

**CAMBRIDGE INTERNATIONAL EXAMINATIONS**

Cambridge International Advanced Subsidiary and Advanced Level

**MARK SCHEME for the March 2016 series**

**9706 ACCOUNTING**

**9706/32**

Paper 3 (A Level Structured Questions),  
maximum raw mark 150

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1 (a)

Kelang Limited			
Manufacturing account for year ended 31 December 2015			
	\$		\$
Direct materials consumed			
Inventory at 1 January 2015	24 600		
Purchases	287 000		
Carriage inwards	3 700 (1)		
Inventory at 31 December 2015	<u>(28 800)</u>		286 500 (1)of
Direct wages			<u>344 000</u>
Prime cost			630 500 (1of)
Factory overhead			
Indirect materials	43 000	} (1)	
Indirect wages	69 000		
Depreciation on property	14 000	} (1)	
Depreciation on plant and machinery	24 000		
Water and electricity expenses	12 400 (1)		
Other factory overheads	<u>32 500</u>		194 900
			<u>825 400</u>
Work in progress at 1 January 2015	66 800	} (1)	
Work in progress at 31 December 2015	<u>72 200</u>		
Cost of goods manufactured			820 000
Factory profit 20%			<u>164 000 (1)of</u>
Transferred to the Trading section of the Income Statement			<u>984 000</u>
			<b>[8]</b>

(b)

Kelang Limited			
Income statement for the year ended 31 December 2015			
	\$		\$
Revenue			1 562 000
Cost of sales			
Finished goods at 1 January 2015	162 000		
Transferred from Manufacturing account	984 000 (1of)		
Finished goods at 31 December 2015	<u>186 000</u>		<u>960 000</u>
Gross profit			602 000 (1of)
Administrative expenses	374 000		
Depreciation on property	6 000	} (1)	
Depreciation on office equipment	18 000		
Water and electricity	<u>3 100 (1)</u>		
			<u>401 100</u>
Factory profit			<u>200 900</u>
Less: Increase in provision for unrealised profit			164 000 (1of)
Profit from operations			<u>4 000 (1)</u>
			<u>360 900 (1of)*</u>
			<b>[7]</b>

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### Workings

1	Depreciation on property	$\$400\,000 \times 5\% = \$20\,000$
	Allocated to production	$\$20\,000 \times 70\% = \$14\,000$
	Allocated to administration	$\$20\,000 \times 30\% = 6000$
2	Depreciation on manufacturing plant and machinery	$(\$350\,000 - \$230\,000) \times 20\% = \$24\,000$
3	Depreciation on office equipment	$\$120\,000 \times 15\% = \$18\,000$
4	Year end unrealised profit	$\$186\,000 \times 1 / (5 + 1) = 31\,000$
5	Water and electricity	$\$14\,000 + 1500 = \$15\,500$
	Allocated to production	$\$15\,500 \times 80\% = \$12\,400$
	Allocated to administration	$\$15\,500 \times 20\% = \$3100$

(c) Responses could include:

transfer price includes unrealised profit  
 transfer price less unrealised profit represents the cost of finished goods  
 prudence concept  
 inventory valued at the lower of cost and net realisable value IAS 2

(1 mark)  $\times$  three valid points

[3]

(d) Responses could include:

Arguments for 'should not continue'  
 not acceptable for external reporting  
 the % of mark-up is subjective

Arguments for 'should continue'  
 production department continues to be treated as profit centre  
 facilitates pricing  
 cost of production department is better controlled  
 compare efficiency, reward efficient managers  
 facilitates a system of responsibility accounting

**Max 2  $\times$  3 marks** (1 mark for stating and 2 for development) for justification

(max 3 for arguments for should continue  
 max 3 for arguments for should not continue)

**1 mark** for recommendation

[7]

[Total: 25]

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2 (a) (i)  $1250 \div 50 = \$25$  (1) [1]

(ii)  $(3050 \times 1000/100)$  (1) – 25 000 (1) – 4000 (1) = \$1500 (1of) [4]

(b) (i)

	Consignment account		
	\$		\$
Goods on consignment	25 000 (1)	Sumit (sales)	54 000 (1)
Bank (freight)	4 000 (1)	Balance c/d	3 050 (1)
Sumit (import duties)	1 500 (1of)		
Sumit (commission)	10 800 (1of)		
Consignment profit	15 750 (1of)		
	<u>57 050</u>		<u>57 050</u>
Balance b/d	3 050 (1of)		

[8]

(ii)

	Sumit account		
	\$		\$
Consignment a/c (sales)	54 000 (1)	Consignment a/c (import duties)	1 500 (1of)
		Consignment a/c (commission)	10 800 (1of)
		Bank	26 800 (1)
		Balance c/d	14 900 (1of)
	54 000		54 000
Balance b/d	14 900 (1of)		

[6]

(c) Chin should make this change (1) of decision

This would reduce costs (1) and hence increase profit on consignment (1) by  $11$  (1)  $\times$  \$160 = \$1760 (1of)

Increased risk (1) Demand may fall (1) resulting in unsold inventory (1)

Finance may be required to buy all the inventory in one go (1) Borrowing may increase during the year (1) There may be an opportunity cost of surplus funds (1)

On average radios would stay in inventory much longer (1) with risk of obsolescence (1) or theft/damage (1)

Sumit might not be able to organise adequate storage space (1) with inventory holding costs and might require a higher rate of commission to cope with the added responsibility (1)

**1 mark for decision**

**Max 2 for calculation**

**Max 3 for discussion**

[6]

[Total: 25]

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- 3 (a) Equity and liabilities section of the Statement of financial position at 31 December 2015

	\$
Equity and liabilities	
Equity	
\$0.50 ordinary shares	300 000 (1)
5% \$0.25 Non-redeemable preference shares	25 000
Share premium	150 000 (1)
Retained earnings	<u>(3 000) (1)</u>
Total equity	<u>472 000</u>
Non-current liabilities	100 000 (1)
Current liabilities	<u>10 000 (1)</u>
Total equity and liabilities	<u>582 000</u>

[5]

- (b) (i) dividend cover  
 $(144\,000 - 2000) = 142\,000 / 54\,000$  (1) = 2.63 times (1)

- (ii) gearing ratio  
 $125\,000(1) / 572\,000 \times 100 = 21.85\%$  (1) of

- (iii) return on capital employed  
 $192\,000 / 572\,000(1) \times 100 = 33.57\%$  (1) of

[6]

- (c) Johnson plc has a higher dividend cover (1), a lower ordinary dividend per share (1) of \$0.09 (1) and a lower earnings per share (1) of \$0.24 (1) but a lower gearing ratio (1) a higher return on capital employed (1)

This means that Johnson plc is not borrowing as much from external sources proportional to the amount of capital employed compared to Samuel plc (1). Samuel has more risk. (1)

The capital the company is being used more efficiently as there is a greater return (1)

However the ordinary dividends could only be paid out of profits 2.63 times compared to 2.1 times for Samuel plc. (1). **Max 9**

[9]

- (d) The amount of dividend on ordinary shares is variable with the level of profits therefore for short term return Samuel plc may be better as the dividend return is much better (1) as is the earnings per share (1) Better in short term (1)

However Johnson plc has borrowed less from external sources (1) and is using its capital employed to achieve a greater return. (1) so may be better for long term growth (1)

Recommendation either Samuel or Johnson (1)

**Max 4 marks for justification**

**1 mark for recommendation**

[5]

[Total: 25]

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4 (a)

Fernando and Gurdip – Statement of Financial Position at 1 July 2015

	\$	\$
Assets		
Non-current assets		308 000 (1)
Current assets		
Inventories	46 893 (1)	
Trade receivables	61 110 (1)	
Cash and cash equivalents	4 100	112 103
Total assets		<u>420 103</u>
Capital and liabilities		
Capital – Fernando	96 750	
– Gurdip	281 853	
		<u>378 603 (7)</u>
Current liabilities		
Trade payables	41 500 (1)	
Total capital and liabilities		<u>420 103</u>
Workings		
	Fernando	Gurdip
Balance b/d	94 450	259 000 (1) both
Non-current assets	6 000	22 000 (1) both
Inventories	(650)	(307) (1) both
Provision	(1 050)	(840) (1) both
Goodwill	7 000	20 000 (1) both
Goodwill written off	(9 000)	(18 000) (1) both
	<u>96 750</u>	<u>281 853 (1) of both</u>

[11]

(b)

	\$	\$	\$
Budgeted profit for the year			80 000
Add:			
Interest on drawings – Fernando	1 620		
– Gurdip	1 200		2 820 (1) both
			<u>82 820</u>
Deduct:			
Salary – Fernando	30 000		
– Gurdip	20 000	50 000 (1)	
Interest on capital – Fernando	3 870		
– Gurdip	11 274	15 144 (1) of	(65 144)
			<u>17 676</u>
Profit after appropriations – Fernando			5 892
– Gurdip G			<u>11 784 (1) of both (correct ratio)</u>
			<u>17 676</u>

[4]

(c) The legal formation of a corporate entity separate from the partners (1).

[1]



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(d)

	Alpha	Beta
	\$	\$
Machine set-up	66 000	44 000 <b>(1)both</b>
Machine maintenance	81 000	99 000 <b>(1)both</b>
Materials handling	60 000	30 000 <b>(1)both</b>
Product inspection	100 000	60 000 <b>(1)both</b>
	<u>307 000</u>	<u>233 000</u>

[4]

(e)

	Alpha	Beta
	\$	\$
Direct materials	80 000	240 000
Direct labour	150 000	300 000
Production overheads	307 000 <b>(of)</b>	233 000 <b>(of)</b>
Total production costs	537 000	773 000
Unit cost	<u>537.00</u> <b>(1of)</b>	<u>154.60</u> <b>(1of)</b>
Mark-up 50%	<u>268.50</u>	<u>77.30</u> <b>(1of)</b>
Unit selling price	<u>805.50</u> <b>(1of)</b>	<u>231.90</u> <b>(1of)</b>

[5]

(f) Responses could include:

the market price of the products  
the impact on the profit  
the impact on the customers/demand  
the effect on competition

Accept any reasonable alternative

**(2 marks)** × 3 explanations

[6]

(g) Responses could include:

Should change/should not change **(1)** recommendation

Jumal Limited set the selling price on cost-plus base, therefore accurate cost information is very important.

Comparing the traditional approach with activity based costing approach, if traditional approach is adopted, Alpha is under-costed (Alpha consumes a higher level of resources) while Beta is over-costed (Beta consumes a lower level of resources). This is the consequence of subsidisation.

The problem of product under costing and over costing gives rise to a wrong selling price setting.

Accept any reasonable alternative

**(2 marks)** × explanation

**1 mark for recommendation**

[3]

[Total: 25]



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6 (a)

	\$	
Sales	<u>2 072 000 (1)</u>	$\$1\,184\,000 \times 175\%$
Direct materials	288 000 (1)	$8000 \text{ units} \times 3 \text{ kilos} \times \$12$
Direct labour	640 000 (1)	$8000 \text{ units} \times 4 \text{ hours} \times \$20$
Fixed overhead	<u>256 000 (1)</u>	$8000 \text{ units} \times 4 \text{ hours} \times \$8$
Manufacturing costs	<u>1 184 000</u>	
Gross profit	<u>888 000 (1) of</u>	

[5]

(b) Responses could include:

Flexible budget facilitates variance analysis

Comparison with the actual result is more meaningful if the budget is at the same activity level of the actual result.

What the budget will be if the actual output is known? In contrast with static budget which is prepared at the beginning of the budget period, flexible budget is prepared at the end of the budget period. This facilitates comparing the actual result for control purpose.

More realistic.

Accept any reasonable alternative

(1 mark)  $\times$  2 reasons

[2]

(c) (i) Direct materials price

$$(\$12 \times 22\,850 \text{ kg}) - \$269\,000 = \$5200(1) \text{ (F) (1)}$$

(ii) Direct materials usage

$$(7500 \times 3 \text{ kg} - 22\,850 \text{ kg}) \times \$12 = \$4200(1) \text{ (A) (1)}$$

(iii) Fixed overhead expenditure

$$\$256\,000 - \$250\,000 = \$600\,091 \text{ (F) (1)}$$

(iv) Fixed overhead volume

$$(8000 \text{ units} - 7500 \text{ units}) \times 4 \text{ hours} \times \$8 = \$16\,000(1) \text{ (A) (1)}$$

[8]

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- (d) (i) Adverse direct labour rate variance
- wage rate increases
  - trade union activity
  - inflation
  - use of more skilled labour
  - increase in overtime
  - poor labour supply increasing the rate per hour/ increase in minimum wage per hour.

Adverse direct labour efficiency variance

- workers not well trained
- workers with low skill
- poor working condition
- poor staff morale
- inefficient machine

**Accept any reasonable alternative**

(1 mark) × 6 points across labour variances

[6]

- (ii) Adverse fixed overhead volume variance
- actual production less than the budgeted production
  - favourable fixed overhead expenditure variance
  - actual fixed overhead expenditure is lower than the budget

**Accept any reasonable alternative**

(1 mark) × 2 points

[2]

- (e) Response could include:

- better training
- better working condition
- motivate workers with the use of bonus schemes
- better machine
- better working condition
- better quality materials

**Accept any reasonable alternative**

(2 marks) × explanation

[2]

[Total: 25]