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FOREWORD

This booklet contains reports written by Examiners on the work of candidates in certain papers. **Its contents are primarily for the information of the subject teachers concerned**.

ACCOUNTING

GCE Advanced Level and GCE Advanced Subsidiary Level

Paper 9706/01
Multiple Choice

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

General comments

5182 candidates took this paper (June 2003: 4712). The mean score was 16.0 (June 2003: 16.4). The standard deviation was 5.1 (June 2003: 5.5). There was a 10% increase in the number of candidates and the mean score and the standard deviation were only slightly below those in June 2003.

All items were within the scope of the syllabus.

Three items (**7**, **16** and **25**) were too easy with discrimination factors over 0.80.

One item (**18**) was too difficult as it fell below the design limit of 0.25.

Comments on specific questions

Item 4

44% of candidates correctly chose **D**. 40% chose **C**. In all, 56% showed that they had not mastered the accounting for assets given in part exchange. This would repay further attention in class.

Item 5

The item tested knowledge of the treatment of bad debts. Over one third of candidates failed to deduct the bad debts not yet written off from the total debtors balances before calculating the provision. Bad debts are written off and not provided for.

Item 11

Nearly one third of candidates failed to recognise that the error concerning the Purchase Ledger Control account balance had created a difference equal to twice the amount, and selected **A**.

Item 13

A third of the candidates chose **A**. They treated subscriptions in the Income and Expenditure Account on a cash basis ($1152), but on an accruals basis in the Balance Sheet by including a current asset of $48.

Item 18

55% of candidates chose **B** knowing that revenue reserves surplus to requirements may be used to maintain dividends when profits are low. This cannot be done, however, if a company has insufficient funds to pay the dividend. The stem of the item contained an overall restraint on the payment of dividends which did not register with the candidates.

Item 27

Only 26% of candidates calculated the overhead absorption rate correctly, **C**. 32% were unsure of the effect of the over-absorption on the calculation of the rate and selected **B**. The remainder were evenly divided between **A** and **D** suggesting that they were probably guessing. Too small a proportion of candidates understand overhead absorption in spite of the fact that it is a significant topic in the syllabus. It would well repay more attention being given to it.

Paper 9706/02
Structured Questions

General comments

Most candidates produced well presented work of a high standard, as both teachers and candidates gained a degree of familiarity with the syllabus. Since its introduction discursive work has improved greatly and teachers/lecturers are to be praised for promoting this.

Comments on specific questions

Question 1

(a) This was successfully calculated by the great majority of candidates, with the exception of Return on Capital Employed, where some used the net profit rather than the profit before interest figure in their calculations. Unfortunately a large minority failed to place a suffix after each calculation, thereby losing valuable marks. The 2002 figures should have been as follows: Acid test, 1.61:1, Stock turnover either 16.43 times or 22.21 days, Debtors collection 61.64 days (or the equivalent in weeks or months, though days are preferred), Gross profit ratio 30.00% (or 0.30:1), Net profit ratio 11.11% (or 0.11 to 1), ROCE 12.17%. Some candidates reversed ratios, e.g. acid test was shown as 1:1.61, which is wrong – ratios such as this must *always* end in 1. Also many candidates failed to show the answers to two decimal places, despite the clear instruction at the top of the page.

(b) This followed from **(a)** and again a large minority did not follow the instructions given at the top. Twelve marks were available, that is two for each ratio, and candidates were asked to state whether the changes from 2002 to 2003 were better or worse, and why. There were many well-written answers which did not comply with the question. The words 'better' or 'worse' should, for clarity, have been used, 'good' or 'bad' were acceptable, but 'increase' or 'decrease' or similar were not, as they did not indicate that the candidate understood the implication of the increase or decrease. Increased net profit is good, increased debtors collection period is bad, and the reason why was asked for, not the result of the change.

(c) Many and varied were the answers and most candidates gained good marks.

Question 2

(a) Not well answered though most candidates did gain some marks. The agreed values of the businesses transferred to the partnership were $45 000 and $30 000. This was made up of the assets and liabilities of the partners, plus goodwill which had then to be written off. There were various ways of doing this, all of which involved both crediting and debiting goodwill in the capital accounts, so that it was written off. The usual though not exclusive method was debit Titus $10 740, debit Ronicus $7 160, credit Titus $15 000, credit Ronicus $2 900, total on each side $17 900.

(b) Good answers for the most part, though the instruction that interest was to be charged on the partners' *cash* drawings was often ignored, and interest charged on goods as well. A few included drawings in the appropriation account thereby losing marks. Not many candidates realised that the $1 050 for goods taken from the business had to be added back on to the $56 000 net profit at the beginning of the appropriation account.

(c) Excellent answers from most candidates. As always, the candidates' figures from part **(b)** were used in this part thereby giving many full marks.

Question 3

(a) Almost all candidates gained some marks here by simply subtracting the given cost of production figure of $606 500 from the sales of $1 125 000 and calling the result a net profit of $518 500. Additional costs were ignored. A few did gain full marks.

(b)(i) Labour costs increased by $52 500 made up as follows: Basic pay $270 000 based on each unit taking 10 hours to manufacture at a cost of $60, ie $6 per hour. A further 5000 hours at $9 per hour ($45 000) plus 5000 hours at $1.50 ($7 500), total $322 500. There are other methods of calculating this figure, but only a few found the correct answer. The sales figure increased to $1250 000 which almost all candidates calculated correctly and the fixed costs remained at $345 000 (fixed overheads $125 000, administrative overheads $70 000 and advertising $150 000).

(ii) The market research costs of $17 500 had already been spent and therefore was not included in the costs of option 2. However, the $50 000 for hire of machinery was included.

(iii) Variable and fixed costs as in **(a)**, additional sales of $125 000 less cost of buying in $100 000 leaves additional profit of $25 000 over **(a)**, i.e. profit of $260 500.

Very few candidates used the figure of $345 000 for fixed costs throughout but provided the appropriate figures were included somewhere in their calculations, then marks were awarded.

Paper 9706/03

Multiple Choice (Extension)

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

General comments

4050 candidates took this paper (June 2003:3773). The paper consisted of 30 items. The mean score fell to 15.6 (June 2003:16.4). The standard deviation was 5.4 (June 2003: 5.4). While the number of candidates increased by 277 (7.3%), the results were less encouraging when judged by the fall of nearly 1 mark in the mean.

All items were within the syllabus.

Two items (**12** and **26**) proved to be too difficult (answered correctly by less than 25% of candidates).

No items appeared to be too easy (answered correctly by more than 80% of candidates).

Comments on specific questions

Item 1

33% of candidates correctly chose **A** but 45% chose **C**. Most candidates have yet to become familiar with the revised form of cash flow statement. This may be because old editions of text books are still being used in some schools.

Item 7

25% of candidates correctly chose **D**. Slightly more chose **A** and 38% chose **C**. It is surprising that 75% of candidates failed to recognise Goodwill included in the price paid for the business and that it increased the net assets of the company.

Item 12

21% of candidates correctly chose **B**. The definition of exceptional items and the requirement for them to be shown separately in Profit and Loss Accounts need to receive more attention in class. Statistics show that, in the absence of knowledge on this topic, candidates were reduced to wholesale guessing.

Item 15

26% of candidates selected **B**. This option would be selected by candidates who misread the number of shares issued as a capital of $8 000 000 in shares of $0.50.

Item 25

34% of candidates correctly selected **D**. 27% calculated the percentage decrease in the break-even point and selected **B**.

Item 26

Statistics show that this item was mainly answered by guesswork. Material Y should be valued at current purchase price and material X at net realisable value.

Paper 9706/04

Problem Solving (Extension)

General comments

The mean mark was only slightly higher than last year but the standard deviation had increased markedly. The increase in the number of candidates achieving high marks was not as great as the increase in those at the other end of the scale.

The vast majority of candidates managed to attempt all three questions and this indicated that there was enough time available to complete the examination. It also showed that the candidates had covered the topics being tested in their preparation for the examination. Nevertheless, the evidence suggested that the coverage had not been sufficiently thorough. Numerous elementary errors betrayed a lack of proper understanding of topics and probably of insufficient pre-examination practice.

Discursive questions are included in the paper to test the depth of candidates' understanding of topics. Once again, the questions suffered from vague answers and repetition of the same points, which do not earn marks. 20% of the marks were allocated to these questions and could have had a significant effect on candidates' results. Preparation for these types of question should not be sidelined by the need to spend time on teaching the preparation of financial statements and computational topics. Candidates should be taught to answer discursive questions clearly and without repetition or the introduction of irrelevant points.

In **Question 1**, answers to part **(a)** were disappointing as very few candidates knew the bookkeeping entries entailed to close the partners' Capital accounts. Part **(b)** was generally answered more competently although Goodwill was nearly always overlooked. It was also overlooked in part **(c)** which was intended to test the topic of Goodwill.

Question 2 was answered well in parts but weaknesses were revealed in the flexible budget for Process 2 and the ledger account for Process 2 based on actual level of activity. The answers to parts **(d)** and **(e)** could have been improved.

Question 3 was often answered better than the others. The application of the 'own figure' rule, whereby an error is penalised only once on its first appearance in an answer, helped to improve the marks gained. Thus, if net receipts were incorrectly calculated in part **(b)**, they would not be penalised again if used in part **(c)**. Part **(d)** provided candidates with an opportunity to improve their overall marks.

<u>Comments on specific questions</u>

Question 1

(a) The main problems encountered were:

- The opening balances were reduced by the partners' drawings. The balances brought forward should have been the balances that had been carried forward on the Capital accounts.
- The profit on realisation was divisible between the partners in their profit/loss sharing ratios. Difficulty was experienced in calculating the profit. In many cases, the profit (or loss) was calculated on the values at which the assets were taken over instead of the values at which they stood in the partnership books.
- It was common for candidates to calculate a Goodwill figure and a loss on realisation and enter both in the Capital accounts.
- In many cases, all the partnership assets and liabilities were transferred to the Capital accounts by candidates who were weak on the bookkeeping procedure for the sale of a business.
- The debits to the Capital accounts for the shares in Shindig Ltd were often shown based on the nominal value of the shares with additional entries for the premium on the shares. There would not be a Share Premium account in the partnership books and the shares should have been debited in the Capital accounts at $1.50 per share. (The Share Premium account would be in Shindig Ltd's books.)
- The Capital accounts should have been closed by amounts debited from the partnership Bank account totalling $14 000. ($2000 in the partnership Bank account before the take-over plus the $12 000 paid by Shindig Ltd.) Most candidates failed to calculate the amount in the Bank account with the result it was left with an undistributed balance or in overdraft.
- Although the exercise was to close the Capital accounts, some candidates left the accounts with balances carried forward.
- Cash was debited in the partnership Capital accounts direct from the Bank account in Shindig Ltd's books.
- In a few cases a Capital account for Shindig Ltd was included in answers.
- At this level, candidates are expected to have a good knowledge of basic bookkeeping but the overall standard was disappointing.

(b) Generally speaking, this part was answered significantly better than part **(a)**. The main points arising were:

- The majority of candidates overlooked Goodwill. Many of those who included Goodwill did not allow for the creditors taken over by Shindig Ltd in their calculations.
- Marks were lost when freehold and leasehold premises were shown as a single item in the fixed assets. This is not an acceptable practice.
- The debentures were not shown as long term liabilities and marks were lost if they were shown under the headings of current liabilities or share capital and reserves.
- Many candidates showed the current assets at the partnership values and failed to take account of the additional $3000 creditors.
- The partners' Capital and Current accounts should not have been included in the company's Balance Sheet.

(c) The main thrust of this part was to see if candidates knew that while Goodwill may arise in the case of the purchase of a business, it never arises on the purchase of assets. Unfortunately, most of the answers included such obvious statements as the acquisition of the partnership assets by Shindig Ltd would increase the company's assets, or payment to the partners for the assets would reduce Shindig Ltd's bank balance. Such comments are far below the standard expected of A Level candidates and cannot be expected to gain any marks.

Question 2

(a) This part was answered well and full marks were often gained. The main points arising were:

- The goods transferred for Process 1 were not included in Process 2.
- Overhead was calculated incorrectly by some candidates and, in a few cases, deducted from cost.

(b) Many candidates found difficulty flexing the budget for Process 2 and it was clear that they did not really understand the procedure.

- The production from Process 1 was either not flexed or was omitted altogether.
- The calculations were based on actual production and reproduced the answer for Process 2 in part **(c)**.

(c) The account for Process 1 was prepared correctly in nearly every instance. The account for Process 2, however, caused problems in many cases:

- The materials transferred from Process 1 were omitted.
- The added materials, labour and overhead were generally calculated incorrectly.
- The cost of finished goods and work in progress was generally calculated incorrectly.
- Many candidates prepared the expense accounts for materials, labour and overhead instead of the process accounts.

(d) Few candidates gained full marks for the variances. Marks were sacrificed through inability to calculate and express the variances correctly. The most common errors were:

- Failure to state whether the variances were favourable or adverse. Unless this was done, the variances were meaningless and failed to gain marks.
- Failure to express the variances in $s. Marks were deducted for the omission of $ signs.
- Variances were calculated per unit when they should always be calculated for the total output.
- Many candidates did not know the formulae for the variances.

(e) The definitions of by-products and waste products were weak and suffered from inability to express them in clear, simple language. Many candidates gave examples of the products instead of giving a definition. These were not an acceptable alternative. A question asking for a definition requires one, and a list of examples does not show that a candidate knows why the examples are by-products or waste products. There was little indication as to how by-products and waste products are treated in process accounts.

(f) This was generally answered reasonably well but many advantages mentioned were not specifically attributable to standard costing but rather to marginal costing.

Question 3

This question tended to gain more marks than either of the others. Candidates benefited from the application of the 'own figure' rule whereby an error is penalised only once, not every time it occurs in the answer.

(a) The calculation of Accounting Rate of Return was generally satisfactory but the following observations should be noted.

- In the absence of a generally accepted method of calculating the average capital employed, the following were accepted:

  $\frac{\text{Initial outlay}}{2}$ + additional working capital

  $\frac{\text{Initial outlay+ disposal proceeds}}{2}$ + additional working capital

  $\frac{\text{Initial outlay - disposal proceeds}}{2}$ + additional working capital

- Many candidates incorrectly divided the additional working capital by 2 although it is not a depreciating asset.
- The average capital was often calculated by dividing the outlay by 5, the life of the project.
- In many cases, the rate of return was not expressed as a percentage. 18 is a very different answer from 18%.

(b) The calculation of the discounted payback period generally gained good marks but the following comments arose from answers given.

- The workings were often untidy and unclear.
- Calculations were based on the average profit from part **(a)** instead of on net cash flows.
- The disposal proceeds were deducted from the initial outlay in year 0.
- In a few cases, the net cash flows were not discounted.

(c)(i) Good marks were often scored on this part because of the 'own figure' rule, but the main points arising were:

- The disposal proceeds were either incorrectly deducted from the initial outlay in year 0 or were omitted entirely.
- Candidates misread the question and assumed that the discounting rates at 20% were at 15%.
- Many candidates, finding that net cash flows at 20% produced a positive net present value, wasted time calculating a rate that would produce a negative result. Once again, it is necessary to remind candidates that the rates given in the question are the only ones they should use. The Internal Rate of Return may be calculated from two positive net present values, although the result will not be quite as accurate as if a negative net present value is used. The formula for calculating IRR must be adjusted to meet the situation.

(ii) This was answered well provided the results of the previous parts were quoted and used in support of the comments.

(d) Many candidates boosted their marks with their responses to this part and most of the salient points were mentioned.

- There was much repetition of points.
- Many candidates, having discounted the net proceeds in part **(b)** stated that the payback period does not recognise the time value of money. They should have qualified that remark.
- Some candidates still think that cash flows are discounted to take account of inflation. That is completely wrong and shows that they have not understood what is meant by the time value of money. If inflation were a factor, cash flows would be discounted by the rate of inflation instead of by the cost of capital.
- A number of candidates presented their answers in tabular form. This is often to be recommended.

Summary

From the detailed comments made above, it is recommended that the following topics should receive more attention in preparation for the examination:

- closure of capital accounts in businesses which have been purchased by companies
- preparation of a company's Balance Sheet following the purchase of another business
- preparation of flexible budgets
- calculation of the cost of finished products and work in progress in process accounts
- calculation of variances and their statement in correct form
- definitions and treatments of by-products and waste products in process accounts
- calculation of Accounting Rate of Return and Internal Rate of Return
- reason for discounting future receipts to net present values
- preparation of discursive answers clearly and simply without repetition or the inclusion of irrelevant points. A definition must be given when required.