
ACCOUNTING**9706/32**

Paper 3 Structured Questions

May/June 2017

MARK SCHEME

Maximum Mark: 150

Published

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 2017 series for most Cambridge IGCSE[®], Cambridge International A and AS Level and Cambridge Pre-U components, and some Cambridge O Level components.

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1(a)	<p style="text-align: center;">Richard Ang Manufacturing account for year ended 31 July 2016</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td></td> <td style="text-align: right;">\$</td> <td style="text-align: right;">\$</td> <td></td> </tr> <tr> <td>Opening inventory of raw materials</td> <td></td> <td style="text-align: right;">14 800</td> <td></td> </tr> <tr> <td>Purchases</td> <td></td> <td style="text-align: right;">207 600</td> <td></td> </tr> <tr> <td>Carriage inwards</td> <td></td> <td style="text-align: right;"><u>6 800</u></td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">229 200</td> <td></td> </tr> <tr> <td>Closing inventory of raw materials</td> <td></td> <td style="text-align: right;"><u>16 400</u></td> <td></td> </tr> <tr> <td>Cost of raw materials consumed</td> <td></td> <td style="text-align: right;">212 800</td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Direct wages</td> <td></td> <td style="text-align: right;"><u>171 500</u></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Prime cost</td> <td></td> <td style="text-align: right;">384 300</td> <td style="text-align: right;">(1)OF</td> </tr> <tr> <td>Indirect wages</td> <td></td> <td style="text-align: right;">51 400</td> <td></td> </tr> <tr> <td>Factory overhead</td> <td></td> <td style="text-align: right;"><u>161 000</u></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">596 700</td> <td></td> </tr> <tr> <td>Opening work in progress</td> <td style="text-align: right;">23 500</td> <td></td> <td></td> </tr> <tr> <td>Closing work in progress</td> <td style="text-align: right;"><u>20 200</u></td> <td style="text-align: right;"><u>3 300</u></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Cost of goods manufactured</td> <td></td> <td style="text-align: right;">600 000</td> <td></td> </tr> <tr> <td>Factory profit 20%</td> <td></td> <td style="text-align: right;"><u>120 000</u></td> <td style="text-align: right;">(1)OF</td> </tr> <tr> <td>Transferred to (Trading section of) the Income Statement</td> <td></td> <td style="text-align: right;"><u>720 000</u></td> <td style="text-align: right;">(1)OF</td> </tr> </table> <p>Workings</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td>Direct wages</td> <td style="text-align: right;">\$168 000+\$3500=\$171 500</td> </tr> <tr> <td>Factory overheads:</td> <td></td> </tr> <tr> <td>Total rent:</td> <td style="text-align: right;">\$24 000+\$16 000=\$40 000</td> </tr> <tr> <td>Revised allocation rate 3:</td> <td style="text-align: right;">1</td> </tr> <tr> <td>Factory overheads:</td> <td style="text-align: right;">\$40 000×3/4=\$30 000</td> </tr> <tr> <td>Factory overheads</td> <td style="text-align: right;">=\$155 000+(\$30 000–\$24 000)=\$161 000</td> </tr> </table>		\$	\$		Opening inventory of raw materials		14 800		Purchases		207 600		Carriage inwards		<u>6 800</u>				229 200		Closing inventory of raw materials		<u>16 400</u>		Cost of raw materials consumed		212 800	(1)	Direct wages		<u>171 500</u>	(1)	Prime cost		384 300	(1)OF	Indirect wages		51 400		Factory overhead		<u>161 000</u>	(1)			596 700		Opening work in progress	23 500			Closing work in progress	<u>20 200</u>	<u>3 300</u>	(1)	Cost of goods manufactured		600 000		Factory profit 20%		<u>120 000</u>	(1)OF	Transferred to (Trading section of) the Income Statement		<u>720 000</u>	(1)OF	Direct wages	\$168 000+\$3500=\$171 500	Factory overheads:		Total rent:	\$24 000+\$16 000=\$40 000	Revised allocation rate 3:	1	Factory overheads:	\$40 000×3/4=\$30 000	Factory overheads	=\$155 000+(\$30 000–\$24 000)=\$161 000	7
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1(d)	<p>To remove unrealised profit from income statement (1) otherwise profits are overstated (1) by amount of unrealised profit.</p> <p>In accordance with the prudence concept (1), to ensure inventories are not overvalued (1) and are valued at cost and not cost plus a mark-up (1).</p> <p>Max 4</p>	4																															
1(e)	<p>Responses could include:</p> <p>Advantages</p> <p>Family help</p> <ul style="list-style-type: none"> Potential for new market Less risk of obsolete stock <p>Disadvantages</p> <ul style="list-style-type: none"> Less inventory to sell/may not be able to respond to increase in demand More competition May undercut him If doesn't charge sister he will lose profit If sister's business fails he might not get paid <p>1 mark for each advantage. Max 2</p> <p>1 mark for each disadvantage. Max 2</p>	4																															
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2(a)	<p>(i) Return on capital employed $\frac{\\$400\,000^*}{\\$6\,300\,000} = 6.35\%$ (1)OF</p> <p>*Profit from ops for 2016 $\\$160\,000 \div (1-60\%) = \\$400\,000$</p> <p>(ii) Earnings per share $\frac{\\$400\,000}{1\,000\,000} = \\0.40 (1)OF</p> <p>(iii) Price earnings ratio $\frac{\\$6.4}{\\$0.4} = 16.00$ (1)OF</p> <p>(iv) Dividend cover $\frac{\\$400\,000}{\\$240\,000} = 1.67$ times (1)OF</p> <p>(v) Dividend yield $\frac{\\$240\,000}{1\,000\,000} = \\0.24 (1)OF</p> <p>$\frac{\\$0.24}{\\$6.4} = 3.75\%$ (1)OF</p>	8																																				
2(b)	<p>Share capital and reserves at 31 December 2017</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;"></td> <td style="text-align: right; width: 10%;">\$000</td> <td style="width: 30%;"></td> </tr> <tr> <td>Ordinary shares capital</td> <td style="text-align: right;">6000</td> <td>(1)</td> </tr> <tr> <td>Share premium</td> <td style="text-align: right;">700</td> <td>(1)</td> </tr> <tr> <td>Retained earnings (W1)</td> <td style="text-align: right;"><u>1034</u></td> <td></td> </tr> <tr> <td></td> <td style="text-align: right;"><u>7734</u></td> <td></td> </tr> <tr> <td colspan="3"> </td> </tr> <tr> <td>W1</td> <td style="text-align: right;">\$000</td> <td></td> </tr> <tr> <td>Retained earnings at 1.1.2017</td> <td style="text-align: right;">800</td> <td>(1)</td> </tr> <tr> <td>Profit for the year for 2017</td> <td style="text-align: right;">585</td> <td>(1)OF</td> </tr> <tr> <td>(400+185)</td> <td></td> <td></td> </tr> <tr> <td>Dividend paid $585 \times 60\%$</td> <td style="text-align: right;"><u>(351)</u></td> <td>(1)OF</td> </tr> <tr> <td>Retained earnings at 31.12.2017</td> <td style="text-align: right;">1034</td> <td>(1)OF</td> </tr> </table>		\$000		Ordinary shares capital	6000	(1)	Share premium	700	(1)	Retained earnings (W1)	<u>1034</u>			<u>7734</u>					W1	\$000		Retained earnings at 1.1.2017	800	(1)	Profit for the year for 2017	585	(1)OF	(400+185)			Dividend paid $585 \times 60\%$	<u>(351)</u>	(1)OF	Retained earnings at 31.12.2017	1034	(1)OF	6
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2(c)	<p>(i) Return on capital employed $\frac{\\$585\,000}{\\$7\,734\,000} = 7.56\%$ (1)OF (1)OF</p> <p>(ii) Earnings per share $\frac{\\$585\,000}{1\,200\,000} = \\0.49 (1)OF (1)</p>	6
2(d)	<p>Responses could include:</p> <ul style="list-style-type: none"> • Better/higher/increased return on capital employed • Better/higher/increased earnings per share • Share price may increase due to improved profitability • Share price may decrease with more shares in circulation • The project return is higher than the 2016 return on capital employed <p>(1 mark) for the recommendation + (1 mark × 4 reasons)</p>	5
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3(a)	<p>Responses may include:</p> <ul style="list-style-type: none"> • Financial statements need to be understandable by different interested stakeholders; • Financial statements need to be relevant for decision making • Financial statements need to be reliable • Financial statements need to be comparable • Accounting policies adopted are appropriate • Accounting concepts/assumptions are adhered to, i.e. Prudence, accrual, going concern and consistency • To ensure fair representation and to show true and fair view • Form the basis of auditor's opinion <p>Accept any reasonable alternative (1 mark) × 4 valid points</p>	4

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3(b)	The directors manage the company on behalf of the owners (shareholders) (1) . They are accountable and report to the owners (shareholders) (1)	2																																																																																				
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3(d)	<p>Treatment of compensation (reference IAS 37) (1) There is a 90% probability(1) of losing the case. Therefore a provision for compensation (\$29 000) should be shown as a current liability/other payable (1)</p> <p>Treatment of trade receivables Z Limited only recovered \$21 000 in the form of non-current assets. (1) The remaining \$9000 which is irrecoverable debt should be written off as bad debt (or a specific provision) against retained earnings (1). The full \$30 000 has been deducted from trade receivables (1).</p> <p>Treatment of machinery (reference IAS 36) (1) According to IAS 36, an asset is impaired when its carrying amount (\$40 000) is more than its recoverable amount (\$32 500). (1). Recoverable amount is the higher of its fair value (\$32 500) and value in use (\$19 500)(1). The impaired loss of the piece of machinery is \$7500 (\$40 000–\$32 500) which has to be written off against retained earnings. (1)</p> <p>Max 2 marks for each adjustment</p>	6
3(e)	<p>Advantages</p> <ul style="list-style-type: none"> • increase the credibility/reliability of accounts • maybe helpful if Jack wants to apply for a bank loan/investment from 3rd parties • help identify weaknesses in the internal procedures <p>Disadvantages</p> <ul style="list-style-type: none"> • high cost of audit fee • no segregation of ownership and management in Jack’s business • no need for audit as sole trader <p>Max 3 marks for the advantages and Max 2 marks for the disadvantages</p>	5
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4(e)	<p>The responses may include:</p> <ul style="list-style-type: none"> • ROCE before the acquisition is 7.79% ($\\$352\,000/\\$4\,516\,000$) • Additional return from this acquisition is 23.5% $\langle (\\$540\,000 - \\$352\,000)/\\$800\,000 \rangle$ • Shareholders may receive higher dividend • Improvement through the synergy effect, e.g. greater buying power, discounts from suppliers • Economy of scale • Alex and Brown's skills, experience and methods may bring additional benefits • Goodwill of partnership brings additional revenue/customers • Efficiency in operation • Access to wider market <p>(1 mark) × 5 valid points</p>	5
	Total:	25

Question	Answer	Marks																												
5(a)	<p style="text-align: center;">Flexed budget for April</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td></td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td></td> </tr> <tr> <td>Sales</td> <td></td> <td style="text-align: right;">270 000</td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Direct labour</td> <td style="text-align: right;">75 600</td> <td></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Direct materials</td> <td style="text-align: right;">65 880</td> <td></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Variable overheads</td> <td style="text-align: right;">18 000</td> <td></td> <td style="text-align: right;">(1)</td> </tr> <tr> <td>Fixed overheads</td> <td style="text-align: right;"><u>19 300</u></td> <td style="text-align: right;"><u>178 780</u></td> <td></td> </tr> <tr> <td>Profit</td> <td></td> <td style="text-align: right;"><u>91 220</u></td> <td style="text-align: right;">(1)OF</td> </tr> </table>		\$	\$		Sales		270 000	(1)	Direct labour	75 600		(1)	Direct materials	65 880		(1)	Variable overheads	18 000		(1)	Fixed overheads	<u>19 300</u>	<u>178 780</u>		Profit		<u>91 220</u>	(1)OF	6
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5(b)(iii)	MUV = 1220 (1) A (1)	2																												
5(b)(iv)	MPV = 3850 (1) F (1)	2																												

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5(c)	<p>MUV – extra hours meant staff were demotivated/tired which increased wastage (1) inefficient use of material (1) MPV – quantity discount given (1) purchased materials from cheaper supplier (1)</p> <p>Maximum 1 for MUV and 1 for MPV</p>	2
5(d)	<p>The suggestion appears sound (1) because the actual labour costs are higher (1) by \$11 390 (2)* than labour costs under the suggestion.</p> <p>* (\$95 630 (1)–\$84 240 (1))=\$11 390</p> <p>But inexperienced staff might make more errors (1) leading to an increase in the adverse materials usage variance. (1). Although labour costs are saved there will be higher training costs (1) which will impact on production/profit (1).</p> <p>Decision (1) Justification (5)</p>	6
5(e)	<p>Helps preparation of budgets. Helps calculation of quotes/prices. Highlights the activities giving rise to the variances. Enables responsibility accounting.</p> <p>Any three comments × (1 mark)</p>	3

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5	90 000																																																																								
6(c)	<p>Simple to calculate/understand. Uses cash flows not profits so not corrupted by accounting methods. Reduces risk by preferring early cash flows/short term projects. Useful as a first screening tool. Useful for capital rationing decisions to identify those projects that generate cash quickly. Better for liquidity—prefers early cash flows.</p> <p>(1 mark) × any 3 reasons, Max 3</p>	3																																																																							

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Question	Answer	Marks																																																																									
6(d)	<table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;"></td> <td style="text-align: center;">Year 0</td> <td style="text-align: center;">Year 1</td> <td style="text-align: center;">Year 2</td> <td style="text-align: center;">Year 3</td> <td style="text-align: center;">Year 4</td> <td style="text-align: center;">Year 5</td> <td style="text-align: center;">NPV</td> <td></td> </tr> <tr> <td></td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td style="text-align: center;">\$</td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Total cash flows</td> <td style="text-align: right;">(125 000)</td> <td style="text-align: right;">24 000</td> <td style="text-align: right;">25 000</td> <td style="text-align: right;">25 000</td> <td style="text-align: right;">25 000</td> <td style="text-align: right;">90 000</td> <td></td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Discount factor</td> <td style="text-align: right;">1</td> <td style="text-align: right;">0.909</td> <td style="text-align: right;">0.826</td> <td style="text-align: right;">0.751</td> <td style="text-align: right;">0.683</td> <td style="text-align: right;">0.621</td> <td></td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Discounted cash flow</td> <td style="text-align: right;">(125 000)</td> <td style="text-align: right;">21 816</td> <td style="text-align: right;">20 650</td> <td style="text-align: right;">18 775</td> <td style="text-align: right;">17 075</td> <td style="text-align: right;">55 890</td> <td style="text-align: right;">9206</td> <td></td> </tr> <tr> <td></td> <td style="text-align: right;">(1)OF</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">(1)OF</td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: center;">⌋</td> <td style="text-align: center;">⌋</td> <td style="text-align: center;">⌋</td> <td style="text-align: center;">⌋</td> <td style="text-align: center;">⌋</td> <td></td> <td></td> </tr> <tr> <td></td> <td></td> <td colspan="5" style="text-align: center;">all 5 years (1)OF</td> <td></td> <td></td> <td></td> </tr> </table>		Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	NPV			\$	\$	\$	\$	\$	\$	\$		Total cash flows	(125 000)	24 000	25 000	25 000	25 000	90 000			Discount factor	1	0.909	0.826	0.751	0.683	0.621			Discounted cash flow	(125 000)	21 816	20 650	18 775	17 075	55 890	9206			(1)OF						(1)OF				⌋	⌋	⌋	⌋	⌋					all 5 years (1)OF								3
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6(e)	$10\% (1) + \left[20 - 10(1) \times \frac{9206}{9206 + 24953} (1OF) \right] = 12.695\% (1)OF$	4																																																																									
6(f)	<p>NPV Both are positive but alternative machine has the better/higher NPV (1) IRR First machine has the better/higher IRR (1) Payback First machine has the better/shorter payback (1) Cost First machine has the lower initial outlay which helps as Tisha has limited capital available (1)</p> <p>Choose the first machine (1) 1 For decision + Maximum 3 for reasons</p>	4																																																																									
6(g)	<p>Cash flow patterns (1) how reliable are they? (1) Which one is closest to current ROCE (1) Cost of capital (1) Source of capital/funding (1) Quality of output (1) Training time/costs (1) Environmental issues (1)</p> <p>1 mark for valid point, Max 4</p>	4																																																																									
	Total:	25																																																																									