CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the May/June 2015 series

9706 ACCOUNTING

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

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1 (a)

**Patel’s Income statement for the year ended 31 December 2014**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount ($)</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales:</strong> Credit (156 420 + 13 690 – 14 670)</td>
<td>155 440</td>
<td>(1)OF</td>
</tr>
<tr>
<td><strong>Cash:</strong> (20 700 + 4800 – 800 + 950)</td>
<td>25 650</td>
<td>(2)OF</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>181 090</td>
<td></td>
</tr>
<tr>
<td><strong>Less cost of sales</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Inventory at 1 Jan 2014</strong></td>
<td>21 750</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Purchases:</strong> (109 620 + 14 900 – 16 750)</td>
<td>107 770</td>
<td>(2)OF</td>
</tr>
<tr>
<td><strong>Less goods for own use</strong></td>
<td>(2 600)</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>126 920</td>
<td></td>
</tr>
<tr>
<td><strong>Less inventory at 31 December 2014</strong></td>
<td>(22 450)</td>
<td></td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>104 470</td>
<td></td>
</tr>
<tr>
<td><strong>Less expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Wages:</strong> (22 670 + 1400 – 1200)</td>
<td>22 870</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Rent</strong></td>
<td>16 000</td>
<td></td>
</tr>
<tr>
<td><strong>Electricity</strong></td>
<td>8 650</td>
<td></td>
</tr>
<tr>
<td><strong>General expenses</strong></td>
<td>4 750</td>
<td></td>
</tr>
<tr>
<td><strong>Loss on motor vehicle:</strong> (2880 – 1500)</td>
<td>1 380</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Depreciation on: motor vehicles:</strong> (7600 – 2880(1) + 16 400) × 0.2</td>
<td>4 224</td>
<td>(1)OF</td>
</tr>
<tr>
<td><strong>fixtures and fittings</strong></td>
<td>1 500</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Provision for doubtful debts:</strong> (13 690 – 750) × 0.05</td>
<td>647</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Bad debts written off</strong></td>
<td>750</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(60 771)</td>
<td></td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td>15 849</td>
<td>(1)OF</td>
</tr>
</tbody>
</table>

[15]
Patel’s Statement of financial position at 31 December 2014

$          $          
Non-current assets
Land and buildings  50 000  (1) for L&b & FF
Motor vehicles (7600 – 2880(1) + 16400 – 4224(1)  16 896
Fixtures and fittings  4 500

Total non-current assets  71 396

Current assets
Inventory  22 450
Trade receivables (13 690 – 750 – 647)  12 293  (1)OF
Rent in advance (1000 + 19 000 – 16 000)  4 000  (1)
Cash at bank  14 510
Cash  950

Total current assets  54 203

Total assets  125 599

Capital and liabilities
Opening capital (W1)  100 850  (1)
Add profit for the year  15 849

Less drawings (4800 (1) + 2600 (1))  7 400

Current liabilities
Trade payables  14 900
Wages  1 400

Total capital and liabilities  125 599

Working notes

W1
Capital at 1 January 2013
Bank  16 980
Land and buildings  50 000  Trade payables  16 750
Fixtures and fittings  6 000  Wages  1 200
Motor vehicles  7 600
Trade receivables  14 670
Inventory  21 750
Cash  800
Rent  1 000

118 800  17 950

Capital  100 850

[9]
(c) Five year loan

Advantage:
- Fixed rate of interest
- Helps plan cash flow

Disadvantage:
- May pay more interest if rates fall
- Interest payable for whole period
- May be secured on assets

Bank overdraft

Advantage
- No interest charged if not used
- Can be paid off whenever you like

Disadvantage
- Higher rate of interest than loan
- Can be called in by the bank at any time

1 mark for each advantage and disadvantage.
1 mark x 2 for development.

[Total: 30]
2 (a) Mark up expresses the gross profit (1) as a percentage of cost price of the goods sold (1). [2]

(b) Trading section of income statement for the year ended 31 March 2014.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>100 000</td>
<td>420 000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening inventory</td>
<td>40 000 (1)</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>340 000 (1)OF</td>
<td></td>
</tr>
<tr>
<td>Closing inventory*</td>
<td>(80 000) (4)</td>
<td>300 000 (1)OF</td>
</tr>
<tr>
<td>Gross profit (1)</td>
<td></td>
<td>120 000 (1)OF</td>
</tr>
</tbody>
</table>

[*300000 (1) / 5 (1) = 60000 x 2 (1) – 40000 (1)]

(c) (Gross profit / Revenue) (1) both x 100 (1) [2]

(d) (i) It shows the efficiency of assets to generate income (1). It shows how much every dollar of non-current assets (1) generates in sales revenue (1). A higher value indicates better utilisation of resources (1). [4]

(ii)  

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Formula</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current asset turnover</td>
<td>Sales revenue / non-current asset NRV(1)</td>
<td>420 000 (1) = 0.76 (1) times 550 000</td>
</tr>
</tbody>
</table>

(e) 1 Avoid overstating trade receivables
2 Be prudent.
3 Anticipate that some customers may not pay and become bad debts.
4 Application of matching principle [Max 3] [3]

(f) Provision for doubtful debts account [3]

(g) (i) $250 is to be added below gross profit in the income statement (1) as a decrease in the provision for doubtful debts. (1) [2]
(ii) $1400 is to be shown as a deduction of trade receivables (1) in current assets (1) in the statement of financial position. [2]

[Total: 30]
3 (a) Variable costs labour: $233 000 – $65 000 = $168 000 / 70 000 units = $2.40 per unit
  Variable costs overheads: $190 000 – $36 000 = $154 000 / 70 000 units = $2.20 per unit

  Selling price  12.00
  Materials ($259 000 / 70 000)  3.70 (1)
  Labour  2.40 (1)
  Overheads  2.20 (1)  8.30
  Contribution  $3.70 (1)  [4]

(b) Variable costs labour: $372 000 – $48 000 = $324 000 / 90 000 units = $3.60 per unit
  Variable costs overheads: $207 000 – $45 000 = $162 000 / 90 000 units = $1.80 per unit

  Selling price  8.00
  Materials ($180 000 / 90 000)  2.00 (1)
  Labour  3.60 (1)
  Overheads  1.80 (1)  7.40
  Contribution  $0.60 (1)  [4]

(c) Breakeven point = ($48 000 + $45 000 (1)) / $0.60 (1)OF = 155 000 units  [2]

(d) Breakeven point = 155 000 units (1)OF × $8 = $1 240 000 (1)OF  [2]

(e) Margin of safety = (90 000 – 155 000) (1)OF × $8 = $(520 000) (1)OF  [2]

(f) Proposal 1

  Revised sales of Zed: 90 000 × 95% = 85 500 units
  Revised contribution of Zed: $0.60 + $1.20 = $1.80

  Contribution Zed (85 500 (1) × $1.80 (1))  153 900
  Fixed overheads ($48 000 + $45 000)  93 000 (1)
  Revised profit Zed  60 900 (1)
  Profit Wye  158 000
  Revised profit  218 900 (1)  [5]

(g) Proposal 2

  Original profit Wye  158 000 (1)
  Additional contribution (70 000 × 40%) × $3.70  103 600 (1)
  Less: Additional fixed costs – redundancy (20 000) (1)
  Zed overheads (45 000) (1)
  Revised profit  196 600 (1)OF  [5]

  Accept revised profit of $148 600 if existing fixed costs of $48 000 are not stated.
(h) Company should choose proposal 1 / continue producing Zed (1)

Reasons

- Year 1 profit is higher by $22,300 (1)
- Subsequent years profits are higher by additional $20,000 (1) due to no further redundancy costs (1)
- But may lose customers for Wye due to not being able to supply Zed (1)
- May encounter bad publicity because of the redundancies (1)
- Forecast 40% increase in Wye sales may not be accurate (1)

[max 5 for reasons and 1 for decision] [6]

[Total: 30]