Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ACCOUNTING **9706/21**

Paper 2 Structured Questions (Core) **October/November 2016**

MARK SCHEME

Maximum Mark: 90

Published

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1 **(a)**

Alan, Jack and Max
Capital accounts at 1 October 2014

	$ Alan	$ Jack	$ Max			$ Alan	$ Jack	$ Max	
Goodwill	16 000	16 000	8 000	**(1)**	Balance b/d	139 800	128 000		
Loan	15 000 **(1)**				Bank			27 000	**(1)**
Balance c/d	128 800	132 000	24 000		Inventory			5 000	**(1)**
					Goodwill	20 000	20 000 **(1)**		
	159 800	148 000	32 000			159 800	148 000	32 000	
					Balance b/d	128 800	132 000	24 000	**(1of)**

Goodwill: Accept Alan 4000 Cr, Jack 4000 Cr, Max 8000 Dr **(2)** **[6]**

(b) **(i)** Goodwill is the excess of the valuation of a whole business over the netbook value of its net assets **(1)** **[1]**

(ii) Reputation **(1)** customer base/monopoly **(1)** location **(1)** quality product **(1)** skilled workforce **(1)** **Max 3** **[3]**

(c)

Alan, Jack and Max
Current accounts

	$ Alan	$ Jack	$ Max			$ Alan	$ Jack	$ Max
Drawings	16 000	24 000	8 000	**(1)**	Balance b/d	9 500	7 500	
Interest on drawings	480	720	240	**(1)**	Loan interest	1 500 **(1)**		
Balance c/d	40 180	28 680	21 560		Interest on capital	9 660	9 900	1 800 **(1) of**
					Salary			10 000 **(1)**
	56 660	53 400	29 800		Share of residual profit	36 000	36 000	18 000 **(1)**
						56 660	53 400	29 800
					Balance b/d	40 180	28 680	21 560 **(1of)**

[7]

(d)

	$	
Share of profit (36 000 + 36 000 + 18 000)	90 000	**(1)**
Add:		
Interest on capital (9660 + 9900 + 1800)	21 360	**(1of)**
Salary – Max	10 000	**(1of)**
	121 360	
Less: interest on drawings (480 + 720 + 240)	(1 440)	**(1of)**
Profit for the year	119 920	**(1of)**

[5]

(e) **(i)** Answers could include:

the liquidity ratio (which excludes inventory) has fallen from 1.1 to 0.85. The partnership would be unable to pay all short-term liabilities from liquid assets **(1)** without selling inventory. **(1)**

trade receivable collection days have increased from 34 to 42 days. This may suggest that credit control is not working as well **(1)** or that longer terms are being allowed to maintain the level of sales. **(1)** Increased risk of bad debts. **(1)**

the partnership may find it difficult to obtain further supplies on credit **(1)** and may be unable to take advantage of cash discounts offered by suppliers. **(1)**
Max 4 **[4]**

(ii) the partners may need to consider introducing some additional capital **(1)** or Max could reduce his salary in exchange for a higher profit share. **(1)**

if there are any surplus non-current assets in the partnership, these could be sold. **(1)** The partnership may need to negotiate a non-current loan. **(1)**

the partners should review their credit control policy and make any necessary improvements such as sending statements or telephoning ahead of the due date and promptly chasing overdue accounts. **(1)**

the partners could consider offering cash discounts for early settlement, charging interest on overdue amounts and refusing further sales unless overdue debts are cleared. **(1)**

to help with liquidity, if debtors are taking longer to pay then the partners could consider taking longer to pay their trade payables. **(1)**
Max 4 **[4]**

[Total: 30]

2 **(a)** Sales ledger control account

	$			$	
Balance b/d	20 470		Irrecoverable debt written off	250	**(1)**
Bank	200	**(1)**	Discount allowed	830	**(1)**
			Contra	1 370	**(1)**
			Balance c/d	18 220	
	20 670			20 670	
Balance b/d	18 220	**(1of)**			

[5]

(b)

		$	
Original sales ledger balances extracted		18 740	
1	Sales invoice	960	**(1)**
2	Irrecoverable debt written off	(250)	**(1)**
3	Bank	(760)	**(1)**
	Bank	(670)	**(1)**
4	Unpaid cheque	200	**(1)**
Amended sales ledger balances		18 220	

[5]

(c) Accuracy / errors **(1)**
Prevention of fraud **(1)**
Total for trade receivables / final accounts **(1)** **[3]**

(d) Error of omission **(1)**
Error of commission **(1)**
Compensating error **(1)**
Error of original entry **(1)**
Max 2 **[2]**

[Total: 15]

3 (a)

	Ordinary shares $		Share premium $		Revaluation reserve $		Retained earnings $		Total	
Opening balance	300 000		20 000				635 210		955 210	**(1)(for row)**
Revaluation					250 000	**(1)**			250 000	
Issue of shares	30 000	**(1)**	(20 000)	**(1of)**	(10 000)	**(1of)**			–	
Profit for the year							230 809		230 809	
Dividends							(26 400)	**(1)**	(26 400)	
Total	330 000		0		240 000		839 619		1 409 619	**(1of)**

[7]

(b) The revaluation reserve is a capital reserve. **(1)** Capital reserves are not allowed to be used for the payment of a cash dividend. **(1)** The creation of a revaluation reserve is not a cash transaction as no cash has been generated for the payment of dividends. **(1)**
The capital reserve will increase the asset value **(1)** of the company and the shareholders interest and is in the accounts to reflect a true and fair view of the company accounts.**(1)**
Cash gain can only be realised if the asset is sold. **(1)**
Max 4 **[4]**

(c) Issue bonus shares **(1)**
Write off formation/preliminary expenses **(1)** **[2]**

(d) A bonus issue of shares is a capitalisation of reserves **(1)**
Free issue of shares/ no cash **(1)**
A rights issue is to existing shareholders **(1)**
A rights issue generates cash for the business **(1)**
Max 1 bonus, max 1 rights **[2]**

[Total: 15]

4 **(a)** Variable costs

		$	
Materials	220 × $22	4 840	
Production labour bonus	220 × $0.50	110	
Finishing labour bonus	220 × $0.25	55	
Weekly variable costs	22.75 **(1)** OR	5 005	**(1)**

Fixed costs: 345 + 280 + 150 + 500 + 260 = $1535 **(1)**

Contribution = (220 × $30) **(1)** – 5005 **(1of)** = $1595
OR
30 **(1)** – 22.75 **(1of)** = $7.25 per bookcase

Breakeven point = $1535 / $7.25 = 212 bookcases **(1of)** **[5]**

(b) Margin of safety: 220 – 212 = 8 bookcases **(1of)** × $30 = $240 revenue **(1of)** **[2]**

(c)

	$	
Sales revenue ($30 × 220 × 52)	343 200	**(1)**
Variable costs ($5005 × 52)	260 260	
Contribution ($1595 × 52)	82 940	**(1of)**
Fixed costs ($1535 × 52)	79 820	**(1of)**
Profit	3 120	**(1of)**

[4]

(d) Variable costs

	$	
Material (($22 + $2.25)	24.25	**(1)**
Production labour bonus*	0.50	}* **(1) for both**
Finishing labour bonus*	0.25	
Total variable costs	25.00	**(1)**

Selling price: 25 × (100 / 80) = $31.25 **(1of)** **[4]**

(e)

		$	$	
Sales revenue	220 × $30 × 52	343 200		
	100 × $29 × 52	150 800	494 000	**(1of)**
Variable costs	$5005 × 52	260 260		
	$2500 × 52	130 000	390 260	**(1of)**
Contribution			103 740	**(1of)**
Fixed costs	(79 820 + (140 × 52))		87 100	**(1of)**
Profit			16 640	**(1of)**

[5]

(f) Reasons for proceeding:

- Additional $13 520 profit
- Utilisation of spare capacity
- Less reliant on only one customer
- Only small increase in fixed costs
- Positive contribution

Reason for not proceeding

- Dando plc may cause problems due to lower price being offered to retailer
- Competitors may lower price and start price war

All answers based on previous own figures
Reasons for proceeding max 2
Reasons for not proceeding max 1
Advice 1 **[4]**

(g) Advantages **(max 4, 1 + 1 for development)**

- Averaging smooths out fluctuations in costs making comparison between periods more valid
- Averaged prices used to value closing inventory likely to be closer to latest prices
- Avoids identical items being charged to a job at different prices

Disadvantages **(max 2, 1 + 1 for development)**

- Average price has to be re-calculated after each purchase – time consuming
- Average price does not represent any price actually paid

[6]

[Total: 30]