CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level

MARK SCHEME for the May/June 2014 series

9706 ACCOUNTING

9706/42 Paper 4 (Problem Solving [Supplement]), maximum raw mark 120

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the May/June 2014 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

1 (a)

Income statement for year ended 31 December 2013

	$		$		
Sales ($85 000 + 20 000 **(1)** – 30 000)			75 000	**(1) of**	
Opening inventory	15 000				
Purchases ($30 000 + 55 000 **(1)** – 25 000) **(1) of**	60 000				
	75 000	**(1) both**			
Closing inventory	30 000		45 000		
Gross profit			30 000	**(1) of**	
Expenses	20 500	**(1)**			
Interest on loan – Tan	2 000	**(1)**	22 500		
Profit for the year			7 500	**(1) of**	**[9]**

(b)

Current account Tan

	$			$	
Balance b/d	4 000	**(1)**	Share of profit	2 500	**(1) of**
			Interest on loan	2 000	**(1) of**
Drawings	2 000		Balance c/d	1 500	
	6 000			6 000	
Balance b/d	1 500	**(1) of**			

[4]

(c)

Capital accounts

	Ann	**Jan**	**Tan**			**Ann**	**Jan**	**Tan**	
	$000	$000	$000			$000	$000	$000	
Goodwill	12	6 **(1) row**			Bal b/d	40	40	30	**(1) row**
Motor vehicle			5	**(1)**	Gain on revaluation	10	10	10	**(1) row**
Current A/c			1.5	**(1) of**	Goodwill	6	6	6	**(1) row**
Bank			67.5	**(1) of**	Loan			30	**(2)**
Bal c/d	44	50							
	56	56	76			56	56	76	
					Bal b/d	44 **(1) of**	50 **(1) of**		

[11]

(d) Dividend yield for XY limited

$$\frac{[100\,000 \times 8\%]\,\mathbf{(1)} \div 100\,00\,\mathbf{(1)}}{\$2\,\mathbf{(1)}} \times 100 = \frac{\$0.08}{\$2} \times 100 = 4\%\ \mathbf{(1)\ of}$$

[4]

(e) Dividend cover for XY limited

$24 000 **(1)** ÷ $8 000 **(1) of** = 3 times **(1) of** **[3]**

(f) Option 1 will provide Tan with a return on his investment of 4% **(1) of**. He can buy $67 500 ÷ 2 share = 33 750 shares **(1) of** which will give him income of 33 750 × $0.08 = $2 700 **(1) of**.

Option 2 will provide him with no return until year 2 **(1)**. This will be just over 2.9% **(1)** ($2000 ÷ 67500) **(1)**.

Option 3 will give a return of 5% **(1)** ($67500 × 5% = $3375) **(1 of)**.

Option 1 may lead to both an increase in dividends in the future **(1)** and also possible capital growth in the value of the share **(1)**. The company looks reasonably secure with a dividend cover of 3 times **(1)** The shareholder would have voting rights **(1)** but no management role **(1)**. Dividends are not guaranteed but dependent on level of distributable profits. **(1)**. Limited liability **(1)**.

Option 2 is less secure **(1)** as his figures are only projections which may or may not happen **(1)**. unlimited liability **(1)**. He will be his own boss **(1)** but this comes with responsibilities **(1)** He can have all available profits but is also liable to all the losses **(1)**.

Option 3 is a safe return **(1)** but no chance of any growth of income or capital **(1)**. guaranteed return **(1)** fixed return **(1)**.

2 marks per option (1) per advantage (1) per disadvantage.
(1) decision (0 – 2) justification. **[Max 9]**

[Total: 40]

2 (a)

Bridlington PLC
Income statement for year ended 30 September 2013

Revenue	936 011	**(1)**
Cost of sales	(484 263)	**(2)**
Gross profit	451 748	**(1) of (narr. req.)**
Distribution costs	(112 967)	**(4)**
Administrative expenses	(262 042)	**(5)**
Profit from operations	76 739	**(1) of (narr. req.)**
Tax	(16 730)	**(1)**
Profit for the year	60 009	**(1) of**

Workings
Cost of sales: 177 838 + 479 352 – 172 927 **(1)** = 484 263 **(1) of**

Distribution costs

Trial balance	108 376			
Prepayment	(2 760)	**(1)**	Depreciation:	
Loss	212	**(1)**	Buildings	11 200
Depreciation	7 139		P + M	10 500
	112 967	**(1) of**	M.V.	6 856
				28 556 **(1)**

Administrative expenses:

Trial balance	236 758		
Accrual	4 525	**(1)**	Provision:
Provision	(1 296)	**(1)**	Receivables 138 450 × 4%
Loss	638	**(1)**	= 5 538
Depreciation	21 417	**(1) split**	Adjustment = 5 538 – 6 834
	262 042	**(1) of**	t = (1 296)

[16]

(b)

	Land	Buildings		Plant and Machinery		Motor vehicle	
Cost							
Balance 1/10/2012	100 000	280 000		95 000		81 000	**(1) row**
Additions				10 000	**(1)**		
Disposal						(16 000)	**(1)**
	100 000	280 000		105 000		65 000	
Depreciation							
Balance 1/10/2012	Zero	78 400		66 500		44 578	**(1) row**
Disposal						(7 000)	**(1)**
Charge	Zero	11 200	**(1) of**	10 500	**(1) of**	6 856	**(1) of**
	Zero	89 600		77 000		44 434	
NBV at 30.09.13	100 000	190 400		28 000		20 566	**(1) of ro**
NBV at 30.09.12	100 000	201 600		28 500		36 422	**(1) row**

[10]

(c) **Assets**

Non-current assets		
Property, plant and equipment	338 966	**(1) of**
Current assets		
Inventories	172 927	
Trade and other receivables	135 672	**(2)**
Cash and cash equivalents	Zero	
	308 599	
Total assets	647 565	
Equity and liabilities		
Equity		
Share capital	400 000	
Share premium	40 000	
Retained earnings	117 395	**(1) of**
	557 395	
Current liabilities		
Trade and other payables	55 768	**(2)**
Tax liability	16 730	**(1)**
Bank overdraft	17 672	**(1)**
	90 170	
Total equity and liabilities	647 565	

Working

Trade and other receivables:			
Trade receivables from TB	138 450		
Provision	(5 538)		
	132 912		
Prepayment	2 760	**(1)**	
	135 672	**(1)**	
Trade and other payables:			
Trade payables from TB	51 243		
Accrual	4 525	**(1)**	
	55 768	**(1)**	**[8]**

(d) **Equity**

Share capital	495 000	**(2)**	
Share premium	20 000	**(2)**	
Revaluation reserve	100 000	**(1)**	
Retained earnings	120 010	**(1) of**	
	735 010		**[6]**

Working

Share capital 400 000 + 50 000 **(1)** + 45 000 **(1)** = 495 000
Share premium 40 000 + 25 000 **(1)** – 45 000 **(1)** = 20 000
Retained earnings 117 395 + 2 615 = 120 010

[Total: 40]

3 **(a)**

Year	Revenue $	Costs $	Interest $	Net cash $	
0	(200 000)			(200 000)	**(1)**
1	110 000	(40 000)	(20 000)	50 000	**(1)**
2	115 500	(41 200)	(20 000)	54 300	**(1)**
3	121 275	(42 436)	(20 000)	58 839	**(1)**
4	127 339	(43 709)	(20 000)	63 630	**(1)**
5	133 706	(45 020)	(20 000)	68 686	**(1)**
Total	407 820	(212 365)	(100 000)	95 455	**(1) of**

[7]

(b)

Year	10% Factor	Net cash flow	Net present value	
0	1.000	(200 000)	(200 000)	
1	0.909	50 000	45 450	**(1) of**
2	0.826	54 300	44 852	**(1) of**
3	0.751	58 839	44 188	**(1) of**
4	0.683	63 630	43 459	**(1) of**
5	0.621	68 686	42 654	**(1) of**
Net present value **(1)**			**20 603**	**(1) of**

[7]

(c) \$95 455 **(1) of** / 5 **(1)** = \$19 091 **(1) of**
19 091 / (200 000 / 2) **(1)** × 100 = 19.09% **(1) of** **[5]**

(d)

Year	40% Factor	Net cash flow	Net present value	
0	1.000	200 000	– 200 000	**(1)**
1	0.714	50 000	35 700	
2	0.510	54 300	27 693	
3	0.364	58 839	21 417	**(1) of** if 40% D.F used
4	0.260	63 630	16 544	
5	0.186	68 685	12 775	
Total			– 85 870	**(1) of**
Internal rate of return			**15.81%**	

10% **(1)** + [30% **(1)** × \$20 603 / \$(20 603 + 85 870) **(1) of**] = 15.81% **(1) of** **[7]**

(e) Drake should invest in Project Sylvania **(1)**, because the accounting rate of return is greater **(1) of**, the net present value is greater **(1) of**, and the internal rate of return is greater **(1) of** than Project Utopia. **[4]**

(f) Interest would not be charged to the project **(1)**, therefore the profits should be higher. This will result in a higher accounting rate of return **(1)**.
ARR = 195 455 / 5 = 39 091 **(1) of** / 100 000 **(1)** = 39.09% **(1) of**.

(g) Preference shares fixed dividend **(1)** in priority to ordinary shareholders **(1)**.
Debenture secured on the asset **(1)**. Interest charged may be at a lower rate than on the bank loan **(1)**. Interest is charged before dividend is paid to ordinary and preference shareholders **(1)**.
Sale of surplus non current assets **(1)** as long as this does not affect trading **(1)**.
Venture capitalist could invest **(1)** but would require a return on his investment **(1)**

Accept other reasonable alternatives. **[Max 4]**

[Total: 40]