UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level

MARK SCHEME for the November 2004 question paper

9706 ACCOUNTING

9706/04   Paper 4 Problem Solving (Supplementary Topics), maximum raw mark 120

This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which Examiners were initially instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began. Any substantial changes to the mark scheme that arose from these discussions will be recorded in the published *Report on the Examination*.

All Examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes must be read in conjunction with the question papers and the *Report on the Examination*.

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CIE is publishing the mark schemes for the November 2004 question papers for most IGCSE and GCE Advanced Level syllabuses.

Grade thresholds taken for Syllabus 9706 (Accounting) in the November 2004 examination.

	maximum mark available	minimum mark required for grade:		
		A	B	E
Component 4	120	92	82	44

The thresholds (minimum marks) for Grades C and D are normally set by dividing the mark range between the B and the E thresholds into three. For example, if the difference between the B and the E threshold is 24 marks, the C threshold is set 8 marks below the B threshold and the D threshold is set another 8 marks down. If dividing the interval by three results in a fraction of a mark, then the threshold is normally rounded down.

GCE A LEVEL

MARK SCHEME

MAXIMUM MARK: 120

SYLLABUS/COMPONENT: 9706/04

ACCOUNTING
Paper 4 Problem Solving (Supplementary Topics)

1 **(a)** **Rengaw Ltd**

Balance Sheet after redemption of shares and debentures

	$000	$000	$000
Fixed assets			142
Current assets			
Stock		82	
Debtors		30	
		112	
Current liabilities **(1) (1) (1)**			
Bank overdraft (28 - 42 + 45 - 36)	5 **(1)**		
Creditors	59		
Proposed dividend	8	72	40
			182 **(1) OF**
Capital and reserves			
Ordinary shares of $1 (80 + 30) (must be shown as single item)			110 **(1)**
Share premium			15 **(1)**
Debenture redemption reserve **(1) (1)**			40 **(1)**
Retained profit (65 - 42 - 6)			17
			182 **(2) OF**

[12]

(b) **Cash forecast for four months to January 2005**

	2004 October $000	November $000	December $000	2005 January $000
Cash sales	12 **(1)**	15 **(1)**	14 **(1)**	9 **(1)**
Debtors	<u>30</u> **(1)** <u>42</u>	<u>36</u> **(1)** <u>51</u>	<u>45</u> **(1)** <u>59</u>	<u>40</u> **(1)** <u>49</u>
Creditors	27 **(1)**	32 **(1)**	40 **(1)**	36 **(1)**
Wages	28 **(1)**	28 **(1)**	28 **(1)**	28 **(1)**
Overheads	10 **(1)**	10 **(1)**	10 **(1)**	10 **(1)**
Dividend				8 **(1)**
Purchase of machine	<u>-</u> 65	<u>30</u> **(1)** 100	<u>-</u> 78	<u>-</u> 82
Net payments	(23)	(49)	(19)	(33)
Brought forward	<u>(5)</u> **1 (OF)**	<u>(28)</u>	<u>(77)</u>	<u>(96)</u>
Carried forward	(28)	(77)	(96)	(129) **(1) OF**

[17]

Actions to keep bank balance within overdraft limit

- reduce stock **(1)** by (82 000 - 32 000) $50 000 **(1)**
- delay purchase of machine **(1)** saving $30 000 **(1)**
  Alternatively hire machine **(1)** saving most of $30 000 **(1)**
- increase selling prices by 5% **(1)** if this can be done without decreasing volume **(1)** increasing revenue by $10 000 **(1)**
- reduce cost of purchases by 5% **(1)** $6 000 (1) by obtaining discounts **(1)** or buying from cheaper suppliers **(1)**
- delay payment of dividend **(1)** $8 000 **(1)**
- give incentives to customers to purchase for cash **(1)**
- negotiate longer credit from suppliers if possible without loss of confidence **(1)**
- issue shares **(1)**
- issue debentures **(1)**
- renegotiate overdraft **(1)**

      1 mark for identification
      1 mark for development
      1 mark for effect on bank balance

Max [11]

2 (a) Calculation of operating profit for the year ended 30 June 2004

			$000
Retained profit at::	30.6.2004		31
	30.6.2003		(15)
Retained profit for the year			16 **(1)**
Add: interim dividend paid			21 **(1)**
proposed final dividend			35 **(1)**
transfer to general reserve			20 **(1)**
debenture interest paid	(5 + 3)		8 **(1)**
Operating profit			100

[5]

(b) Reconciliation of operating profit to net cash flow from operating activities

				$000
Operating profit				100 **(1) (OF)**
Depreciation charges				320 **(1)**
Profit less loss on sale of fixed assets:				
Plant and machinery	(10 - 5)	(5)	**(1)**	
Motor vehicles	(7 - 5)	2	**(1)**	(3)
Increase in stock				(13) **(1)**
Decrease in debtors				6 **(1)**
Increase in creditors				12 **(1)**
Net cash inflow from operating activities				422

[7]

(c)   Cash Flow Statement

		$000	$000
Net cash inflow from operating activities			422 **(1) (OF)**
Returns on investment and servicing finance			
Interest paid			(8) **(1) (OF)**
Capital expenditure		(552) **(1)**	
Less proceeds of sales		15 **(1)**	(537)
	(1) (1)		(123)
Equity dividends paid	(25 + 21)		(46)
			(169)
Financing			
Issue of shares			225 **(1)**
Redemption of debentures			(40) **(1)**
Increase in cash			16 **(1)**

[9]

		$000	
(d)	Balance at bank at 30.6.2003	87	**(1) or 0**
	Increase in cash in year ended 30.6.2004	16	**(1) OF**
	Balance at bank at 30.6.2004	103	**(1) or 0**

[3]

(e) Cash flow statements are important to shareholders because they show

- the ability of a business to generate cash internally **(1)**
- how much cash has been raised externally **(1)**
- the causes of change in liquidity **(2)** or cash inflows **(1)** cash outflows **(1)**
- viability **(1)** whether business can generate cash to service finance, pay tax and maintain its fixed assets **(1)** going concern **(1)**
- stability of business **(1)** reliance upon internal sources **(1)** external sources **(1)** for financing
- profitability and liquidity reconciled **(1)** shareholders may confuse profitability with liquidity **(1)**
- indication of future cash flows **(1)**; capital investment (expansion of activities) and its effect on future cash flows **(1)**

(1 mark per point + 1 for development)

max [8]

(f)

Cash Flow Statement	Cash budget
Based on historical data **(1)**	Based on future plans **(1)**
An account of the directors' stewardship of funds **(1)**	For internal use **(1)**
Cannot (legally) be manipulated **(1)**	May be adjusted to reflect management policy **(1)**
A requirement for some companies **(1)**	Desirable for management purposes **(1)**
It may be produced for budgeting purposes **(1)**	Often gives rise to the principal budget factor **(1)**
Max [5]	**Max [5]**

(1 mark per point plus 1 mark for development)

overall max [8]

3 (a) (i) NPV 8%

$

		$
Year 0	Cost	(125 000) **(1)**
1	$30 000 **(1)** X 0.926	27 780 **(1) OF**
2	$30 000 **(OF)** X 0.857	25 710 **(1) OF**
3	$30 000 **(OF)** X 0.794	23 820 **(1) OF**
4	$30 000 **(OF)** X 0.735	22 050 **(1) OF**
	(OF) **(1)**	
5	$(30 000 + 30 000) X 0.681	40 860 **(1) OF**
	NPV **(1)**	15 220 **(1) OF**

[10]

(ii) IRR 14% $

Year 0   Cost   (125 000) **(1)**

1   $30 000 **(OF)** X 0.877   26 310
2   $30 000 **(OF)** X 0.769   23 070
3   $30 000 **(OF)** X 0.675   20 250
4   $30 000 **(OF)** X 0.592   17 760
5   $60 000 **(OF)** X 0.519   31 140
                                                      (6 470) **(1) OF**

(OFS)
(1)   (1)   (1)   (1)

IRR 8% + (6% X $^{15\,220}/_{21\,690}$) = 12 2% **(1)**

[7]

(iii)   ARR   **(1)**   **(1)**   **(1)**   **(1)**
                $^{30\,000\,-\,19\,000}/_{1/2}$ X 155 500 X 100   = 14.29%   **(1) OF**

[5]

(b)   **Budgeted Manufacturing, Trading and Profit and Loss Accounts**

	$	$	
Direct material		22 000	**(1)**
Direct labour		21 000	**(1)**
Prime cost (or cost of production)		43 000	**(1) OF**
Factory profit (10%)		4 300	**(1) OF**
		47 300	
Sales		90 000	**(1) OF**
Cost of sales		47 300	**(1) OF**
Gross profit		42 700	
Administration expenses	17 000 **(1)**		
Depreciation	19 000 **(1)**	36 000	
Net profit on trading		6 700	**(1) OF**
Manufacturing profit		4 300	**(1) OF**
Net profit		11 000	

[10]

(c)

Direct materials usage variance	(4 000 - 4 200)$5.50	$1 100 (A)	**(2/1/0)**
Direct materials price variance	$(5.50 - 5.25)4 200	$1 050 (F)	**(2/1/0)**
Direct labour efficiency variance	(1 750 - 1 500)$12	$3 000 (F)	**(2/1/0)**
Direct labour rate variance	$(12.00 - 12.60)1 500	$ 900 (A)	**(2/1/0)**

Each correct variance **(2)** If $ sign omitted **(1)**

1 mark for direction

[8