Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

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ACCOUNTING **9706/32**

Paper 3 Structured Questions **October/November 2017**

MARK SCHEME

Maximum Mark: 150

Published

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This document consists of **11** printed pages.

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th></tr>
<tr><td>1(a)</td><td>
<table>
<tr><th></th><th>$</th><th></th><th>$</th><th></th></tr>
<tr><td>Revenue</td><td>45 000</td><td></td><td></td><td></td></tr>
<tr><td>Cost of sales</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Opening inventory</td><td>825</td><td>(1)</td><td></td><td></td></tr>
<tr><td>Purchases</td><td>28 700</td><td>(2)</td><td></td><td></td></tr>
<tr><td></td><td>29 525</td><td></td><td></td><td></td></tr>
<tr><td>Closing inventory</td><td>(1 650)</td><td>(1 OF)</td><td>(27 875)</td><td>(1OF)</td></tr>
<tr><td>Gross profit</td><td></td><td></td><td>17 125</td><td>(1 OF)</td></tr>
<tr><td>Deduct:</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Insurance</td><td>3425</td><td>(2)</td><td></td><td></td></tr>
<tr><td>Electricity</td><td>775</td><td>(1)</td><td>(4 200)</td><td></td></tr>
<tr><td>Restaurant profit</td><td></td><td></td><td>12925</td><td>(1 OF)</td></tr>
</table>
Purchases 28 350 – 1750 (1) + 2100 (1) = 28 700
Insurance (4800 + 950 +1100) (1) · 50% = 3425 (1OF)
</td><td>10</td></tr>
<tr><td>1(b)(i)</td><td>Gross margin = 17 125 / 45 000 = 38.06% (1OF)
Difference = 45.00 – 38.06 = 6.94% (1OF)</td><td>2</td></tr>
<tr><td>1(b)(ii)</td><td>Consider market (1) – provide higher quality food (1) to appeal to target market. (1)
Seek cheaper suppliers / seek discounts from suppliers / buy in bulk (1) to reduce cost of sales. (1)
Increase the prices for items served in the restaurant. (1) Should earn higher revenue. (1)
Reduce food wastages. (1) This should increase the gross margin. (1)

2 marks · Max 3 points (1 mark for stating and 1 mark for developing)</td><td>6</td></tr>
<tr><td>1(c)</td><td>The subscription received is debited to the bank/receipts and payments account and credited to the life membership fund. (1)
An amount is transferred annually to the income and expenditure account. (1)
The remaining balance in the fund is shown in the statement of financial position. (1)
Max 2</td><td>2</td></tr>
</table>

Question	Answer	Marks
1(d)	Beneficial if live longer than 10 years. **(1)** Otherwise not beneficial. **(1)** Does he have funds available to pay $1000? **(1)** Saves ‘trouble’ of renewing every year. **(1)** Avoids any increases in subscriptions over the period. **(1)** There may be other benefits for life membership. **(1)** If he wishes to resign before the ten-year period, he may not get any refund. **(1)** Decision. **(1)** **Max. 4 + Decision 1**	**5**

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th></tr>
<tr><td>2(a)</td><td>
<table>
<tr><th></th><th>Ordinary share capital
$000s</th><th>Share premium
$000s</th><th>General reserve
$000s</th><th>Retained earnings
$000s</th></tr>
<tr><td>At 1 Jan 2016</td><td>1000</td><td>300</td><td>100</td><td>220 (1) for four</td></tr>
<tr><td>Share issue</td><td>700 (1)</td><td>560 (1)</td><td></td><td></td></tr>
<tr><td>Bonus issue</td><td>510 (1)</td><td>(510) (1)</td><td></td><td></td></tr>
<tr><td>Profit for the year</td><td></td><td></td><td></td><td>195 (3) *W1</td></tr>
<tr><td>Transfer to general reserve</td><td></td><td></td><td>40 (1)</td><td>(40) (1)</td></tr>
<tr><td>Dividend paid</td><td></td><td></td><td></td><td>(55) (1)</td></tr>
<tr><td>At 31 Dec 2016</td><td>2210</td><td>350</td><td>140</td><td>320 (1 OF) for four</td></tr>
</table>
*if 288, one mark only
W1: 288 – 52 (1) – 41 (1) = 195 (1) OF
</td><td>12</td></tr>
<tr><td>2(b)</td><td>It is not included in the statement of financial position/statement of changes in equity, (1) but as a note to the financial statements. (1)</td><td>2</td></tr>
<tr><td>2(c)</td><td>This is a non-adjusting event (1) as per IAS 10, (1) which is material / significant to the business. (1) Thus it is disclosed in the notes to the financial statements for 2016. (1) It will be recorded in the 2017 financial statements. (1)

Max 3</td><td>3</td></tr>
</table>

Question	Answer	Marks
2(d)	The ratio may indeed fall in the short term as non-current assets increase. **(1)** Once the new factory is established, sales revenue or profit should rise too. **(1)** The ratio may actually rise in due course. **(1)** Shareholders are more interested in profits and dividends. **(1)** The disclosure of the purchase enables users of the financial statements to make informed comparisons. **(1)** Directors do not need to be greatly concerned. **(1)** The directors should be concerned **(1)** as shareholders may sell their shares, **(1)** which may reduce the market price of their shares. **(1)** Shareholder confidence may fall. **(1)** New shareholders may not be attracted to buy shares in the future. **(1)** The shareholders may dismiss the directors. **(1)** **Decision (1)** **Justification Max 2 for positive + Max 2 for negative**	**5**
2(e)	It increases the value of non-current assets in the statement of financial position. **(1)** It increases/creates the revaluation reserve in the statement of financial position. **(1)** It reduces the accumulated depreciation. **(1)** It is recorded in the statement of changes in equity. **(1)** **Max 3**	**3**

Question	Answer	Marks
3(a)(i)	Stewardship is the responsibility which managers/directors have for the management of resources **(1)** within a business on behalf of the owners/shareholders. **(1)**	**2**
3(a)(ii)	The directors have responsibility as stewards of the company to report **(1)** at the AGM **(1)** to the shareholders on the performance of the company. **(1)** To maintain proper accounting records. **(1)** Responsible for the preparation of financial statements. **(1)** Manage the business on a day to day basis. **(1)** Safeguard the assets. **(1)** **Max 2**	**2**
3(a)(iii)	External auditors are appointed by the shareholders to carry out an audit, which is a systematic and independent examination **(1)** of books, accounts, documents and vouchers of an organization, **(1)** to ascertain how far the financial statements present a true and fair view of the business **(1)** and comply with IAS/Companies Acts. **(1)** To prepare an audit report expressing an opinion. **(1)** **Max 2**	**2**

Question	Answer	Marks
3(b)(i)	$ $ Sales 182 000 Less: returns (8 000) **(1)** sale or return (6 000) **(1)** 168 000 Purchases 154 000 Less: returns 12 000 142 000 **(1)** Closing inventory 74 800 **(1 OF)** Cost of sales 67 200 **(1 OF)** Gross profit 100 800	**5**
3(b)(ii)	168 000 · 60% (3/5) = $100 800 **(1OF)**	**1**
3(c)	Percentage change is 100 800 – 50 000 (100 800 – *50 800) **(1OF)** = 50 800 **(1OF)** / 100 800 = 50.4% **(1OF)** * 74 800 – 24 000	**3**
3(d)	Reasons for closing inventory to be different than as per records: Inventory has been stolen/damaged **(1)** due to little control. **(1)** Inventory is obsolete, **(1)** so has no value in reality but might in the inventory records. **(1)** Sales have been omitted in the records, **(1)** i.e. Inventory has been sent out on consignment or a sale or return basis, so not yet sold. **(1)** Purchases of inventory have been recorded twice, **(1)** or not all inventory was counted. **(1)** Sales returns were amended in the records **(1)** but the purchases returns were not. **(1)** **2 marks · Max 3 points** (1 mark for stating and 1 mark for developing)	**6**
3(e)	If book value is used, profit and current assets would be overstated **(1OF)** which is against the prudence concept **(1) and** does not give a true and fair view. **(1)** Inventory should be recorded at the lower of cost and net realisable value, **(1)** in line with IAS2 **(1).** Therefore the warehouse inventory valuation should be used. **(1)** 1 for decision + max 3 for comments	**4**

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th></tr>
<tr><td>4(a)(i)(ii)
(iii)(iv)</td><td>
<table>
<tr><td>Income gearing</td><td>235 000 / 1 580 000</td><td>14.87%</td><td>(1)</td></tr>
<tr><td></td><td>or 234 800 / 1 580 000</td><td>14.86%</td><td></td></tr>
<tr><td>Gearing ratio</td><td>2 935 000 / (2 935 000 + 4 540 000)</td><td>39.26%</td><td>(1)</td></tr>
<tr><td>Dividend cover</td><td>1 345 000 / 325 000</td><td>4.14 times</td><td>(1)</td></tr>
<tr><td>Price earnings ratio*</td><td></td><td>3.44(times)</td><td>(2)</td></tr>
</table>
*EPS = 1345 / 3000 = 0.45 (1)
PE ratio = 1.55 / 0.45 = 3.44 (1OF)
</td><td>5</td></tr>
<tr><td>4(b)(i)</td><td>
<table>
<tr><td></td><td>$000</td><td></td></tr>
<tr><td>Profit from operations</td><td>1600</td><td></td></tr>
<tr><td>Finance costs (200 000 + 235 000)</td><td>(435)</td><td>(1)</td></tr>
<tr><td>Profit for the year</td><td>1165</td><td>(1) OF</td></tr>
</table>
</td><td>2</td></tr>
<tr><td>4(b)(ii)</td><td>
<table>
<tr><td>Equity and liabilities</td><td>$000</td><td></td></tr>
<tr><td>Ordinary share capital</td><td>1500</td><td></td></tr>
<tr><td>Share premium</td><td>500</td><td></td></tr>
<tr><td>Retained earnings</td><td>3430</td><td></td></tr>
<tr><td>Total equity</td><td>5430</td><td>(1)</td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td>Non-current liabilities</td><td></td><td></td></tr>
<tr><td>8% debentures 2020</td><td>2935</td><td rowspan="2">} (1) both</td></tr>
<tr><td>10% debentures 2026</td><td>2000</td></tr>
<tr><td></td><td>4935</td><td></td></tr>
</table>
*Retained earnings = 2 540 000 + (1 600 000 – [435 000 + 275 000]) =
3 430 000 or (2 540 000 + 1 165 000 – 275 000) = 3 430 000
</td><td>2</td></tr>
<tr><td>4(c)(i)</td><td>
<table>
<tr><td></td><td></td><td></td><td>Workings</td></tr>
<tr><td>Income gearing</td><td>27.19%</td><td>(1 OF)</td><td>435 000 / 1 600 000</td></tr>
<tr><td></td><td>27.18%</td><td></td><td>or 434 800 / 1 600 000</td></tr>
<tr><td>Gearing ratio</td><td>47.61%</td><td>(1 OF)</td><td>4 935 000 / 10 365 000</td></tr>
<tr><td>Dividend cover</td><td>4.24 times</td><td>(1 OF)</td><td>1 165 000 / 275 000</td></tr>
<tr><td>Price earnings ratio</td><td>3.33 times</td><td>(1 OF)</td><td>1 165 000 / 3 000 000 = 0.39</td></tr>
<tr><td></td><td></td><td></td><td>1.30 / 0.39 = 3.33</td></tr>
</table>
</td><td>4</td></tr>
</table>

Question	Answer	Marks
4(c)(ii)	Income gearing has increased **(1)** significantly from 2016 because of extra interest payable on debentures. This is worse **(1)** for a shareholder. This will reduce profit available to equity holders and therefore also impact other investment ratios. **(1)** **(Max 2)** The gearing ratio has also increased **(1)** because of the debenture issue being a greater increase than the increase in retained earnings. **(1)** This increases the risk **(1)** of the company because of the need to pay interest and repay debt. **(1)** **(Max 2)** Dividend cover has stayed reasonably stable/increased **(1)** over the two years – as the profit available for distribution has decreased **(1)**, so have the dividends. **(Max 2)** The price earnings ratio has decreased **(1)**. This is also a reflection of the market price of a share and the risk attached to it, depending on the market confidence. **(1)** **(Max 2)**	**8**
4(d)	The issue of the debentures had an adverse **(1)** effect on the income gearing and gearing ratios. The company is now seen to be more risky. **(1)** The company may be perceived as being less attractive to investors. **(1)** The company has had to pay additional finance costs. **(1)** This has reduced profits available to distribute to shareholders. **(1)** This may have a negative effect on its liquidity. **(1)** The company has a significant repayment commitment **(1)** and annual interest payment, **(1)** for which the directors need to plan if profits fall. **(1)** Debentures may be secured on the assets of the company **(1)** which may mean the asset is sold to repay it, if necessary. **(1)** 1 for comment + 1 for development **2 marks** · **Max 2 points** (1 mark for stating and 1 mark for developing)	**4**

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th></tr>
<tr><td>5(a)</td><td>Payback does not consider the time value of money, (1) whereas net present value does. (1)
Payback calculates the time it takes to cover the initial cost of the investment and does not consider the net cash flow after the payback period. (1)
Net present value considers the discounted cash flows for the whole life of the investment. (1)</td><td>4</td></tr>
<tr><td>5(b)</td><td>Net present value is:
<table>
<tr><td></td><td>$</td><td></td></tr>
<tr><td>Cost</td><td>(55 000.00)</td><td></td></tr>
<tr><td>Total present values</td><td>55 700.75</td><td></td></tr>
<tr><td>Net present value</td><td>700.75</td><td>(1)</td></tr>
</table></td><td>1</td></tr>
<tr><td>5(c)(i)</td><td>Annual net cash flows:
<table>
<tr><th>Year</th><th>Present value $</th><th>Discount factor</th><th>Net cash flows $</th><th></th></tr>
<tr><td>1</td><td>3 683.40</td><td>0.877</td><td>4 200</td><td>(1)</td></tr>
<tr><td>2</td><td>6 536.50</td><td>0.769</td><td>8 500</td><td>(1)</td></tr>
<tr><td>3</td><td>9 483.75</td><td>0.675</td><td>14 050</td><td>(1)</td></tr>
<tr><td>4</td><td>14 977.60</td><td>0.592</td><td>25 300</td><td>(1)</td></tr>
<tr><td>5</td><td>21 019.50</td><td>0.519</td><td>40 500</td><td>(1)</td></tr>
</table></td><td>5</td></tr>
<tr><td>5(c)(ii)</td><td>Payback period is therefore 4 years (1OF) and (2950 / 40 500 × 365) 27 days (1OF)</td><td>2</td></tr>
<tr><td>5(c)(iii)</td><td>Units for each year are:
<table>
<tr><th>Year</th><th>Net cash flow From (c)(i)</th><th>Contribution per unit</th><th></th><th></th><th>Units</th><th></th></tr>
<tr><td>1</td><td>4 200</td><td>40 – 20 = 20</td><td>(1)</td><td>(years 1 and 2)</td><td>210</td><td>(1 OF)</td></tr>
<tr><td>2</td><td>8 500</td><td>40 – 20 = 20</td><td></td><td></td><td>425</td><td>(1 OF)</td></tr>
<tr><td>3</td><td>14 050</td><td>50 – 25 = 25</td><td>(1)</td><td>(years 3 and 4)</td><td>562</td><td>(1 OF)</td></tr>
<tr><td>4</td><td>25 300</td><td>50 – 25 = 25</td><td></td><td></td><td>1012</td><td>(1 OF)</td></tr>
<tr><td>5</td><td>40 500</td><td>55 – 25 = 30</td><td>(1)</td><td></td><td>1350</td><td>(1 OF)</td></tr>
</table></td><td>8</td></tr>
</table>

Question	Answer	Marks
5(d)	The machine has a positive net present value, but it is very small. **(1)** The payback is within the life of the machine. However, it is very late by being in the fifth year. **(1)** Wong Ho should purchase the machine as it has a positive net present value **(1)**, it pays back within the life of the machine **(1)** and it increases the production level. **(1)** Wong Ho should not purchase the machine as the data is all estimated **(1)** and could be wrong. If the small positive net present value becomes negative, **(1)** the payback does not happen in the lifetime and the production does not exceed the current production levels. **(1)** There may be additional potential costs, **(1)** such as training. **(1)** **1 for decision and max 4 for explanation**	**5**

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th></tr>
<tr><td>6(a)</td><td>
<table>
<tr><td></td><td>Jan
$</td><td></td><td>Feb
$</td><td></td><td>March
$</td><td></td></tr>
<tr><td>Balance b/f</td><td>4 500</td><td></td><td>(8 500)</td><td></td><td>(5 500)</td><td></td></tr>
<tr><td>Receipts from trade receivables</td><td>150 000</td><td></td><td>180 000</td><td></td><td>200 000</td><td>(1) all</td></tr>
<tr><td>Payments to trade payables</td><td>148 000</td><td>(2)</td><td>162 000</td><td>(2)</td><td>171 000</td><td>(2)</td></tr>
<tr><td>Payment for expenses</td><td>15 000</td><td></td><td>15 000</td><td></td><td>15 000</td><td>(1) all</td></tr>
<tr><td>Balance c/f</td><td>(8 500)</td><td></td><td>(5 500)</td><td></td><td>8 500</td><td>(1 OF)</td></tr>
</table>
Workings:
<table>
<tr><td></td><td>Nov
$</td><td>Dec
$</td><td></td><td>Jan
$</td><td></td><td>Feb
$</td><td></td><td>Mar
$</td><td>April
$</td></tr>
<tr><td>Revenue</td><td>150 000</td><td>180 000</td><td></td><td>200 000</td><td></td><td>210 000</td><td></td><td>225 000</td><td>240 000</td></tr>
<tr><td>Cost of sales</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Mark-up 25%</td><td>120 000</td><td>144 000</td><td>(1)</td><td>160 000</td><td>(1)</td><td>168 000</td><td>(1)</td><td>180 000</td><td>192 000</td></tr>
<tr><td>Closing inventory</td><td>36 000</td><td>40 000</td><td></td><td>42 000</td><td></td><td>45 000</td><td></td><td>48 000</td><td></td></tr>
<tr><td>Cost of sales</td><td>120 000</td><td>144 000</td><td></td><td>160 000</td><td></td><td>168 000</td><td></td><td>180 000</td><td></td></tr>
<tr><td>Closing inventory</td><td>36 000</td><td>40 000</td><td></td><td>42 000</td><td></td><td>45 000</td><td></td><td>48 000</td><td></td></tr>
<tr><td>Opening inventory</td><td></td><td>36 000</td><td></td><td>40 000</td><td></td><td>42 000</td><td></td><td>45 000</td><td></td></tr>
<tr><td>Purchases</td><td></td><td>148 000</td><td>(1 OF)</td><td>162 000</td><td>(1 OF)</td><td>171 000</td><td>(1 OF)</td><td>183 000</td><td></td></tr>
</table>
</td><td>9</td></tr>
<tr><td>6(b)</td><td>
Budgeted income statement
for the three-month period ending 31 March 2018
<table>
<tr><td></td><td>$</td><td></td><td>$</td><td></td></tr>
<tr><td>Sales</td><td></td><td></td><td>635 000</td><td>(1)</td></tr>
<tr><td>Opening inventory</td><td>40 000</td><td></td><td></td><td></td></tr>
<tr><td>Purchases</td><td>516 000</td><td>(1 OF)</td><td></td><td></td></tr>
<tr><td>Closing inventory</td><td>48 000</td><td></td><td>508 000</td><td></td></tr>
<tr><td>Gross profit</td><td></td><td></td><td>1275 000</td><td></td></tr>
<tr><td>Operating expenses</td><td></td><td></td><td>45 000</td><td></td></tr>
<tr><td>Depreciation</td><td></td><td></td><td>9 000</td><td></td></tr>
<tr><td>Profit for the period</td><td></td><td></td><td>73 000</td><td>(1 OF)</td></tr>
</table>
</td><td>3</td></tr>
</table>

Question	Answer	Marks
6(c)	$ Profit from operations 73 000 **(1 OF)** Depreciation 9 000 **(1 OF)** Increase in inventory (8 000) **(1 OF)** Increase in trade receivables (105 000) **(1)** Increase in trade payables 35 000 **(1)** Increase in cash 4 000 **(2 CF or 1 OF)** Cash at 1 January 2018 4 500 Cash at 31 March 2018 8 500 **(1 OF)** Workings: Increase in trade receivables ($210 000 + 225 000) – ($150 000 + $180 000) = $105 000 Increase in inventory ($48 000 – $40 000) = $8000 Increase in trade payables ($183 000 – $148 000) = $35 000	**8**
6(d)	Management decision will result in a cash deficit for March 2018 **(1OF)**. Therefore possibly delay purchase. **(1)** Review cash budget after March to see if payment can be delayed. **(1)** Arrange alternative finance, e.g. loan. **(1)** Will incur interest charges **(1)** which will affect profit. **(1)** Ask supplier for more favourable payment terms which don't impact cash flow as much. **(1)** May have to delay payment to suppliers/expenses, **(1)** which may affect credit terms or confidence **(1)** of suppliers. If these issues can be overcome then it may be worth purchasing the new system. **(1)** Purchase of new system may allow better management of cash flow. **(1)** Accept any reasonable analysis. **(1 mark)** for decision **+** **4 marks** for valid discussion points	**5**