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	(28 800)		286 500	**(1)of**
Direct wages			344 000	
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	32 500		194 900	
			825 400	
Work in progress at 1 January 2015	66 800	**}(1)**		
Work in progress at 31 December 2015	72 200		(5 400)	
Cost of goods manufactured			820 000	
Factory profit 20%			164 000	**(1)of**
Transferred to the Trading section of the Income Statement			984 000	

[8]

(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	186 000		960 000	
Gross profit			602 000	**(1of)**
Administrative expenses	374 000			
Depreciation on property	6 000	**}(1)**		
Depreciation on office equipment	18 000			
Water and electricity	3 100	**(1)**		
			401 100	
			200 900	
Factory profit			164 000	**(1of)**
Less: Increase in provision for unrealised profit			4 000	**(1)**
Profit from operations			360 900	**(1of)***

[7]

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Workings

1	Depreciation on property	\$400 000 × 5% = \$20 000
	Allocated to production	\$20 000 × 70% = \$14 000
	Allocated to administration	\$20 000 × 30% = 6000
2	Depreciation on manufacturing plant and machinery	(\$350 000 – \$230 000) × 20% = \$24 000
3	Depreciation on office equipment	\$120 000 × 15% = \$18 000
4	Year end unrealised profit	\$186 000 × 1 / (5 + 1) = 31 000
5	Water and electricity	\$14 000 + 1500 = \$15 500
	Allocated to production	\$15 500 × 80% = \$12 400
	Allocated to administration	\$15 500 × 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**) × 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 × **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 ÷ 50 = $25 **(1)** **[1]**

(ii) (3050 × 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)**		
	57 050		57 050
Balance b/d	3 050 **(1of)**		

[8]

(ii)

Sumit account

	$		$
Consignment a/c (sales)	54 000 **(1)**	Consignment a/c (import duties)	1 500 **(1)of**
		Consignment a/c (commission)	10 800 **(1)of**
		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)** × $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	(3 000) **(1)**
Total equity	472 000
Non-current liabilities	100 000 **(1)**
Current liabilities	10 000 **(1)**
Total equity and liabilities	582 000

[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 × 100 = 21.85% **(1)of**

(iii) return on capital employed
192 000 / 572 000**(1)of** × 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		420 103
Capital and liabilities		
Capital – Fernando	96 750	
– Gurdip	281 853	
	378 603 **(7)**	
Current liabilities		
Trade payables	41 500 **(1)**	
Total capital and liabilities	420 103	

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**
	96 750	281 853 **(1)of both**

[11]

(b)

	$	$	$
Budgeted profit for the year			80 000
Add:			
Interest on drawings – Fernando	1 620		
– Gurdip	1 200		2 820 **(1) both**
			82 820
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)
			17 676
Profit after appropriations – Fernando			5 892
– Gurdip G			11 784 **(1) of both (correct ratio)**
			17 676

[4]

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

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(d) Advice. **(1)**

Benefits – limited liability **(1)**, easier to change ownership through shares **(1)**, easier to raise capital **(1)**, shareholders can be paid in dividends **(1)** and some customers / suppliers prefer dealing with companies rather than partnerships **(1)**.
Limitations – stricter rules **(1)**, more paperwork **(1)** and higher accountancy costs **(1)**.
Divorce of ownership and control **(1)**.

Max 2 benefits + 2 limitations
1 mark for stating **+ 1 mark** for development of **each** benefit and limitation.
1 mark for advice **[9]**

[Total: 25]

5 (a) (i)

	Alpha	Beta
	$	$
Direct materials	80 000	240 000
Direct labour	150 000	300 000
Production overheads*	90 000	450 000
Total production costs	320 000 **(1)**	990 000 **(1)**

*$540 000 × 5000 / (5000 + 25 000) = $90 000 $540 000 × 25 000 / (5000 + 25 000) = $450 000

(ii) Unit cost $320 **(1of)** $198 **(1of)** **[4]**

(b)

	Alpha	Beta
	$	$
Unit production cost	$320 **(of)**	$198 **(of)**
Mark-up 50%	$160	$99
Unit selling price	$480 **(1of)**	$297 **(1of)**

[2]

(c) Responses could include:

more accurate cost information to management for decision making, i.e. pricing
can monitor the efficiency of various activities
allocation of overhead is more fair because it is based on the activities consumed, not on an arbitrary allocation (i.e. labour hours)
can also allocate non-manufacturing overhead, i.e. administrative support.

Accept any reasonable alternative

(**1 mark**) × 1 benefit **[1]**

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(d)

	Alpha $	Beta $	
Machine set-up	66 000	44 000	**(1)both**
Machine maintenance	81 000	99 000	**(1)both**
Materials handling	60 000	30 000	**(1)both**
Product inspection	100 000	60 000	**(1)both**
	307 000	233 000	

[4]

(e)

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

[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	2 072 000 **(1)**	$1 184 000 × 175%
Direct materials	288 000 **(1)**	8000 units × 3 kilos × $12
Direct labour	640 000 **(1)**	8000 units × 4 hours × $20
Fixed overhead	256 000 **(1)**	8000 units × 4 hours × $8
Manufacturing costs	1 184 000	
Gross profit	888 000 **(1)of**	

[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**) × 2 reasons **[2]**

(c) (i) Direct materials price
($12 × 22 850 kg) – $269 000 = $5200(1) (F) **(1)**

(ii) Direct materials usage
(7500 × 3 kg – 22 850 kg) × $12 = $4200(1) (A) **(1)**

(iii) Fixed overhead expenditure
$256 000 – $250 000 = $600 091) (F) **(1)**

(iv) Fixed overhead volume
(8000 units – 7500 units) × 4 hours × $8 = $16 000 (1)(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 overheard expenditure variance
- actual fixed overheard 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]

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