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ACCOUNTING **9706/33**

Paper 3 Structured Questions **October/November 2016**

MARK SCHEME

Maximum Mark: 150

Published

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1 (a)

M Limited
Manufacturing Account for the year ended 31 December 2015

	$		$	
Inventory – raw materials at 1 January 2015	10 400			
Purchases of raw materials	146 200			
Carriage inwards	3 160	**(1)**		
	159 760			
Less inventory at 31 December 2015	(11 750)		148 010	
Direct wages			249 400	
Prime cost			397 410	**(1of)**
Indirect wages	54 650			
Rent	36 000	**(1)**		
Heat, light and power	25 680	**(1)**		
General expenses	9 450	**(1)**		
Depreciation on machinery	20 000	**(1)**	145 780	
			543 190	
Inventory work-in-progress 1 January 2015	12 600			
Inventory work-in-progress 31 December 2015	14 670		(2 070)	**(1)**
Factory cost of finished goods			541 120	
Add factory profit (20%)			108 224	**(1)of**
Factory cost transferred to income statement			649 344	**(1)of**

Workings:

Rent 49 000 – 4 000 = 45 000 / 5 = 9 000 × 4 = 36 000 (1)
Heat, light and power 28 600 + 3 500 = 32 100 / 5 = 6 420 × 4 = 25 680 (1)
General expenses 12 600 / 4 = 3 150 × 3 = 9 450 (1) **[9]**

(b)

	$		$	
Revenue			742 490	
Inventory of finished goods at 1 January 2015	14 904			
Finished goods transferred from the manufacturing account	649 344			
Inventory of finished goods at 31 December 2015	(15 750)		648 498	**(1)**
Gross profit			93 992	**(1)of**
Office salaries	24 780			
Carriage outwards	2 790	**(1)**		
Rent	9 000			
Heat, light and power	6 420	**(1)**		
General expenses	3 150			
Depreciation on motor vehicle	6 250	**(1)**		
Depreciation on office equipment	1 560	**(1)**	(53 950)	
Profit from operations			40 042	
Add factory profit	108 224	**(1)of**		
Less increase in provision for unrealised profit	141	**(2)**	108 083	
Profit for the year			148 125	**(1)of**

Workings:

Office machinery depreciation 15 000 – 4 600 = 10 400 × 15%
Provision for unrealised profit 15 750 – 14 904 = 846(1) × 20 / 120 = 141 (1)of **[10]**

(c) Transfer price is the price of goods calculated in the manufacturing account and completed **(1)** and transferred to the income statement **(1)**. It often includes an additional percentage for factory profit **(1)** and this is included in the inventory of finished goods as unrealised profit **(1)**.
Max 2

[2]

(d)

Factory cost here is actually $54.11 each **(1)of** and the cost of transfer is $64.93 **(1)** only because it reflects an element of factory profit. **(1)** The offer price is therefore higher than M's cost. **(1)** The company should delay the decision until they need extra supplies **(1)**.

If demand exceeds 10 000 capacity accept offer although contribution per unit will be reduced. **(1)** However, the products supplied must be of the same quality **(1)** and delivery reliable. **(1)**

(Decision 1 Justification max 3) **[4]**

[Total: 25]

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2 **(a)** Making a profit is not the main reason for clubs **(1)** They provide facilities for the members **(1)**. The club is owned by the members **(1)** providing they have paid a subscription for membership **(1)**. Any surplus is used to improve the facilities and provide other benefits for the members **(1)**. **Max [2]**

(b)

AB Cricket Club
Income and expenditure account for the year ended 31 August 2016

	$		$	
Profit from refreshments			720	**(1)**
Match ticket sales			6400	
Profit on the sale of equipment			360	**(1)**
Subscriptions			11290	**(4)**
Life membership			230	**(1)**
			19000	
Groundsman's wages	7500	**(1)**		
Repairs to clubhouse	700			
Awards to players	1450			
Administration expenses	760			
Depreciation on equipment	666	**(2)**	11076	
Surplus of income over expenditure			7924	**(1of)**

Workings:

Subscriptions 490 + 165 + 11200 **(1)** =11855 – (270 **(1)** + 295 **(1)**) = 11290 **(1)of**
Equipment = (7800 – 3640 + 2500) **(1)** = 6660 × 10% = 666 **(1)**
Life membership 1500 + 800 = 2300 / 10 = 230 **[11]**

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(c)

AB Cricket Club
Statement of financial position as at 31 August 2016

	$	
Non-current assets		
Equipment at net book value **W1**	5 994	**(2)**
Current assets		
Inventory	390	
Subscriptions in arrears	165	**(1)**
Bank	11 880	
Savings account	3 500	
	15 935	
Total assets	21 929	
Accumulated fund at 1 September 2015	7 825	
Add surplus for the year	7 924	**(1of)**
Accumulated fund at 31 August 2016	15 749	
Life membership fund	2 070	**(1)**
Clubhouse fund	3 500	**(1)**
Current liabilities		
Subscriptions in advance	295	**(1)**
Creditors for refreshments	315	**(1)**
	610	
Total funds and liabilities	21 929	

W1 6660 – 666**(1)**of = 5994**(1)**of

[8]

(d) The life membership is payment of a lump sum **(1)**. It will inflate the surplus if it is all entered in the income and expenditure account in the year in which it is paid. **(1)** Also the club owes those members the benefit of membership for a number of years **(1)** not just the year of joining. **(1)**

[4]

[Total: 25]

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3 **(a)** Stewardship is the responsibility which managers have for the management of resources **(1)** within a business on behalf of the owners.**(1)** **[2]**

(b) An end of year audit is the process of checking the financial records of a business **(1)** by an independent person **(1)**, in order to ensure that the records show a true and fair view. **(1)** max 2 marks **[2]**

(c) The published audit report would be qualified **(1)**. **[1]**

(d) **(i)** 1 IAS 36. **(1)**
Non-current assets should not be stated at more than their highest amount to be recovered through their use or sale.**(1)** In this case the assets are obsolete and have no resale value so XY Limited must reduce the carrying amount of the non-current assets to their recoverable value (net book value) **(1)** which is the higher of the fair value and its value in use.**(1)** The value of the assets reduce by $180 000 in the statement of financial position. **(1)** This impairment loss should also be recorded in the income statement **(1)** max 3

2 IAS2 / IAS8 **(1)**
Inventories should be valued at the lower of cost and net realisable value. (prudence concept).**(1)** In periods of rising prices using FIFO will give a higher inventory value than using AVCO.**(1)** However in the long term profits will be the same.**(1)** The consistency concept states that the method should not be frequently changed so comparisons can be made. **(1)** The value of inventory should be decreased by $42 000 both in the statement of financial position **(1)** and in the income statement which will decrease the amount of profit for the year **(1)** max 3

3 IAS 10 **(1)**
If a material event exists at the end of the year and the outcome is known before the accounts are approved, then this is an adjusting event **(1)** and the financial statements must be amended.**(1)** The bad debt written off amounted to $81 000. **(1)**The current assets will be increased in the statement of financial position **(1)** and the amount of debt written off previously as bad in the income statement should now be recorded as bad debt recovered**(1)** of $60 750 **(1)** max 3 **[9]**

(ii)

	$	
Original operating profit	174 000	**(1)**
Impairment	(180 000)	**(1)**
Overvaluation of inventory	(42 000)	**(1)**
Irrecoverable debt recovered	60 750	**(2) W1**
Adjusted profit for the year	12 750	**(1of)**

W1 675 000 × 12% = 81 000 **(1)** × 75% = 60 750 **(1)** **[6]**

(e) A qualified audit report which indicates that the auditor is not satisfied **(1)** that the financial statements audited present a true and fair view. **(1)** This is a safeguard of the shareholders interests **(1)** as it signals that the statements are incorrect in the opinion of the external independent examiner. **(1)** This may also put potential shareholders off investing in the business **(1)** **[5]**

[Total: 25]

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4 **(a)** **(i)** Goods sent on consignment account

	$	
Consignment to Patel	12 000	**(1)**

[1]

(ii) Consignment to Patel account

	$			$	
Goods sent	12 000	**(1)**	Sales	10 600	**(1)**
Delivery and insurance	610		Value of inventory c/d **W1**	3 921	
Insurance	110				
Storage charges	350				
Selling expenses	245	**(1)**			
Commission **W2**	530	**(2)**			
Irrecoverable debt	120	**(1)**			
Bank charges	12	**(1)**			
Profit to income st	544	**(1)of**			
	14 521			**14 521**	
Value of inventory b/d W1	3 921	**(2)of**			

W1 value of inventory
cost 12 000 + expense 1070 = 13 070 **(1)** × 30% = 3921 **(1of)**
W2 5% × 10 600 **(1)** = 530 **(1of)** **[11]**

(iii) Patel account

	$			$	
Consignment	10 600	**(1)**	Commission	530	**(1)**
			Expenses	350	**(1)**
			Selling expenses	245	**(1)**
			Irrecoverable debts	120	**(1)**
			Cash	7 475	**(1)**
			Bank	1 880	**(1)of**
	10 600			10 600	

[7]

(b) The irrecoverable debt will reduce profitability/ profit for the year **(1)** by $120 **(1)** **[2]**

(c) Yes. Hamid and Patel should enter into partnership.
Partnership has unlimited liability as do sole traders **(1)**
shared responsibility**(1)** / shared liability to debts **(1)**
shared workload **(1)**
greater access to skills **(1)** and customer base **(1)**
trust and reliability considerations between two of them **(1)**

No. Hamid and Patel should not enter into partnership.
practical issues such as speed of communication for decision making between countries **(1)**
e.g. time differences
trust and reliability considerations between two of them **(1)**
restricted trading opportunities.
(1) decision **max 3** for justification **[4]**

[Total: 25]

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5 (a)

	Option 1			Option 2		
Year	Cash flow	Discounted cash flow		Cash flow	Discounted cash flow	
	$	$		$	$	
0	(225 000)	(225 000)	**(1)**	(225 000)	(225 000)	**(1)**
1	69 000	62 721	**(1)**	69 000	62 721	**(1of)**
2	245 000	202 370	**(1)**	70 000	57 820	**(1)**
3				66 000	49 566	**(1)**
4				117 000	79 911	**(1)**
NPV		40 091	**(1of)**		25 018	**(1of)**

[10]

(b) The directors should adopt option 1 **(1of)** because it has the higher NPV **(1)**. **[2]**

(c) If candidate selects option 1 in **(b)**

$$\frac{40\,091\ \textbf{(1of)}}{225\,000\ \textbf{(1)}}\times 100 = 17.82\%\ \textbf{(1of)}$$

If candidate selects option 2 in **(b)**

$$\frac{25\,018\,\textbf{(1of)}}{225\,000\,\textbf{(1)}}\times 100 + 11.12\%\,\textbf{(1of)}$$

[3]

(d) If candidate selects option 1 in **(b)**

$$\text{Average profit} = \frac{(210\,000 - 71000)\ \textbf{(1)} - 50\,000\ \textbf{(1)}}{2\ \textbf{(1)}} = 44\,500\ \textbf{(1of)}$$

$$\text{Average investment} = \frac{(225\,000 + 175\,000)\ \textbf{(1)}}{2} = 200\,000\ \textbf{(1)}$$

$$\text{ARR} = \frac{44\,500}{200\,000}\times 100 = 22.25\%\ \textbf{(1)}$$

If candidate selects option 2 in **(b)**

$$\text{Average profit} = \frac{(425\,000 - 178\,000)\,\textbf{(1)} - 150\,000\ \textbf{(1)}}{4\ \textbf{(1)}} = 24\,250\,\textbf{(1of)}$$

$$\text{Average investment} = \frac{225\,000 + 75\,000\ \textbf{(1)}}{2} = 150\,000\ \textbf{(1)}$$

$$\text{ARR} = \frac{24\,250}{150\,000}\times 100 = 16.17\%\ \textbf{(1of)}$$

[6]

(e) Decision **(1)** Reasons **(3)** **Max**
* NPV takes account of time value and money **(1)**
Accounting profit is subjective **(1)**
NPV takes account of the cost of capital **(1)** **[4]**

[Total: 25]

6 (a) A master budget is the consolidation of all of the prepared budgets **(1)**. It consists of a budgeted income statement and statement of financial position **(1)**. **[2]**

(b) Production budget January – April 2017

	January	February	March	April	
Opening inventory	(200)	(220)	(240)	(260)	**(1)**
Sales	370	410	380	430	**(1)**
	170	190	140	170	
Closing inventory	220	240	260	260	**(1)**
Production	390	430	400	430	**(1)of**

[4]

(c) Cash budget January – March 2017

Receipts

	January		February		March	
Sales	10 700		11 500		12 000	**(1)**
Interest	500	**(1)**				
	11 200		1 100		12 000	
Payments						
Purchases – cash	1 365		1 505		1 330	**(1)**
Purchases – credit	1 190		1 365		1 505	**(1)**
Direct labour	1 950		2 150		2 000	**(1)**
Overheads	2 280		2 532		2 436	**(1)**
Equipment	6 000	**(1)**				
	12 785		7 552		7 271	
Net cash flow	(1 585)		3 948		4 729	
Opening balance	(10 450)		(12 035)	**(1)of**	(8 087)	**(1)of**
Closing balance	(12 035)		(8 087)		(3 358)	**(1)of**

[10]

(d) Increase selling price **(1)**. Reduce direct materials **(1)** by seeking cheaper suppliers **(1)**, direct labour **(1)** and overheads **(1)**. Postpone purchase of equipment **(1)**. Seek more favourable credit terms **(1)**. Review credit control **(1)**. **Max 6** **[6]**

(e) Advice **(1)**. Justification **(2)**
If overdrawn balance is expected every month for the next year **(1)** then a loan is recommended **(1)**

An agreed loan should be cheaper than a long term overdraft.**(1)** **[3]**

[Total: 25]