CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2013 series

9706 ACCOUNTING

9706/21 Paper 2 (Structured Questions – Core), maximum raw mark 90

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October/November 2013 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

1 (a) (i)

Booksellers Limited
Income statement for the year ended 31 December 2012

				$000		$000	
Gross profit for the year						415	
Reduction in provision for bad debts						2	**(2)**
						417	
Less expenses							
Wages 127 + 23				150	**(2)**		
Rent 44 – 8				36	**(2)**		
Heating and Lighting				15			
Motor expenses				50			
Office expenses				19			
Insurance				15			
Discount allowed				2			
Other expenses				53			
Debenture interest				1	**(1)**		
Bad debts				5	**(1)**		
Depreciation	Motor vehicles	22	**(1)**				
	Shop fittings	3	**(2)**				
	Office fittings	3	**(1)**	28		374	
Retained profit for the year						43	

Reduction in provision: (45 – 5) = 40 **(1)** × 5% **(1)** = 2; 4 – 2 = 2

Depreciation – shop fittings: (42 – 12) = 30 **(1)** × 10% **(1)** = 3 **[12]**

(ii) Calculation of retained earnings at 31 December 2012

	$000	
Retained profit for the year	43	
Add retained profit b/f	26	**(1)**
Retained profit at 31 December 2012	69	**(1of)**

[2]

(b)

Booksellers Ltd
Statement of Financial Position at 31 December 2012

	$000s	$000s	$000s	
Non-current assets	Cost	Depreciation	Net book value	
Motor vehicles	176	68	108	
Shop fittings	42	15	27	
Office fittings	25	6	19	**(1)**
Goodwill			44	
			198	**(1of)**
Current assets				
Inventory		37		
Trade receivables	40			
Less provision for doubtful receivables	2	38 **(1of)**		
Other receivables		8 **(1)**		
Bank		37		
		120		
Current liabilities				
Trade payables	15			
Other payables {23 **(1)** + 1 **(1)**}	24	39		
Net current assets			81	
Non-current liabilities				
5% debentures			20	**(1)**
			259	
Equity				
Ordinary share capital			190	
Retained earnings			69	**(1of)**
			259	

[8]

(c) (i) Ordinary shares; Preference shares; Debentures; Long term loans; Factoring; Disposal of non-current assets no longer used. (**1 mark each for any two**) **[2]**

(ii) **Ordinary Shares:** Advantages: They company does not have to pay a dividend if profits are low. Dividends vary with profits. Disadvantages: Ordinary shareholders have a vote at annual general meetings. In a private company they can change the balance of control.

Preference Shares: Advantages: The shareholders have no right to vote at AGM. The dividends are fixed.
Disadvantages: Low or no profits, dividends may have to be paid or provided.

Debentures/Long term loans: Advantages: Fixed rates of interest, repayment date known. Disadvantages: Interest needs to be paid even if no profit made, security may be required by the lender. **(2 × 3 marks to max 6)** **[6]**

[Total: 30]

2 (a) **Gross profit ratio** = $\frac{\text{Gross Profit}}{\text{Net Sales}} \times \frac{100}{1}$

It tests the profitability of sales.
It is affected by change in cost of sales which may be due to incorrect stock valuation, increased carriage on purchases not passed on to customers, breakages, embezzlement etc. Also affected by changes in sales margin.

Inventory turnover = $\frac{\text{Average Inventory}}{\text{Cost of goods sold}} \times 365 \text{ (days) OR } \frac{\text{Cost of goods sold}}{\text{Average inventory}} \text{ (times)}$

Tests the efficiency of stock control.
Tells how often, on average, a batch of inventory is sold and replaced during the year.
Changes in opening and closing inventory.
Affected by changes in demand levels due to quality of inventory, damage to inventory, fashion changes, obsolescence etc.

Quick (acid test) ratio = $\frac{\text{Current assets} - \text{inventory}}{\text{Current liabilities}}$

Tests the liquidity of the business. The ability to satisfy current liabilities from liquid current assets.
Affected by changes in cash/bank, trade receivables or trade payables.

Return on capital employed = $\frac{\text{Net profit before interest}}{\text{Capital employed}} \times \frac{100}{1}$

Tests the profitability of the business and the efficiency to generate profits from capital.
Affected by any increase or decrease in profit or in capital employed. For instance, better control of expenses would increase profitability.

Trade receivables turnover = $\frac{\text{Trade receivables}}{\text{Credit sales}} \times 365$

Identifies liquidity/efficiency by measuring time taken by debtors to pay their debts; may be thought of as how long resources are tied up in debt. Is compared to previous years – if rising suggests debtors are taking longer to pay. Controlled by personal approach to debtor, introduction of cash discounts for early payment, employment of factor to collect debt etc.

Award **one** mark for each formula, **one** mark for each area and up to **two** marks for reasons.
(Maximum 20 marks)

(b) **Reliability** – information from which ratios are prepared may not be reliable as t[illegible] be errors.

Seasonal variations – date of accounts may affect ratios; for example a toy-maker mig[illegible] have low stock during the month before his busy season but have many debtors at that time.

Timing – by their nature, final accounts are almost out-of-date by the time they are published.

Monthly fluctuations – these cannot be ascertained from yearly accounts.

Cosmetic accounting – Despite regulation it is still possible to alter ratios by, for example, undertaking a robust debt collection exercise or delaying stock purchases thus “modifying” ratios for the year end.

Comparability – Comparisons between businesses are only valid if they are of the same type and size. Use of different accounting policies also limit comparisons.

Non-financial matters – such items as staff loyalty, level of competition and customer base cannot be measured by ratios.
The ratios do not show the cause of the changes.

Economic – changes may be due to a downturn or inflation.

Award marks to the first **five** answers, giving **one** for a brief description and **one** for expansion in each case.

(Maximum 10 marks)

[Total: 30]

3 (a) (i)

	FIFO		AVCO	
	$		$	
Preludes	4600		4300	
Fugues	3900		3750	
Sonatas	1200	**(1)**	1200	**(1)**
Revised closing inventory	9700	**(1of)**	9250	**(1of)**

[4]

(ii) FIFO = 86 300 – 10 200 **(1)** + 9700 **(1of)** = 85 800 **(1of)**
AVCO = 86 300 – 10 200 **(1)** + 9250 **(1of)** = 85 350 **(1of)**

[6]

(b) Inventory must be valued at the lower of cost **(1)** and net realisable value **(1)**.
The accounting concept of prudence **(1)** must be applied when valuing inventory. Prudence states that profits and asset values must not be overstated **(1)**.
The use of the selling price would overstate profit for the year **(1)** and the current asset/net asset value of the business would be overstated **(1)**.

[6]

(c) Capital expenditure is entered in the Statement of Financial Position **(1)** as a non-current asset **(1)** with only the depreciation for the asset **(1)** being included in the Income Statement **(1)**.
Capital expenditure is charged over consecutive accounting periods **(1)** in accordance with the matching/accruals concept **(1)**.
If there was incorrect classification and the Capital Expenditure was included in the Income Statement then the profit for the year would be understated **(1)** and the asset value in the Statement of Financial Position would be understated **(1)**.
Revenue expenditure should be entered in the Income Statement **(1)** as an expense **(1)**. If this expenditure was placed in the Statement of Financial Position 'profit for the year' would be overstated **(1)** and the asset total in the Statement of Financial Position would be overstated **(1)**. This would contravene the prudence concept **(1)**.

(max. 3 marks for each type) **[6]**

(d) (i)

	Dr		Cr	
	$		$	
Property	115 000	**(1)**		
Provision for depreciation	14 000	**(1)**		
Revaluation reserve			129 000	**(1)**

[3]

(ii) Reserves **[1]**

(iii) $315 000 **(1)** × 50% **(1)** × 2% **(1)** = $3150 **(1)** **[4]**

[Total: 30]