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**ACCOUNTING**

**9706/32**

Paper 3 Structured Questions

**February/March 2018**

PROVISIONAL MARK SCHEME

Maximum Mark: 150

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**IMPORTANT NOTICE**

Mark Schemes have been issued on the basis of **one** copy per Assistant examiner and **two** copies per Team Leader.

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This document consists of **11** printed pages and **1** blank page.

## 1 (a) Manufacturing Account for Marco for year ended 31 January 2018

	\$	\$	
Opening inventory of raw materials		40 000	
Purchases of raw materials	568 000		
Carriage inwards	12 000		(1)
Returns outward	<u>(23 000)</u>		(1)
Net purchases		<u>557 000</u>	
		597 000	
Closing inventory of raw materials		<u>(42 000)</u>	(1) both
Cost of raw materials consumed		555 000	
Direct factory wages		<u>265 000</u>	(1)
Prime cost		820 000	(1) OF
Factory overheads			
Indirect factory wages	159 000		(1)
Heating and lighting	56 000		(1)
Machinery depreciation	66 000		(1)
Rent and rates	<u>72 000</u>	<u>353 000</u>	(1)
		1 173 000	
Opening work in progress	60 000		
Closing work in progress	<u>(80 000)</u>	<u>(20 000)</u>	(1) both
Cost of production		1 153 000	
Factory profit		<u>288 250</u>	(1) OF
Transfer price		<u>1 441 250</u>	(1) OF

[12]

## (b) Extract from statement of Financial Position for Marco at 31 January 2018

	\$	\$	
Current assets			
Inventories			
Raw materials		42 000	(1) both
Work in progress		80 000	
Finished goods	150 000		
Less provision for unrealised profit	<u>(30 000)</u>	<u>120 000</u>	(1)
		<u>242 000</u>	(1) OF

[3]

## (c) Realisation concept (1)

Prudence concept (1)

[2]

## (d) (i) It is important that Marco creates a provision for unrealised profit because:

IAS2 states that inventory is valued at the lower of cost and net realisable value, so unrealised profit should be removed from the inventory valuation otherwise profits (1) and current assets (1) will be overvalued.

Realisation concept states that revenue should only be recorded in the business books of account when the goods have been sold for credit or cash(1) and prudence concept states that losses should be provided for as soon as they are anticipated but profits are not recorded until realised (1)

[4]

- (ii) Profit will be greater (1) by \$30 000 (1) if there is no provision for unrealised profit. However this profit is overstated (1) as the inventories have not been adjusted for unrealised profit. (1) Any decision based on these levels of profit would be based on expectations of a higher profit which may not be achieved (1) [4]

[Total: 25]

<b>2 (a)</b>		\$		
	Sales (1850 + 340)	2190	(1)	
	Purchases (900 + 200 – 60)	(1040)	(1)	
	Repairs (160 + 120)	(280)	(1)	
	Carriage (90 + 50)	(140)	*(1)	
	Rental	(100)	*	
	Advertising	(70)	*(1) both*	
	Profit	<u>560</u>	(1) OF	[6]

**(b)** Raj's books  
Joint venture with John account

	\$		\$	
Purchases	900		Sales (\$1 850 + \$340)	2190 (1)
Repairs (\$160 + \$120)	280 (1)			
Carriage	90 (1)			
Share of profit	280 (1) OF			
Cash to John	500 (1)			
Cash in settlement to John	<u>140</u>			
	<u>2190</u>		<u>2190</u>	[5]

John's books  
Joint venture with Raj account

	\$		\$	
Rental	100 *(1)	Cash in settlement from Raj	140 (1) OF in both ac	
Advertising	70 *	Bicycle for daughter	60 (1)	
Purchases	200 (1)	Cash from Raj	500 (1)	
Carriage	50 (1)			
Share of profit	<u>280 (1) OF</u>			
	<u>700</u>		<u>700</u>	[7]

**(c)** In a joint venture one person may have the skills and another the contacts. **(1)** In this instance Raj has the selling contacts and can repair bicycles, whereas John is able to pay the overheads. **(1)** [2]

**(d)** Raj appears to be doing most of the work **(1)** repairing and selling the bicycles. **(1)** The bicycles purchased by John were not as profitable as the ones he purchased. **(1)** Raj purchased bicycles for \$990 less repairs of \$160 = 830 but sold for \$1850 so profit of \$1020/12 = \$85 each **(1)** whereas the bicycles John purchased only made a profit of \$270 (\$250 – \$120 = \$130 but sold for \$400). This is \$270/4 = \$67.50 each.

It may be more beneficial for Raj to work on his own rather than enter into a partnership with John **(1)**

**Decision (1) plus 4 marks** [5]

[Total: 25]

## 3 (a) (i)

	R Limited		Joe Tu	
	\$		\$	
Sales revenue	1 500 000		250 000	
Gross profit 50%/45%	750 000		112 500	<b>(1) both</b>
Profit for the year	132 000		19 800	
Directors' fee	60 000	<b>(1)</b>	0	
Operating expenses	558 000	<b>(1) OF</b>	92 700	<b>(1) OF</b>

[4]

## (ii)

	\$	\$	
Sales revenue			
$(\$1\,500\,000 + \$250\,000) \times 120\%$	<u>2 100 000</u>		
Gross profit	1 050 000	1 050 000	
Original gross profit $(\$750\,000 + \$112\,500)$	862 500	<u>(862 500)</u>	
Increase in gross profit		187 500	<b>(1) OF</b>
Decrease in operating expenses		<u>195 210</u>	<b>(1) OF</b>
$(\$558\,000 + \$92\,700) \times 30\%$		382 710	
Directors' fee $\$30\,000 \times 3$		<u>(90 000)</u>	<b>(1)</b>
		292 710	
Original profit of both $(132\,000 + 19\,800)$		<u>151 800</u>	
Additional profit		<u>140 910</u>	<b>(1) OF</b>

[4]

(b) To reward the owner with the benefits of the increase in value over time of the assets. (1)

The fair value of assets (1) forms the base of calculating the purchase consideration. (1)

Max 1

[1]

(c)

R Limited  
Statement of financial position after acquisition

	\$	
Non-current assets		
Land and buildings <b>(W1)</b>	621 000	<b>(3)</b>
Plant and equipment	308 000	*
Goodwill <b>(W2)</b>	<u>18 000</u>	<b>(2)</b>
	<u>947 000</u>	
Current assets		
Inventory	138 000	* <b>(1)</b>
Trade receivables	159 000	**
Cash and cash equivalents	<u>58 000</u>	
	<u>355 000</u>	
Total assets	<u>1 302 000</u>	
Equity and liabilities		
Equity		
Ordinary shares of \$1 each	950 000	<b>(1)</b>
Share premium	30 000	<b>(1)</b>
Revaluation reserve	28 000	<b>(1)</b>
Retained earnings	<u>132 000</u>	<b>(1)</b>
	<u>1 140 000</u>	
Current liabilities		
Trade payables	<u>162 000</u>	
Total equity and liabilities	<u>1 302 000</u>	

**W1:** \$454 000 **(1)** + \$139 000 **(1)** + \$28 000 **(1)** = \$621 000

**W2**

	\$	
Land and buildings	139 000	
Plant and equipment	14 000	
Inventory	40 000	
Trade receivables	36 000	
Trade payables	<u>(67 000)</u>	
	162 000	<b>(1)</b>
Purchase consideration	<u>180 000</u>	<b>(1)</b>
Goodwill	<u>18 000</u>	

[11]

(d) Responses could include:

For the purchase:

- Joe Tu's expertise/knowledge/experience brought to the business
- Issuing shares to Joe Tu so that his personal interest is linked with the business
- Synergy effect which has long-term benefit
- Economy of scale

**Max 3**

Against the purchase:

- Control is diluted
  - Interest in the company is diluted
  - May be friction between the directors
- Accept any reasonable alternative

**Max 2**

**[5]**

**[Total: 25]**

## 4 (a) Responses could include:

Shareholders	Directors
Principal	Agent
Master	Steward
Owners of the company	Management of the company
Entrust responsibilities to directors	Accountable to shareholders
Do not interfere with the daily operations of the company	Conduct daily operations of the company
Making decisions in general meeting relating to e.g. appointment of auditor	Making daily operating, financing and investing decisions

(1 mark) × 4 valid points

**Max 2 for each****[4]**

## (b) Responses could include:

- It is not required by law
- Sole proprietor is the one who contributes capital and manages the business

Accept any reasonable alternative

(1 mark) × one valid reason

**[1]**

## (c)

	\$	
Original profit	78 000	
Less : Inventory overvalued	(16 000)	(1)
Add : Cash dividend	75 000	(1)
Proposed dividend	82 500	(1)
Less : Rent undercharged	<u>(21 000)</u>	(2)
Adjusted profit	<u>198 500</u>	(1) <b>OF</b>

Working

Inventory overvalued \$120 000 – \$104 000 = \$16 000

Rent undercharged (\$21 000 × 6) – \$105 000 (1) = \$21 000 (1)

**[6]**

## (d) Responses could include:

Stock valuation

- Both FIFO and AVCO are permitted by IAS 2
- Adoption of either method is an accounting policy
- Accounting policy should be consistently applied
- Accounting policy should not be changed for the sole purpose of increasing current year profit.

Dividend

- Dividend paid is distribution of profit, not expenses.
- Dividend paid should be accounted for in the Statement of Changes in Equity
- Proposed dividend is not regarded as liability

(1 mark) × 6 valid points, 3 marks for each item

**[6]**



**(e)** Statement of Changes in Equity for the year ended 31 December 2017

	Share Capital \$	Share Premium \$	Retained Earnings \$	Total \$	
Balance at 1 January 2016	500 000	80 000	94 000	674 000	
Profit for the year			198 500 <b>(1) OF</b>	198 500	
Dividend paid			75 000 <b>(1)</b>	(75 000)	
Bonus shares	<u>50 000</u> <b>(1)</b>	<u>(50 000)</u> <b>(1)</b>			
Balance at 31 December 2016	<u>550 000</u>	<u>30 000</u>	<u>217 500</u>	<u>797 500</u>	<b>[4]</b>

**(f)** Responses could include:

- True and fair view
- Auditor is independent third party so more dependable
- More credible documents
- The bank may also request for other information, i.e. budgeted financial statements
- Request a business plan
- Bank may require collateral

Accept any reasonable alternative

1 for decision

**(1 mark)** × 3 valid points**[4]****[Total: 25]**

- 5 (a) Budgetary control is the planning of the use of resources (1) including money through the use of budgets (1) to achieve an overall objective. (1) max 2 [2]

(b) Labour budget

	Casting		Polishing		Finishing
	\$		\$		\$
Production	24 000		24 000		24 000
Labour hours	16 000 (1)		6 000 (1)		48 000 (1)
Number of employees	8 (1) OF		3 (1) OF		24 (1) OF
Labour cost	192 000 (1) OF		48 000 (1) OF		672 000 (1) OF

Each employee works  $50 \times 40 = 2000$  hours a year [9]

- (c) Hyung Min would find budgetary control beneficial to achieve the target profit because it would control (1) resources i.e. staff so correct number of staff (1) allocated to correct department (1) and not sitting around idle. (1)

- Plan (1) by allocating the right number of staff as needed (1) to keep labour costs down (1)
- communicate and coordinate (1) between production, sales and human resources (1) so right number of staff for the right department (1)

May also explain the following reasons:

- Motivation to reach targets
- Performance evaluation
- Aids decision making

((1) for each benefit plus (1) for explanation and relevance to Hyung Min)  $\times 3$

[6]

- (d) With the casting department Hyung Min has an adverse efficiency variance of \$57 000. This means the workforce employed were not as efficient and spent more time than expected to produce the 28 500 vases. (1) this may be because they were not as skilled as expected (1) or the machinery kept breaking down (1) or there were other faults in the production line. Finally it could be because the quality of the material was less than expected and so took longer to use (1) max 3

In both the polishing and finishing departments there are adverse rate variances which means that Hyung Min paid out more money per hour than he expected to do (1) This may be because he employed employees with more skills in these departments. (1) Alternatively there may be a scarcity of labour in the area so more has to be paid to attract the workforce (1)

Overall max 4 (1)

[4]

- (e) Overall total labour variance was favourable (1) by \$1500 (1). Therefore it is not a cause of concern (1). However, rate variance in finishing and efficiency in casting are quite high. Therefore take some action to reduce these (1). [4]

[Total: 25]

- 6 (a) Net present value uses discounted rates to calculate the present value of future money (1) whereas the payback method does not. (1)

The net present value method considers all (1) the cash flows of a capital investment whereas the payback method just considers those cash flows up to the date of payback. (1)

[4]

- (b) (i) Payback is 3 years (1) and 2 months (1)

[2]

(ii)

year	net cash flow \$		discount rate	present value \$	
0	(210 000)		1	(210 000)	
1	72 000	(W1)	0.926	66 672	(1) OF
2	72 000		0.857	61 704	(1) OF
3	72 000		0.794	57 168	(1) OF
4	72 000		0.735	52 920	(1) OF
5	72 000		0.681	<u>49 032</u>	(1) OF
			Net present value	<u>77 496</u>	(1) OF

W1  $210\,000/35 = 6000$  (1) per month  $\times 12 = 72\,000$  (1) per year

[8]

(iii) ARR

Machine A  $72\,000 - 210\,000/5 = 30\,000$  profit (1)

Cost of investment  $210\,000/2 = 105\,000$  (1)

ARR =  $30\,000/105\,000 \times 100 = 28.57\%$  (1) OF

Machine B  $51\,000 - 161\,500/4 = 10\,625$  (1)

Cost of investment  $161\,500/2 = 80\,750$  (1)

ARR  $10\,625/80\,750 \times 100 = 13.16\%$  (1) OF

[6]

(c) Decision (1) plus (4) for justification

Machine A has a greater annual cash flow of \$72 000 compared to \$51 000. (1)OF

Machine A has the greater cash flows and expected life (1)OF, NPV (1)OF, ARR (1)OF and quicker payback. (1)OF

Daniyar should choose machine A (1).

Max 5

[5]

[Total: 25]

