for the next nine years.
- Candidates need to have a better understanding of the purposes and significance of capital reductions and reconstructions.
- (b)(i)** Too few candidates were able to calculate the net present values of Milligan and Bentine correctly. The following errors were common.
- depreciation (a non monetary cost) was not deducted from the additional costs.
  - interest on the loans was either added to or deducted from the costs. It was already in the costs and as monetary item had to be left there.
  - additional receipts and additional costs were discounted in separate operations.
  - Milligan was discounted at 10% but Bentine at 20%. It was imperative that both machines should be calculated at the same cost of capital i.e. 10%.

- (ii) Most candidates correctly selected Milligan because it had the higher net present value. However, a number of candidates who had contrived in (i) to arrive at negative net present values for both machines also recommended the purchase of Milligan. Negative net present values should lead to rejection, not purchase, unless there is some other overriding factor.
- (iii) Calculation of the internal rate of return caused most candidates considerable difficulty. Correctly calculated, the rate of 20% gave Milligan a second positive net present value. Candidates were not used to this and many gave up the attempt to find the internal rate of return. Others used the two positive net present values but used the sum of the values instead of the difference between them. Other candidates found the factors for 30% which gave a negative net present value; their initiative gained them marks. The internal rate of return for Milligan could, and should, have been calculated from the two positive net present values. (The answer was, admittedly, less precise than if one of the net present values had been negative.)

### Question 3

- (a)(i) Candidates generally did this part well. The following points should be observed.
  - Money columns should be headed \$ or \$000.
  - If headed \$000, all amounts should be expressed consistently in 000's.
  - Many candidates failed to calculate the cost of materials on 2 litres per Tontaw.
  - Factory profit should be added to factory cost of production to arrive at the amount transferred to the Trading Account as cost of sales.
  - Factory profit should be added to the Net Profit on Trading in the Profit and Loss Account.
- (ii) Not many candidates were able to calculate the contribution per unit or the fixed overheads correctly and so failed to gain a mark for the break-even point.

The mark for the margin of safety was based on a calculation using the answer to break-even. Many candidates lost the mark for this by not expressing the margin as a percentage as required by the question.
- (b)(i) Flexing the budget demonstrated the weakness of many candidates. A frequent error was the failure to recognise that the fixed overheads should remain unchanged. Many responses to this part reproduced the same statement as that prepared for the actual outturn in (ii).

More attention should be given to flexing budgets with special reference to the different treatment of variable items and fixed expenses.
- (ii) This was done reasonably satisfactorily although the variable direct overheads were nearly always overlooked.
- (c) The majority of candidates were weak when they came to calculating variances; the main points were as follows.
  - The formulae were not known.
  - Variances were incorrectly described as favourable when they should have been adverse and vice versa.
  - Many candidates failed to indicate whether variances were favourable or adverse.
  - Brackets used to describe variances were not acceptable.
  - Variances are expressed in monetary amounts and the omission of the \$ sign resulted in loss of marks.
- (d) This part was rarely done, and even more rarely done correctly. Candidates were unable to calculate the contribution per unit from their answer to (c) and to identify the fixed overheads.

- (e) This was often not attempted either because of poor time management earlier in the paper or because candidates did not know what was required. A common failure was to use the profit of the flexed budget as the starting point instead of the profit in the original budget. The variances calculated in (c) were the adjustments to the original profit required in this part.

### **Conclusion**

Most candidates could have increased their marks (and their grade) considerably with improved technical skill and knowledge. The discursive questions (1 (b), (c), (d) and 2 (a)(ii)) should have been treated in greater depth though not necessarily at greater length. While time management in the earlier parts of the paper would have allowed more time to be spent by some candidates on the last two parts of **Question 3**, time did not appear to be a serious problem for most candidates and did not account much for the shortfall in their expectations.

Symbols used in Economics such as  $\uparrow$  and  $\downarrow$  should not be used in Accounting papers to indicate increases, decreases etc. E-mail language such as U (you) and 4 (for) are not acceptable.