

Specimen Paper Answers – Paper 3

# Cambridge International AS & A Level Accounting 9706

For examination from 2023



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## Introduction

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These specimen answers have been produced by Cambridge ahead of the examination in 2023 to exemplify standards for those teaching Cambridge International AS & A Level Accounting 9706. We have selected questions from Specimen Paper 3, Questions 1, 2 and 3.

The marks given are for guidance only and are accompanied by a brief commentary explaining the strengths and weaknesses of the answers. Comments are given to indicate where and why marks were awarded, and how additional marks could be obtained. There is also a list of common mistakes and guidance for candidates for each question.

The specimen materials are available to download from the [School Support Hub](#).

**2023 Specimen Paper 03**

**2023 Specimen Paper Insert 03**

**2023 Specimen Paper Mark Scheme 03**

Past exam resources and other teaching and learning resources are available from the [School Support Hub](#).

## Details of the assessment

### Paper 1

Multiple Choice 1 hour  
 30 marks  
 30 multiple-choice questions  
 Questions are based on sections 1 and 2 of the subject content.  
 Externally assessed  
 28% of the AS Level  
 14% of the A Level

### Paper 3

Financial Accounting 1 hour 30 minutes  
 75 marks  
 Three structured questions  
 Questions are based on section 3 of the subject content; knowledge of material from the AS Level subject content is assumed.  
 Externally assessed  
 30% of the A Level

### Paper 2

Fundamentals of Accounting 1 hour 45 minutes  
 90 marks  
 Four structured questions  
 Questions are based on sections 1 and 2 of the subject content  
 Externally assessed  
 72% of the AS Level  
 36% of the A Level

### Paper 4

Cost and Management Accounting 1 hour  
 50 marks  
 Two structured questions  
 Questions are based on section 4 of the subject content; knowledge of material from the AS Level subject content is assumed.  
 Externally assessed  
 20% of the A Level

## Assessment objectives

The assessment objectives (AOs) are:

### AO1 Knowledge and understanding

- Demonstrate knowledge and understanding of facts, terms, concepts, policies, procedures and techniques relating to financial accounting and cost and management accounting.
- Apply this knowledge and understanding to a variety of accounting situations and problems, and present outcomes in the most appropriate form.

### AO2 Analysis

- Analyse financial accounting information and cost and management accounting information.
- Select, calculate and interpret relevant data and information.
- Communicate outcomes in the most appropriate form.

### AO3 Evaluation

- Evaluate financial accounting information and cost and management accounting information to make informed recommendations and decisions.
- Make judgements and draw conclusions based on financial and non-financial data.

## Question 1

### Question 1(a)

#### 1 Read Source A in the Insert.

- (a) Prepare the statement of cash flows for Y Limited for the year ended 31 December 2020, in accordance with IAS 7.

[14]

Statement of cash flows for the year ended 31 December 2020

	\$000	\$000
Profit / (loss) from operations		(14)
Depreciation – premises	2	
– plant and machinery	11	
Loss on sale of plant and machinery	(1)	
		12
Increase in inventory	(12)	
Decrease in trade receivables	3	
Increase in trade payables	8	
		(1)
Net cash used in operations		(3)
Interest paid		(4)
Taxation paid		(10)
Net cash used in operating activities		(17)
Investing activities		
Proceeds of sales of plants and machinery	6	
Purchase of premises	(39)	
Net cash used in investing activities		(33)
Financing activities		
Proceeds of issue of ordinary shares	70	
Proceeds of bank loans	25	
Ordinary dividends paid	(12)	
Net cash from financing activities		73
Net increase in cash and cash equivalents		23
Cash and cash equivalents at 1 January 2020		14
Cash and cash equivalents at 31 December 2020		37

**Mark awarded = 10 out of 14**

### Examiner comment

This question required preparation of a statement of cash flows in accordance with IAS7. No abbreviation is allowed for labels (div for dividend). The answer provided has treated the loss on disposal incorrectly and missed out the interim dividend.

Although the mark scheme allows OF for the net increase in cash and cash equivalents, in this example this has been incorrectly totalled, so the mark was lost. Additionally, the candidate has used OF to calculate closing cash and cash equivalents. However, no mark is awarded here. This must be a correct figure as provided in the question data.

### Common errors and general guidance for candidates

It is important to note that in many cases figures for opening and closing cash and cash equivalents are provided in the question data. These are correct figures, and thus the net increase/decrease in cash and cash equivalents can be worked out. If the answer worked does not have the same net increase/decrease in cash and cash equivalents, then it is an indication that there is a mistake and the figures need reviewing.

All sections should have a subtotal as this a financial statement. Although in this particular instance there are no marks shown in the mark scheme for this, it is often the case that appropriate presentation marks are awarded for preparation of financial statements.

### Question 1(b)

**(b)** State **three** circumstances under which the auditors will issue an unqualified audit report.

[3]

1 *Financial statements agree with accounting records and books.*

2 *Financial statements comply with international accounting standards and all legal requirements*

3 *Financial statements have been prepared without material errors or omissions.*

**Mark awarded = 3 out of 3**

### Examiner comment

Three circumstances have been clearly stated.

### Question 1(c)

#### Additional information

Y Limited had received a letter in August 2020 from a customer, P Limited, stating that they are taking legal action against Y Limited for a breach of contract. Y Limited's lawyers have indicated there is an 80% probability that Y Limited will lose the case and the estimated amount to settle the case will be \$36 000. This matter has not been taken into account in the draft financial statements for the year ended 31 December 2020.

**(c)** Discuss how the matter should be treated in the financial statements for the year ended 31 December 2020. Justify your answer, making reference to the appropriate International Accounting Standard.

[4]

The claim will be treated according to IAS 37 –provisions contingent liabilities and assets as the company’s lawyers have confirmed that the company has 80% chance to lose the case. Therefore, the company’s obligation to pay is probable and amount \$36 000 is a reliable So, company should make a provision of \$36 000 as current liabilities in the statement of position.

**Mark awarded = 4 out of 4**

**Examiner comment**

The answer identifies the correct International Accounting Standard and three features related to it: 1) that it is probable according to the percentage provided 2) the amount can be measured reliably 3) its treatment in the statement of financial position as a provision under current liabilities. The answer could also have referred to the treatment in the statement of profit or loss.

Note that the answer must identify the relevant International Accounting Standard to achieve full marks.

**Question 1(d)**

**Additional information**

Sarah is the accountant of Y Limited. She reports to the finance director. Her assistant accountant, who was responsible for drafting month-end financial statements and reports, has resigned from the company.

Sarah’s daughter, Jenna, has recently lost her job. Sarah suggests to the finance director that Jenna should be recruited as the new assistant accountant.

Jenna studied A Level Accounting ten years ago and has since worked as an accounting clerk. She has no other accounting qualifications.

The finance director has rejected Sarah’s proposal.

**(d) Explain why the finance director rejected Sarah’s proposal to recruit Jenna.**

Justify your answer with reference to the fundamental principles of the ethical framework for accounting.

[4]

Finance director should reject accountant Sarah’s recommendation as her daughter Jenna, despite working as an accounting clerk for ten years is not professionally competent for this role as she only studied A Level Accounting. This will compromise the ethic of professional competence and due care. Much more, Sarah will be in danger of compromising objectivity ethic if Jenna does anything wrong, because she is her mum.

[Total: 25]

**Mark awarded = 4 out of 4**

**Examiner comment**

The answer clearly provided supporting evidence as to why the proposal was rejected (i.e. a clear explanation). The answer identified two ethical principles and related these to the role of accounting assistant and the position of the person higher up in authority to supervise this role.

**Total marks awarded = 21 out of 25**



## Question 2

### Question 2(a)

#### 2 Read Source B in the Insert.

- (a) State **two** reasons why a business may have non-current liabilities even though it also has substantial retained earnings. [2]

1 Retained earnings are not the same as cash as these are prepared on accrual basis.

2 The business may have invested in other assets e.g. non-current assets for expansion or inventory.

**Mark awarded = 2 out of 2**

#### Examiner comment

Two clear reasons have been stated.

### Question 2(b)

#### Additional information

The following information was also available for the year ended 31 December 2020.

- 1 During the year a long-term bank loan, \$250 000, was taken. The interest charged on this loan by the year end was \$14 000.
- 2 An interim ordinary dividend of \$0.06 per share was paid on all issued shares at 1 January 2020.
- 3 The taxation charge for the year was \$10 000.
- 4 200 000 shares were issued at a premium of \$0.75 per share.
- 5 The profit from operations was \$105 000.
- 6 A transfer to general reserve, \$25 000, was made.
- 7 A final dividend of \$0.08 per share was proposed on all issued shares at 31 December 2020.

- (b) Prepare the statement of changes in equity for the year ended 31 December 2020.

A total column **is** required.

[9]

Workings:

$$W1 = (500\,000/1) \times 0.06 = 30\,000$$

$$W2 = 105\,000 - 14\,000 - 10\,000 = 81\,000$$

## Z Plc

## Statement of changes in equity for the year ended 31 December 2020

	Ordinary share capital (\$1 shares)	Share premium \$	General reserve \$	Retained earnings \$	Total \$
Balance at 1 January 2020	500 000	—	40 000	460 000	1 000 000
Ordinary interim dividend W1				(30 000)	(30 000)
Issue of shares	200 000	150 000	—	—	350 000
Profit for the year W2	—	—	—	81 000	81 000
Transfer to general reserve			25 000	(25 000)	—
Balance at 31 December 2020	700 000	150 000	65 000	486 000	1 401 000

**Mark awarded = 6 out of 9**

### Examiner comment

The answer provided is in the correct format for a statement of changes in equity. The candidate has missed out the debenture interest when calculating the profit for the year. Additionally, the candidate has used a par value of \$1 per share (rather than \$2 per share) when calculating the interim dividend paid and the par value of the share issue.

All rows must be appropriately labelled, and the total of the columns must be equal to the total of the rows.

### Common errors and general guidance for candidates

- incorrect inclusion of debentures/other non-current liabilities
- incorrectly including dividends which have been proposed at the year end
- incorrect treatment of transfers between reserves
- incorrect calculations of the value of share issues (including bonus/rights) based on an incorrect par value.

### Question 2(c)(i)

(c) (i) Calculate, to **two** decimal places, the gearing ratio of Z plc at 31 December 2020.

[3]

$$\begin{aligned} & \frac{\$(400\,000 + 250\,000)}{\$(400\,000 + 250\,000 + 1\,401\,000)} \times 100 \\ &= \frac{\$(650\,000)}{2\,051\,000} \times 100 \\ &= 31.69 \end{aligned}$$

**Mark awarded = 2 out of 3**

**Examiner comment**

The answer provided calculated the gearing ratio correctly to two decimal places by using non-current liabilities and total equity figures from the previous part but expressed it without a percentage sign.

**Common errors and general guidance for candidates**

It is important to ensure that answers are given to the required number of decimal places, and with the appropriate sign.

**Question 2(c)(ii)**

(ii) Calculate the interest cover ratio of Z plc at 31 December 2020.

[2]

$$\begin{aligned} & \$105\,000 \div \$(16\,000 + 14\,000) \\ & = 3.5 \text{ times} \end{aligned}$$

**Mark awarded = 2 out of 2**

**Examiner comment**

The correct calculation is given.

**Question 2(d)(i)****Additional information**

The business had issued the shares and taken out the bank loan in order to finance an extension to the factory.

At the Annual General Meeting one shareholder stated that, rather than issuing shares, the company should have financed the extension entirely by taking out long-term bank loans.

(d) (i) Calculate, to **two** decimal places, the revised gearing ratio if the shareholder's proposal had been adopted.

[2]

$$\begin{aligned} & \$(650\,000 + 350\,000) \div \$2\,051\,000 \times 100 \\ & = \$1\,000\,000 \div \$2\,051\,000 \times 100 \\ & = 48.76\% \end{aligned}$$

**Mark awarded = 2 out of 2**

**Examiner comment**

The answer provided calculated the gearing ratio and expressed it correctly to two decimal places with the correct sign.

**Question 2(d)(ii)**

- (ii) Advise the directors whether or not they should agree with the shareholder. Justify your answer.

[5]

*Directors should not agree with the shareholder as the gearing has increased by 17.07% (48.76-31.69) from low to high making the company more risky. By issuing shares there will not be any finance cost as the dividend payment and rate is discretionary compared to loan interest where it has to be paid and rate is fixed.*

**Mark awarded = 4 out of 5**

**Examiner comment**

The answer provided has a clear decision. However, there are two clear points made against the loan option, and only one point addressing the share issue.

**Specimen answer 2(e)**

- (e) State **two** factors a bank might consider when a business applies for a loan.

[2]

*1 The business's ability to pay interest / repay the principal.*

*2 The security of assets on which the loan could be secured.*

[Total: 25]

**Mark awarded = 2 out of 2**

**Examiner comment**

Two clear factors have been identified.

**Total marks awarded = 20 out of 25**

## Question 3

### Question 3(a)

#### 3 Read Source C in the Insert.

(a) Explain the difference between inherent goodwill and purchased goodwill.

[4]

*Inherent goodwill is gained by the efforts of the business such as reputation, customer base and brand name and is not included in the accounts.*

*Purchased goodwill is when you buy an existing business and it is included in the accounts as intangible non-current assets.*

**Mark awarded = 3 out of 4**

#### Examiner comment

The answer provided has two relevant points for inherent goodwill but only one valid point is awarded for purchased goodwill as this was not an accurate explanation.

#### Common errors and general guidance for candidates

This question asks for an explanation of the difference between two items. It is therefore important to ensure that a contrast is identified.

### Question 3(b)

(b) Calculate the amount of the debenture to be issued to James.

[2]

$$\$9000 \times 4\% = \$360$$

$$\div 0.06 =$$

$$\$6000$$

**Mark awarded = 2 out of 2**

Question 3(c)

(c) Prepare the journal entry in M Limited's books to record the purchase of the partnership.

A narrative is **not** required.

[6]

	Debit	Credit
	\$	\$
Land and buildings	50 000	
Office equipment	14 000	
Inventory	8 000	
Trade receivables	16 000	
Goodwill	2 000	
Current liabilities		14 000
Debenture		6 000
Cash		20 000
Ordinary share capital		50 000

Mark awarded = 4 out of 6

Examiner comment

The answer recorded all the entries correctly and balanced the debits and credits showing OF goodwill as the balancing figure. The office equipment has not been adjusted for the computer taken over by one of the partners and the share premium has been omitted.

Common errors and general guidance for candidates

For journal entries, the debit and credit totals must agree, so it is important for candidates to check this and identify any balancing figures required.

Question 3(d)

(d) Prepare the partners' capital accounts to show the closure of the partnership.

[6]

W1

$$76\,000 - (40\,000 + 16\,000 + 10\,000 + 19\,000 - 14\,000) = 5\,000$$

Profit on realisation

$$\text{Amil } 5\,000 \times 40\% = 2\,000$$

$$\text{James } 5\,000 \times 60\% = 3\,000$$

## Capital accounts

Date 2020	Details	Amil \$	James \$	Date 2020	Details	Amil \$	James \$
1 January				1 January	Balance b/d	43 000	25 000
	6% Debentures		6 000		Profit on realisation	2 000	3 000
	Share capital	20 000	30 000		Bank – bal fig		8 000
	Bank-Bal fig	25 000					
		45 000	36 000			45 000	36 000

**Mark awarded = 3 out of 6**

**Examiner comment**

This question required preparation of partners' capital accounts. The accounts need to be balanced to work out the amounts to be paid to/by partners on closure. The answer provided has missed out the computer taken over by one partner, has used incorrect amounts for the consideration in shares, and has incorrectly calculated the net assets taken over, although has used OF purchase consideration and split the profit on realisation appropriately between the partners. The capital accounts have been closed properly by showing the amount to be paid from the business bank account to each partner (even though the loan from James has not been included).

**Common errors and general guidance for candidates**

When a requirement asks for preparation of capital accounts to show closure, it is important to ensure that the capital accounts are closed off with an appropriate transfer to/from the partnership bank account. Some candidates show this incorrectly as a balance carried down.

**Question 3(e)**

**(e)** Prepare the partnership bank account recording the closure of the partnership.

[2]

Bank account

Date 2020	Details	\$	Date 2020	Details	\$
1 January	Balance b/d	6 000	1 January	Amil's capital	25 000
	James's capital	8 000		James's loan	9 000
	Realisation -M limited	20 000			
		34 000			34 000

**Mark awarded = 1 out of 2**

**Examiner comment**

The answer provided has used the OF figures from the capital accounts in part (d). Although the account has balanced, this is because a payment to James in respect of the loan has been included (omitted from part (d)) but this is an extraneous item here, thus final OF figure mark is lost.

**Common errors and general guidance for candidates**

As this is an account to close the business bank account, it should be in balance. If not, this could help the candidate to identify that an error has been made here or elsewhere in the question.

**Question 3(f)**

- (f) Discuss the advantages and disadvantages of the decision of the directors of M Limited to purchase the partnership.

[5]

*The company will have wider customer base which may lead to greater sales revenue and therefore profit.*

*Purchasing resulted in issue of debentures which will increase the finance cost hence reduce the profits of the company.*

[Total: 25]

**Mark awarded = 4 out of 5**

**Examiner comment**

The answer provided has identified two advantages and two disadvantages, however there were 5 marks available here, thus this should be an indication that an additional point (either advantage or disadvantage) could be made.

**Total marks awarded = 17 out of 25**



Cambridge Assessment International Education  
The Triangle Building, Shaftesbury Road, Cambridge, CB2 8EA, United Kingdom  
t: +44 1223 553554  
e: [info@cambridgeinternational.org](mailto:info@cambridgeinternational.org) [www.cambridgeinternational.org](http://www.cambridgeinternational.org)

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