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CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the May/June 2015 series

9706 ACCOUNTING

9706/21

Paper 2 (Structured Questions – Core),
maximum raw mark 90

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1 (a)

Patel's Income statement for the year ended 31 December 2014

	\$	\$
Sales: Credit (156 420 + 13 690 – 14 670)		155 440 (1)OF
Cash (20 700 + 4800 – 800 + 950)		<u>25 650 (2)OF</u>
		181 090
Less cost of sales		
Inventory at 1 Jan 2014	21 750	
Purchases (109 620 + 14 900 – 16 750)	107 770 (2)OF 1 both creds l o/f total	
Less goods for own use	<u>(2 600) (1)</u>	
	126 920	
Less inventory at 31 December 2014	<u>(22 450)</u>	<u>104 470</u>
Gross profit		76 620 (1)OF
Less expenses		
Wages (22 670 + 1400 – 1200)	22 870 (1)	
Rent	16 000	
Electricity	8 650	
General expenses	4 750	
Loss on motor vehicle (2880 – 1500)	1 380 (1)	
Depreciation on: motor vehicles (7600 – 2880(1) + 16 400) × 0.2	4 224 (1)OF	
fixtures and fittings	1 500 (1)	
Provision for doubtful debts (13 690 – 750) × 0.05	647 (1)	
Bad debts written off	<u>750 (1)</u>	<u>(60 771)</u>
Profit for the year		<u>15 849 (1)OF</u>

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Patel's Statement of financial position at 31 December 2014

	\$	\$	\$
Non-current assets			
Land and buildings			50 000 (1) for L&b & FF
Motor vehicles (7600 – 2880(1) + 16400 – 4224(1))			16 896
Fixtures and fittings			4 500
			<u>71 396</u>
Current assets			
Inventory			22 450
Trade receivables (13 690 – 750 – 647)			12 293 (1)OF
Rent in advance (1000 + 19 000 – 16 000)			4 000 (1)
Cash at bank			14 510
Cash			950
			<u>54 203</u>
Total assets			<u>125 599</u>
Capital and liabilities			
Opening capital	(W1)		100 850 (1)
Add profit for the year			15 849
			<u>116 699</u>
Less drawings (4800 (1) + 2600 (1))			7 400
			<u>109 299</u>
Current liabilities			
Trade payables			14 900
Wages			1 400
			<u>16 300 (1)C/F</u>
Total capital and liabilities			<u>125 599</u>

Working notes

W1

Capital at 1 January 2013

Bank	16 980		
Land and buildings	50 000	Trade payables	16 750
Fixtures and fittings	6 000	Wages	1 200
Motor vehicles	7 600		
Trade receivables	14 670		
Inventory	21 750		
Cash	800		
Rent	1 000		
	<u>118 800</u>		
Capital	<u>100 850</u>		17 950

[9]

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(c) Five year loan

Advantage:

- Fixed rate of interest
- Helps plan cash flow

Disadvantage:

- May pay more interest if rates fall
- Interest payable for whole period
- May be secured on assets

Bank overdraft

Advantage

- No interest charged if not used
- Can be paid off whenever you like

Disadvantage

- Higher rate of interest than loan
- Can be called in by the bank at any time

**1 mark for each advantage and disadvantage.
1 mark x 2 for development.**

[Total: 30]

2 (a) Mark up expresses the gross profit (1) as a percentage of cost price of the goods sold (1). [2]

(b) Trading section of income statement for the year ended 31 March 2014.

	\$		\$
Revenue	100 000		420 000
Cost of sales			
Opening inventory	40 000 (1)		
Purchases	340 000 (1)OF		
Closing inventory*	<u>(80 000) (4)</u>		<u>300 000 (1)</u>
Gross profit (1)			<u>120 000 (1)OF</u>

[9]

[*300000 (1) / 5 (1) = 60000 × 2 (1) – 40000 (1)]

(c) (Gross profit / Revenue) (1) both × 100 (1) [2]

(d) (i) It shows the efficiency of assets to generate income (1). It shows how much every dollar of non-current assets (1) generates in sales revenue (1). A higher value indicates better utilisation of resources (1). [4]

(ii)

Ratio	Formula	Calculation
Non-current asset turnover	Sales revenue / non-current asset NRV(1)	$\frac{420\,000 (1)}{550\,000} = \$0.76 (1)$ times

[3]

- (e) 1 Avoid overstating trade receivables
 2 Be prudent.
 3 Anticipate that some customers may not pay and become bad debts.
 4 Application of matching principle [Max 3] [3]

	\$		\$
Income statement	250 (1)	Bal b/d	1650 (1)
Bal c/d	<u>1400</u>		
	<u>1650</u>		<u>1650</u>
		Bal c/d	1400 (1)

(f) Provision for doubtful debts account [3]

(g) (i) \$250 is to be added below gross profit in the income statement (1) as a decrease in the provision for doubtful debts. (1) [2]

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- (ii) \$1400 is to be shown as a deduction of trade receivables (1) in current assets (1) in the statement of financial position. [2]

[Total: 30]

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- 3 (a) Variable costs labour: $\$233\,000 - \$65\,000 = \$168\,000 / 70\,000$ units = \$2.40 per unit
 Variable costs overheads: $\$190\,000 - \$36\,000 = \$154\,000 / 70\,000$ units = \$2.20 per unit

Selling price		12.00	
Materials (\$259 000 / 70 000)	3.70 (1)		
Labour	2.40 (1)		
Overheads	<u>2.20 (1)</u>	8.30	
Contribution		<u>\$3.70 (1)</u>	[4]

- (b) Variable costs labour: $\$372\,000 - \$48\,000 = \$324\,000 / 90\,000$ units = \$3.60 per unit
 Variable costs overheads: $\$207\,000 - \$45\,000 = \$162\,000 / 90\,000$ units = \$1.80 per unit

Selling price		8.00	
Materials (\$180 000 / 90 000)	2.00 (1)		
Labour	3.60 (1)		
Overheads	<u>1.80 (1)</u>	7.40	
Contribution		<u>\$0.60 (1)</u>	[4]

- (c) Breakeven point = $(\$48\,000 + \$45\,000 (1)) / \$0.60 (1) \text{OF} = 155\,000$ units [2]

- (d) Breakeven point = $155\,000$ units (1)OF $\times \$8 = \$1\,240\,000$ (1)OF [2]

- (e) Margin of safety = $(90\,000 - 155\,000) (1) \text{OF} \times \$8 = \$(520\,000) (1) \text{OF}$ [2]

(f) **Proposal 1**

Revised sales of Zed: $90\,000 \times 95\% = 85\,500$ units
 Revised contribution of Zed: $\$0.60 + \$1.20 = \$1.80$

		\$	
Contribution Zed (85 500 (1) \times \$1.80 (1))	153 900		
Fixed overheads (\$48 000 + \$45 000)	<u>93 000 (1)</u>		
Revised profit Zed	60 900 (1)		
Profit Wye	<u>158 000</u>		
Revised profit	<u>218 900 (1)</u>		[5]

(g) **Proposal 2**

		\$	
Original profit Wye	158 000 (1)		
Additional contribution (70 000 \times 40%) \times \$3.70	103 600 (1)		
Less: Additional fixed costs – redundancy	(20 000) (1)		
Zed overheads	<u>(45 000) (1)</u>		
Revised profit	<u>196 600 (1)OF</u>		[5]

Accept revised profit of \$148 600 if existing fixed costs of \$48 000 are not stated.

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(h) Company should choose proposal 1 / continue producing Zed (1)OF

Reasons

- Year 1 profit is higher by \$22 300 (1)
 - Subsequent years profits are higher by additional \$20 000 (1) due to no further redundancy costs (1)
 - But may lose customers for Wye due to not being able to supply Zed (1)
 - May encounter bad publicity because of the redundancies (1)
 - Forecast 40% increase in Wye sales may not be accurate (1)
- [max 5 for reasons and 1 for decision]**

[6]

[Total: 30]