Cambridge International Examinations
Cambridge International Advanced Level

ACCOUNTING **9706/32**

Paper 3 Structured Questions **October/November 2016**

MARK SCHEME

Maximum Mark: 150

Published

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1 (a) Responses could include:

Donation	**Member subscription**
Voluntary Basis	Member's obligation
From Members and non-members	From members only
Irregular payment	Regular payment, i.e. monthly or annually
Can be ear marked for specific purpose e.g. Buy new equipment	For daily running of the organisation e.g. Paying for day to day expenses
Can be capitalised	Cannot be capitalised

(**1 mark**) × 3 differences **[3]**

(b) Sunshine Social Club
Shop Trading Account for year ended 31 December 2015

	$		$	
Gift shop takings			12 420	
Inventory at 1 Jan 2015	2 400			
Purchases **W1**	84 300	**(2)***		
Inventory at 31 December 2015	18 600			
Cost of sales			89 700	**(1)OF**
Gross profit			34 500	**(1)OF**
Shopkeeper wages **W2**			23 750	**(2)**
Depreciation of shop equipment **W3**			11 800	**(2)**
Insurance **W4**			2 300	**(3)**
Water and electricity **W5**			5 640	**(3)**
Loss			(8 990)	**(1)OF**

[15]

Workings

W1	Gift shop purchases	$74 500 + ($64 300 – $54 500)**(1)** = $84 300**(1)OF**
W2	Shopkeeper wages	$30 400 – ($3450 + $3200)**(1)** = $23 750**(1)OF**
W3	Depreciation of shop equipment	($55 000 + $4000)**(1)** × 20% = $11 800 **(1)OF**
W4	Insurance	$9460 + ($1400**(1)** – $1660**(1)** = $9200
	Allocated to gift shop	$9200 × 25% = $2300**(1)OF**
W5	Water and electricity	$14 800 - $2700**(1)** + $2000**(1)** = $14 100
	Allocated to gift shop	$14 100 x 40% = $5640**(1)OF**

(c) Responses could include:

sell goods to non-members **(1)** to increase revenue **(1)**
reduce (stop) discount to members **(1)** e.g. sell goods at market price **(1)**
reduce expenses **(1)** e.g. reduce staff wages **(1)** ***or*** find cheaper suppliers **(1)**
review the fairness of the allocation of expenses **(1)** and reduce the proportion of expenses allocated to gift shop **(1)**

Accept any reasonable alternative.
(**1 mark** for point + **1 mark** for development) × **2** ways **[4]**

(d) (\$48 000 + \$36 000)**(1)** – \$68 000 **(1)** × 50% = \$8000 **(1)OF** **[3]**

[Total: 25]

2 (a) (i)

Alpha Limited
Manufacturing Account for the year ended 30 April 2016

	\$		\$	
Raw materials at 1 May 2015			1 000	
Purchases of raw materials	12 200			
Carriage inwards	1 100	**(1)**	13 300	
			14 300	
Purchases of raw materials			3 100	
Cost of raw materials consumed			11 200	**(1) OF**
Direct labour			17 500	
Prime cost			28 700	**(1) OF**
Factory rent	6 000	**(1)**		
Supervisor's salary	8 200	**(1)**		
Factory overheads	9 700		23 900	
Cost of production			52 600	**(1) OF**
Factory profit			13 150	**(1) OF**
Transfer price			65 750	**(1) OF**

[8]

(ii)

Alpha Limited
Income Statement for the year ended 30 April 2016

	\$		\$	
Revenue			95 000	**(1)**
Transfer from production			65 750	**(1) OF**
Gross profit			29 250	**(1) OF**
Factory profit			13 150	**(1) OF**
Office rent	2 000	**(1)**		
Office salaries	8 500	**(1)**		
General office expenses	10 000		20 500	
Profit for the year			21 900	**(1) OF**

[7]

(b)

	$	
Profit for year ended 30 April 2016	21 900	**(1)**
Decrease in sales revenue	(9 500)	
Increase in inventory **W1**	6 575	**(1) OF**
Decrease in general office expenses	500	**(1)**
Provision for unrealised profit **W2**	(1 315)	**(1) OF**
Expected profit under option 1	18 160	**(1) OF**

W1 increase in inventory is 10% of transfer from production
W2 6575 × 25/125 = 1315
(6575 – 1315) = 5260 **(2)** **[5]**

(c) Option 1
Has the higher profit. **(1) OF**
It may be advantageous to keep an inventory of finished goods to avoid running out of inventory. **(1)**
Option 1 avoids damaging the relationship with suppliers. **(1)**
Option 1 avoids difficulties in reducing workers' hours/redundancies. **(1)**
If production continues to exceed demand there would be a large build up of inventory. **(1)**

Option 2
Has lower profit **(1)OF**
This fall in demand may be the start of a long term trend **(1)**
Avoids inventory holding costs eg insurance. **(1)**
Avoids the risk of inventory becoming obsolete/damaged. **(1)**
Spare capacity will be available **(1)**
Fixed costs will be spread over fewer units so cost per unit rises **(1)**

Final decision, option I or option 2 **(1)**

[1 mark for decision + max 4 for comments] **[5]**

[Total: 25]

3 (a) FLF Limited

Statement of Financial Position at 1 July 2016

	$	
Assets		
Non-current assets		
Intangible **(1)** – Goodwill (440 000 – 328 500) **(1)**	111 500	**1OF**
Tangible		
Premises (1 000 000 **(1)** + 280 000 **(1)**	1 280 000	
Equipment (190 900 + 14 600)	205 500	**(1)**
Vehicles	81 500*	
	1 678 500	
Current assets		
Inventory (103 600 + 29 500	133 100	**(1)**
Trade and other receivables (99 400 + 17 200 – 1200)	115 400	**(1)**
	248 500	
Total assets	1 927 000	
Equity and liabilities		
Equity		
900 000 ordinary shares of $1 each (800 000 + 100 000)	900 000	**(1)**
Share premium	150 000	**(1)**
Retained earnings	322 500	**(1)**
General reserve	80 000	
Revaluation reserve	184 900	**(1)**
Total equity	1 637 400	
Non-current liabilities		
8% debentures (2025)	120 000	**(1)**
Current liabilities		
Trade and other payables	106 700	***(1)**
Cash and cash equivalents 70 000 **(1)** – 7100 **(1)**	62 900	
	169 600	
Total equity and liabilities	1 927 000	

[16]

(b) Annual profit with the manager could be assumed to be 41 600 – 20 000 = $21 600 **(1)**

Annual income after sales would be:

		$	
Debenture interest	120 000 × 0.08	9 600	**(1)**
Dividends	250 000 × 0.03	7 500	**(1)**
Bank interest	(70 000 – 2000 (1)) × 0.04	2 720	**(1)OF**
Total		19 820	

The nephew is right that the profit with the manager appears to be higher. **(1)**
But he may not have enough experience to do a good job. **(1)**
The profit might have fallen without Husna's involvement. **(1)**
Husna has less risk with her investment being in a larger business. **(1)**
Both options give a return lower than the previous level of drawings. **(1)**
Husna has lost the opportunity for further capital gains on her premises. **(1)**
Husna has gained an opportunity for capital gains on the value of her shares. **(1)**
Husna's shares might fall in value. **(1)**

Dividend **(1)** / debenture interest **(1)** from FLF Limited is not guaranteed, so future income is at risk **(1)**
Husana has shareholder rights but not management involvement **(1)**
Husana does not have the worries of the day to day running of the business **(1)**

Decision- Husana was right / wrong to sell the business **(1)**

[5 for calculations, max 3 for comments and 1 for decision] **[9]**

[Total: 25]

4 (a) Checking financial data **(1)**. Examining accounts **(1)** and systems **(1)**. Reviewing accuracy of records **(1)** and reports **(1)**. Reviewing security of assets **(1)**. Check trade and other receivables/payables **(1).** Attend stock counts **(1)** Recommending changes after review **(1)**. Ensuring procedures are adhered to **(1)**. Produce audit report **(1)**. Comment on true and fair view **(1).** Independent check **(1).** Ensure company directors comply with international accounting standards and company law **(1)**. Verify that the records do not have any material errors **(1)**. **Max 5** **[5]**

(b) A qualified audit report is provided when there is a misstatement in a balance **(1)** or when the auditor is unable to gather evidence to report truthfully on a balance **(1)**. The accounts have not been fairly presented **(1). Max 2** **[2]**

(c) IAS 2 **(1)** requires inventory to be valued at the lower of cost and net realisable value **(1)**. Net realisable value is the selling price less the costs to make the goods saleable and reach their point of sale **(1)**.
The inventory has been valued at cost **(1)** of $1 million but the net realisable value is only $750 000 **(1)** – $200 000 **(1)** = $550 000 **(1)**. The value of the inventory must therefore be reduced by $450 000 **(1)**. This is in accordance with the application of the prudence concept **(1)** to avoid overstatement of assets / profits **(1)**.
This must be reflected in the accounts by charging this reduction to the income statement which will reduce profit **(1)** and reducing the value of the inventory in the statement of financial position **(1)** for them to show a true and fair view **(1)**. **Max 8** **[8]**

(d) True and fair view means that the statements are free from misstatements **(1)** and faithfully represent the financial performance and position of Soames Limited **(1)**.
The shareholders of Soames Limited will have confidence **(1)** since the report will confirm the accuracy of the statements **(1)** and the professional opinion should be trusted due to the expertise **(1)** and independence **(1)** of the auditor.
Share prices might increase **(1)**. The shareholders may be encouraged to invest more / not sell their shares **(1)**
Lenders may be more willing to lend to the business which will improve potential profits for the shareholders **(1)**.

May also present balanced argument:
Auditors do not prepare the accounts **(1)** / correct errors **(1)**.
Report does not provide complete picture of business performance **(1)**
Non-financial factors not included **(1) Max 6** **[6]**

(e) Aamir should not have signed the audit report **(1)** as he is related to a director and therefore not independent **(1)** and does not have the required expertise as he is unqualified **(1)**. The report is therefore invalid/not reliable **(1)** and the directors must re-appoint a qualified, independent auditor **(1)**. **Max 4** **[4]**

[Total: 25]

5 **(a)** Activity Based Costing **(1)** **[1]**

(b) 79 000 / (50 000) **(1)** = $1.58 per unit **(1) OF** **[2]**

(c)

	$ per unit		
Machine set up costs	0.04	**(2)**	**W1**
Production quality inspections	0.10	**(3)**	**W2**
Machine stoppage costs	0.08	**(3)**	**W3**
Machine maintenance	0.16	**(2)**	**W4**
Machine running costs	1.20	**(2)**	**W5**
Total overhead cost per unit	1.58		

W1 2000 / (5 × 50) = $8 **(1)** per day / 200 = $0.04 **(1) OF**

W2 5000/ (50) = $100.00 **(1)** per week / 5 = $20 **(1) OF** per day / 200 = $0.10 **(1) OF**

W3 4000 / 12.5 = $320 per 4 weeks / 4 = $80 **(1)** per week / 5 = $16 **(1)** per day / 200 = $0.08 **(1) OF**

W4 8000 / (50 × 5) = $32 **(1)** per day / 200 = $0.16 **(1) OF**

W5 60 000 / (50 × 5) = $240 **(1)** per day / 200 = $1.20 **(1) OF**

OR

W1 (2000 / 79 000 × $1.58) **(1)** = $0.04 **(1) OF**

W2 (5000 **(1)** / 79 000 × $1.58) **(1)** = $0.10 **(1) OF**

W3 (4000 **(1)** / 79 000 × $1.58) **(1)** = $0.08 **(1) OF**

W4 (8000 / 79 000 × $1.58) **(1)** = $0.16 **(1) OF**

W5 (60 000 / 79 000 × $1.58) **(1)** = $1.20 **(1) OF**

OR

W1 (2000 / 50 000) **(1)** = $0.04 **(1) OF**

W2 (5000 **(1)** / 50 000) **(1)** = $0.10 **(1) OF**

W3 (4000 **(1)** / 50 000) **(1)** = $0.08 **(1) OF**

W4 (8000 / 50 000) **(1)** = $0.16 **(1) OF**

W5 (60 000 / 50 000) **(1)** = $1.20 **(1) OF**

[12]

(d) The benefits of ABC

Avoids apportioning overheads using a basis that may not be relevant. e.g. machine hours for administration costs **(1)**
More realistic / fair **(1)**
Considers batch sizes which are ignored by absorption costing. **(1)**
It charges each product with an accurate cost based on its use of an activity **(1).** (cost driver) **(1)**
If the activity(cost driver) changes then the relevant effect on the cost can be assessed so costs are controlled **(1).** eg how much will costs increase if there is another batch run? **(1)**
Helps to set a selling price **(1)**
Expensive costs may be outsourced **(1)**

Drawbacks
ABC is often of little benefit if there is only one product **(1)** because the overhead cost per unit will be the same. **(1)**
There are still cost pools that are not caused by one particular cost driver **(1)** but by several e.g. marketing **(1)**
This method may be time consuming **(1)** and require a specialist **(1)** to collect the data, which will be more expensive **(1)**
The costs for implementing such a system for a small business often outweigh the benefits **(1)**
The level of accuracy may be immaterial for management decisions **(1)**

Decision – Samir should/should not ask for this analysis **(1)**

(1) decision + **Max 9** for benefits and drawbacks **[10]**

[Total: 25]

6 (a) (i) A cash budget deals with the future whilst a statement of cash flows deals with historic data **(1)**.
A cash budget does not deal with non-cash items whereas a statement of cash flows does, e.g. depreciation **(1)**
A cash budget is an internal document whilst a statement of cash flows is published. **(1)**
Max (1) **[1]**

(ii) Identify and solve cash flow problems **(1)**. E.g. avoid overdrafts
Identify possible investment opportunities for surplus cash **(1)**.
Control of cash **(1)**
Plan timing of expenditure **(1)**
Co-ordination and communication of departmental cash needs **(1)**
Motivates staff to achieve departmental objectives **(1) Max 2** **[2]**

(b) (i) and (ii)

	Sales **(i)**		Cash discount **(ii)**	
	$		$	
January	60 000	**(1)**	1500	**(1)**
February	55 000	**(1)**	1375	**(1)**
March	65 000	**(1)**	1625	**(1)**
		[3]		**[3]**

(iii) Rate of cash discount 5% **(1)** **[1]**

(c) Slanting Stores Limited
Trade receivables budget for the 3 months ended 31 March 2017

	January		February		March	
	$		$		$	
Opening balance	40 000	**(1)**	30 000	**(1) OF**	27 500	**(1) OF**
Sales	60 000		55 000		65 000	**(1) OF**
	100 000		85 000		92 500	
Receipts						
Same month	(28 500)		**(26 125)**		(30 875)	**(1) all**
Discount allowed	(1 500)		**(1 375)**		(1 625)	**(1) OF all**
Second month	(40 000)		**(30 000)**		(27 500)	**(1) all**
	70 000		57 500		60 000	
Closing balance	30 000		27 500		32 500	**(1) OF**

[8]

(d) Increase in cash needed = 15 000 **(1)** + 1600 **(1)** = $16 600

Increase in sales needs to be 16 600 ÷ 0.95 **(1)** × 2 **(1)** = $34 948 **(1) OF** **[5]**

(e) Pay lower amount of dividend
Postpone payment of dividend
Delay purchase of non-current asset
Use lease instead of buying non-current asset
Pay for non-current asset in instalments
Take more credit from suppliers
Find cheaper supplier
Reduce cost of sales
Reduce cash discount
Reduce credit period offered to customers
Sell surplus non-current assets
Sell surplus/obsolete inventory
Arrange loan/Increase overdraft

Any two × **(1 mark)** **[2]**

[Total: 25]