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ACCOUNTING

9706/32

Paper 3 Financial Accounting

February/March 2026

1 hour 30 minutes

You must answer on the question paper.

You will need: Insert (enclosed)

INSTRUCTIONS

- Answer **all** questions.
- Use a black or dark blue pen.
- Write your name, centre number and candidate number in the boxes at the top of the page.
- Write your answer to each question in the space provided.
- Do **not** use an erasable pen. Do **not** use correction fluid or tape.
- Do **not** write on any bar codes.
- You may use an HB pencil for any diagrams, graphs or rough working.
- You may use a calculator.
- International accounting terms and formats should be used as appropriate.
- You should show your workings.

INFORMATION

- The total mark for this paper is 75.
- The number of marks for each question or part question is shown in brackets [].
- The insert contains all of the sources referred to in the questions.

This document has **16** pages.

Merger of sole traders and formation of limited company

2 Or

Source A for Question 1

Purchase of sole traders by limited company

Gustav and Vera had both been in business as sole traders for some years. They decided to join their businesses together and form a limited company, GV Limited.

The balances in their books of account on 31 January 2025 were as follows:

	Gustav \$	Vera \$
premises A	60 000	nil
equipment A	14 000	51 000
motor vehicles A	8 500	19 860
inventory A	4 140	11 200
trade receivables A	3 300	9 960
bank A	4 320	12 130
trade payables L	2 620	11 330
capital = A - L	91 640	92 820

It was decided that both traders would pay the trade payables from their business bank accounts and then form the new company on 1 February 2025. The company took over all the assets of both businesses, including the bank accounts. The assets were revalued as follows:

After Paying T.P. Fair value

	Gustav \$	Vera \$
Bank	1700	800
premises	101 000	nil
equipment	11 500	51 000
motor vehicles	8 600	19 500
inventory	4 100	10 200
trade receivables	3 200	9 620

Fair value of Net Assets takeover 130100 91120

The company was formed with the issue of 280 000 ordinary shares of \$1 each, which were shared equally between Gustav and Vera.

\$280000 < G \$140000
V \$140000

G = Goodwill [140000 - 130100] = \$9900

V = Goodwill [140000 - 91120] = \$48880

\$58780

<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: right;">91640</td> <td style="text-align: right;">Realisation A/c</td> <td style="text-align: right;">140000</td> </tr> <tr> <td style="text-align: right;">Premises</td> <td style="text-align: right;">60000</td> <td style="text-align: right;">P.C</td> </tr> <tr> <td style="text-align: right;">Vehicles</td> <td style="text-align: right;">8500</td> <td style="text-align: right;">140000</td> </tr> <tr> <td style="text-align: right;">Equipment</td> <td style="text-align: right;">14000</td> <td></td> </tr> <tr> <td style="text-align: right;">Inventory</td> <td style="text-align: right;">4140</td> <td></td> </tr> <tr> <td style="text-align: right;">T.R</td> <td style="text-align: right;">3300</td> <td></td> </tr> <tr> <td style="text-align: right;">Bnk</td> <td style="text-align: right;">1700</td> <td></td> </tr> <tr> <td style="text-align: right;"><u>Dissolution Gain</u></td> <td style="text-align: right; border-bottom: 1px solid black;"><u>48360</u></td> <td></td> </tr> <tr> <td style="text-align: right;">Capital A/c</td> <td></td> <td></td> </tr> <tr> <td></td> <td style="text-align: right; border-top: 1px solid black; border-bottom: 1px solid black;"><u>140000</u></td> <td style="text-align: right; border-top: 1px solid black; border-bottom: 1px solid black;"><u>140000</u></td> </tr> </table>	91640	Realisation A/c	140000	Premises	60000	P.C	Vehicles	8500	140000	Equipment	14000		Inventory	4140		T.R	3300		Bnk	1700		<u>Dissolution Gain</u>	<u>48360</u>		Capital A/c				<u>140000</u>	<u>140000</u>	<p style="text-align: center; border: 1px solid black; display: inline-block; padding: 2px;">OR</p>
91640	Realisation A/c	140000																													
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Bnk	1700																														
<u>Dissolution Gain</u>	<u>48360</u>																														
Capital A/c																															
	<u>140000</u>	<u>140000</u>																													

Book value of Net Assets [A - L]	91640
Purchase Consideration	140000
Gain on Dissolution	<u>48360</u>



1 Read **Source A** in the insert.

(a) Prepare Gustav's capital account showing the entries to close his books of account.

Capital Accounts

	\$		\$
GV Ltd (Shares)	140000	Balance b/d	91640
		Dissolution Gain	48360
	140000		140000

[3]

(b) Analyse whether it was reasonable for the shares to be held equally by Gustav and Vera. Support your answer with a calculation of the value of goodwill which arose from the acquisition by the company of each of the sole trader businesses.

Both businesses are taken over by GV limited at \$140,000 meaning the company values both business at same amount.

The fair value tangible net assets contributed by Gustav is \$130100 resulting in Goodwill of (140000-130100) \$9900. Whereas the fair value of Vera tangible net assets are \$91120 resulting in Goodwill of (140000-91120) \$48880.

Gustav has contributed more tangible resources compared to Vera therefore he should have received higher number of shares to give him higher control over business but Vera has undue advantage as contributing lesser capital is giving her equal control and ownership this is because Vera business goodwill is valued at higher amount which is a subjective matter and therefore distribution is unfair.

But if Vera business is more popular than Gustav and have greater market share, higher customer base and will bring greater advantage to business in future and goodwill is valued at reliable basis the distribution is fair.





Workings:

[6]

(c) Prepare the statement of financial position of GV Limited on 1 February 2025.

<u>ASSETS</u>	\$	\$
<u>Non Current Assets</u>		
Tangible - Premises		101000
- Equipment [11500 + 51000]		62500
- Vehicles [8600 + 19500]		28100
Intangible - Goodwill [9900 + 48880]		<u>58780</u>
		250380
<u>C.A</u>		
Inventory [4000 + 10200]	14300	
T.R [3200 + 9620]	12820	
Bank [1700 + 800]	2500	29620
Total Assets		<u>280000</u>
<u>Equity:</u>		
Share Capital of \$1		<u>280000</u>

[5]

[Turn over



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Additional information

At the end of the first year of trading, GV Limited prepared a draft statement of financial position which showed the following summarised figures.

non-current assets (tangible and intangible)
 current assets
 ordinary share capital
 retained earnings
 current liabilities

\$		Goodwill 58780 - 2939
321020		Tangible 262240 - 5000
31250	- 390	
280000		- 2939 + 390
6080	- 250	Bank o/d @ 49700 + 50000
66190		other c.l 16490 + 250

The following additional information is also available.

- The draft figure for current liabilities included a figure for the bank overdraft of \$49700.
1 month before year end
- On 1 January 2026, the company had taken out a long-term bank loan of \$50 000 on which interest was to be charged at the rate of 6% per annum. No entries had been made in the books for either the receipt of the loan or the accrued interest. *Bank 50000 Loan 50000*
- The company had started building an extension to its premises. On 31 January 2026, the builder working on the extension had an accident, resulting in equipment with a carrying value of \$5000 being damaged beyond repair. No entries for this had been made in the books of account. The company had checked the insurance terms and conditions and was now 100% confident that it could claim this amount from the builder's insurer. *Insurance claim Receivable CA*
- Goodwill was yet to be amortised (depreciated). It was considered to have a life of 20 years. *After Year end Adjusting event*
- On 6 February 2026, a credit customer, who had owed \$390 at the year end, was declared bankrupt. *T.R + exp*

(d) Prepare the summarised statement of financial position at 31 January 2026.

Workings:





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	\$	\$
<u>Assets:</u>		
<u>Non Current Assets</u>		
Tangible [262240 - 5000]		257240
Intangible - Goodwill [58780 - 2939]		55841
Total NCA		313081
Current Assets other than Bank [31250 - 390 + 5000]	35860	
Bank [- 49700 + 50000]	300	36160
Total Assets		349241
<u>Equity:</u>		
Share Capital of \$1		280000
Retained Earnings [6080 - 250 - 2939 - 390]		2501
Total Equity		282501
<u>NCL</u>		
6% Bank loan		50000
Current liabilities [16490 + 250]		16740
Total Equity and liabilities		349241





(e) Explain how your answer to 1(d) would be different if the company was less confident that the insurance claim would be successful.

As per IAS 37 if the company would have been less confident than it means cash inflow of resources is uncertain it should have been recorded as an expense decreasing the non-current assets and retained earnings rather than including as insurance claim receivable in current assets. It is in line with prudence concept to ensure profit and assets are not overstated.

[3]

[Total: 25]

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Source B for Question 2

CM Club is a social club which also runs a café for use by members. The summarised bank account for the year ended 31 December 2025 was as follows:

	\$		\$
café takings	10 400	balance b/d	470
subscriptions	10 100	café suppliers	6 410
balance c/d	3 230	non-current asset	1 800
		heating and lighting	5 420
		bank interest	190
		club manager's salary	7 000
		other operating costs	2 440
	<u>23 730</u>		<u>23 730</u>
		balance b/d	3 230

The following additional information is available.

- All sales in the café are made for cash. The café staff were paid \$5200 out of these cash takings, and the remainder was paid into the bank. $10400 + 5200 = 15600$ Sales
- Assets and liabilities of the club were:

	OP at 1 January 2025 \$	CL at 31 December 2025 \$	
amounts owed to café suppliers	990	L 680	$+ 6410 - 990 = 6100$ Purchases
accrued heating and lighting	380 (←)	L 460	$+ 5420 - 380 = 5500$
clubhouse	63 000	A 63 000	
other non-current assets at cost	17 800 + 1 800	? 19 600	NBV = 14 850
provision for depreciation	3 100 + 1 650 =	? 4 750	A
subscriptions in advance	300 +	L 200 (←)	10100
subscriptions in arrears	800 (←)	A 1 200 +	= 10600 Income
café inventory	350	A 390	

- The club does **not** provide depreciation on the clubhouse. Other non-current assets are depreciated using the reducing balance method at the rate of 10% per annum. A full year's depreciation is charged on assets acquired during the year. $19600 - 3100 = 16500 \times 10\% = \1650
- Expenses charged to the café are one-third of total depreciation and 40% of the total cost of heating and lighting. $1650 \times 1/3 = 550$ $5500 \times 40\% = 2200$
- All subscriptions are paid into the bank account. ✓



2 Read **Source B** in the insert.

(a) Prepare the **café statement of profit** or loss for the year ended 31 December 2025.

	\$	\$
Cafe Sales [10400 + 5200]		15600
<u>less: Cost of Sales</u>		
OP. Inv	350	
Purchases	6100	
CL. Inv	<u>(390)</u>	<u>(6060)</u>
Gross Profit		9540
<u>less: expenses</u>		
Depreciation [1650 x 1/3]	550	
Heat and light [5500 x 10%]	2200	
Staff wages	<u>5200</u>	<u>(7950)</u>
Profit from Cafe		<u>1590</u>

Workings:

[6]





(b) Prepare the club's income and expenditure account for the year ended 31 December 2025.

	\$	\$
<u>Income</u>		
Subscription	10600	
Profit From Cafe	<u>1510</u>	
Total Income		12190
<u>less: Expenditures</u>		
Heat and light [5500 x 60%]	3300	
Depreciation [1650 - 550]	1100	
Bank Interest	190	
manager Salary	7000	
operating exp	<u>2440</u>	
Total expenditures		<u>(14030)</u>
 Deficit		 <u>(1840)</u>

Workings:

[6]



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(c) Calculate the club's accumulated fund at **31 December 2025**.

<u>Assets</u>	<u>\$</u>	<u>Liabilities</u>	<u>\$</u>
Club House	63000	Cafe Suppliers	680
Other NCA	14850	exp. owing	460
Inventory	390	Sub in Advance	200
Sub in Arrears	1200	Bank O/d	3230
	<u>79440</u>		<u>4570</u>

$$79440 - 4570 = 74870$$

[4]

Additional information

The club has had an overdraft facility with the bank for several years. The bank intends to withdraw that facility. Therefore, the managing committee wishes to improve the financial standing of the club.

The clubhouse contains several rooms which have **not** been used for years. The managing committee is considering two options.

option 1

To renovate the unused rooms and find a tenant for them.

option 2

To sell the clubhouse and with the proceeds buy smaller premises.





(d) Advise the managing committee which option it should choose. Justify your answer.

Option 1:

It will give club additional source of revenue and also helps in reducing or eliminating the deficit.

Renovation of rooms will require additional expenses and the club is already short of liquid funds.

Finding tenants will require time and it's not clear that tenancy agreement would be short term or long term. The cashflows may not be consistent.

Option 2:

Sale of old club house will yield higher cash inflows than outflows on new smaller club house hence improving cashflows and eliminating overdraft, decreasing interest cost and improving surplus.

The members may not like the idea of moving to smaller premises and some members may resign

[5]

Additional information

The managing committee is considering a change in policy such that subscriptions are paid by direct debit.

(e) Discuss the consequences of making this change.

...It will reduce administrative tasks, no need to send reminders to members..

Cashflows will streamlined and it will also reduce chances of bad debt as collections would be earlier.

It will increase bank charges and sometimes to insufficient funds payments may not process.

Some members maybe reluctant to share account details and like to pay through cheque or cash.

[4]

[Total: 25]

[Turn over



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Source C for Question 3

Kenji owns a manufacturing business. He has applied a rate of factory profit of 10% since the business started. The accountant has prepared the following draft statement of profit or loss using that rate.

Draft statement of profit or loss for the year ended 31 December 2025

revenue		\$	485 000
opening inventory of finished goods (at transfer price) 110%		\$	22 000
transfer price of manufactured goods			308 000
purchases of finished goods			16 400
			<u>346 400</u>
closing inventory of finished goods (at transfer price)			(26 400)
cost of sales			<u>320 000</u>
gross profit			165 000
factory profit			28 000
administrative expenses (including change in provision for unrealised profit)			(103 500)
distribution costs			(68 200)
profit for the year			<u>21 300</u>

Handwritten notes:

- Cost = 100% = \$20000
- F.P = 10% = \$2000
- COGM = 280000
- F.P = 28000
- Cost = 24000
- F.P = 2400
- Inc in UP 400
- 103100
- P. for UP
- B/d 2000
- P/L 400
- c/d 2400

Further information relating to the year ended 31 December 2025 is as follows:

1 Costs included:

	\$
machine operators' wages D.L	91 600
supervisors' salaries FOH	23 100
purchases of raw materials DM	101 000
general factory overheads FOH	59 700
carriage inwards on raw materials	700 DM

2 Inventories were:

	at 1 January 2025	at 31 December 2025
	\$	\$
raw materials	6 000	5 200
work in progress	13 300	?

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3 Read **Source C** in the insert.

(a) Calculate the following for the year ended 31 December 2025:

(i) production cost of goods completed

$$\frac{\$308000 \times 100}{110} = \$280000$$

..... [1]

(ii) cost of raw materials consumed

$$6000 + 101000 + 700 - 5200 = \$102500$$

..... [1]

(iii) prime cost.

$$\$102500 + \$91600 = \$194100$$

..... [1]

(b) Calculate the value of work in progress at 31 December 2025.

.....	\$
Prime cost	194100
Add: Factory overheads [23100 + 54700]	<u>82800</u>
	276900
+ W.I.P opening	13200
(-) W.I.P closing	(?) <u>10200</u>
Cost of Production:	<u>280000</u>
.....	
\$10200	
.....	
.....	[3]





Additional information

Kenji is considering increasing the rate of factory profit to 20%.

- (c) Prepare the provision for unrealised profit account for the year ended 31 December 2025, using the rate of 20%. *last year 10% so OP UP will be same*

2025	\$	2025	\$
		Balance b/d	2000
Balance c/d $(24000 \times 20\%)$	<u>4800</u>	Profit and loss	<u>2800</u>
	<u>4800</u>		<u>4800</u>
		2026	
		1 Jan Balance b/d	4800 [3]



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- (d) Prepare a revised statement of profit or loss for the year ended 31 December 2025, using the rate of 20%.

	\$	\$
Revenue		485000
<u>less: Cost of Sales</u>		
OP. Inv of F.G	22000	
+ Transfer value of Production $[280000 \times 1.2]$	336000	
+ Purchases of F.G	16400	
⊖ Cl. Inv of F.G $[24000 \times 1.2]$	(28800)	(345600)
Gross Profit		139400
Add: Factory Profit $[280000 \times 20\%]$	56000	
less: Inc in U/P	(2800)	53200
		192600
<u>less: Expenses</u>		
Admin exp	103100	
Dist exp	68200	(171300)
Profit		21300

Workings:

[5]





- (e) Advise Kenji whether or not he should change the rate of factory profit to 20%. Justify your answer.

Changing the rate of factory profit doesn't effect the overall profit of the business however it changes the proportion of profit earned from factory and trading. Since goods sold to customers at the same amount it is not effecting the total profit of the business.

Increasing the rate to 20% will increase factory profit proportion in total profit and reduce trading profit. Increasing the rate will also increase the value of closing inventory and increases unrealised profit which is against IAS 2 inventory valuation and prudence concept.

Rate of factory should only be increased if it is justifiable due to increase in market value of goods, increase in value of finished goods purchased from outside supplier or factory being more efficient reducing the cost of production.

[5]



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Additional information

Kenji plans to expand his business. He will take out a bank loan to finance the purchase of extra raw materials and additional factory machinery.

Kenji wants to include the loan interest in the manufacturing account. His accountant intends to record the interest in the statement of profit or loss.

- (f) Discuss why the loan interest should be recorded in the statement of profit or loss rather than the manufacturing account.

Loan interest is a finance cost and not the cost of production. Cost of production only include material, labour and overheads and not the interest expense. As per matching and accrual concept the expenses should be matched against revenues pertaining to relevant year. Interest is the cost of borrowing money and not the cost of converting raw materials into finished goods. Including interest expense in Manufacturing will increase cost of production and will not help in assessing whether to continue or discontinue production.

Furthermore as per IAS 1 finance cost should be included in statement of profit and loss after profit from operations.

[5]

- (g) State **one** reason why the accountant may go against the wishes of Kenji in this matter.

Professional ethics are more important than owner's wishes.

[1]

[Total: 25]

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