Dec 2015/Jan 2016
HKICPA
Exam in BAFS

Paper 2

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

EXAMINATION IN BAFS

Paper 2

Fundamentals of Financial and Management Accounting

Examination Time: 2 hours 15 minutes
This paper must be answered in English

INSTRUCTIONS

(1) There are three sections in this paper.

(2) All questions in Sections A and B are **COMPULSORY**. You are required to answer **ONE** of the two questions in Section C.

(3) Write your answers in the answer book. Start **EACH** question (not part of a question) on a **NEW** page.

Not to be taken away

SECTION A (24 marks)

Answer **ALL** questions in this section.

1. Adam Company sells a single product. It uses periodic inventory system and weighted average method to account for its inventory. Information of the product in November 2015 was as follows:

Date	Transaction
10 November	Purchased 50 units at $100 per unit
15 November	Sold 30 units
17 November	Purchased 40 units at $122.50 per unit
22 November	Sold 16 units

There was no inventory at 1 November 2015. The selling price in November 2015 was $150 per unit. For each sale, the agent charges the company a commission at 10% of sale value. Stocktaking at 30 November 2015 revealed 44 units in stock.

REQUIRED:

(a) Calculate the net realisable value per unit of inventory as at 30 November 2015. (1 mark)

(b) Calculate the value of closing inventory as at 30 November 2015 with explanation to support the valuation. (3 marks)

(c) Calculate the gross profit for the month of November 2015. (2 marks)

(Total: 6 marks)

2. (a) For each of the descriptions in (i) to (iv) below, indicate which of the following is most suitable:

- Direct deposit of cheque
- Dishonoured cheque
- Post-dated cheque
- Stale cheque
- Uncredited cheque
- Unpresented cheque

(i) A cheque was issued to the payee, but the payer's bank had not made payment.

(ii) A cheque was returned due to some reasons, such as, unmatched signature or spelling mistake.

(iii) A cheque was credited to the payee's bank, but the payee did not know.

(iv) A cheque was returned as it had been deposited on a date after six months since its issue date.

(2 marks)

(b) What is the purpose of preparing a bank reconciliation statement? (2 marks)

(Total: 4 marks)

3. (a) Calculate the missing numbers (as a percentage up to one decimal place):

	Mark-up		Profit margin
(i)	25%	=	**?**
(ii)	60%	=	**?**
(iii)	**?**	=	25%
(iv)	**?**	=	60%

(3 marks)

On 7 June 2015, a fire destroyed certain inventory items of Kendy Limited. To claim compensation from the insurer, the company gathered the following information:

(1) Inventories as at 31 May 2015 were $500 000.

(2) During the period from 1 June 2015 to 7 June 2015 (before fire):

(i) Goods purchased and received were $2 080 000.
(ii) Goods sold at $2 400 000 were delivered to customers.
(iii) Goods invoiced at $12 000 were sent to a customer on a sale-or-return basis.
(iv) All goods were sold at a mark-up of 20% on cost.

(3) After the fire, the company examined and revalued (at lower of cost and net realisable value) the inventory in warehouse at $555 000.

The insurer agreed to compensate Kendy Limited for 70% of the inventory loss.

REQUIRED:

(b) Calculate the net loss (after insurance compensation) by the fire. (4 marks)

(Total: 7 marks)

4. Daniel Limited has two production departments, the machine intensive Machining Department and the labour intensive Assembly Department, which manufacture two products, Product A and Product B. The production of both products commences in the Machining Department and finishes in the Assembly Department.

The budgeted direct labour cost per unit of each product is as follows:

	Product A	Product B
Machining Department ($38/hour)	$76	$152
Assembly Department ($32/hour)	$128	$96

The budgeted machine hours per unit of each product are as follows:

	Product A	Product B
Machining Department	2.5 hours	4.5 hours
Assembly Department	0.5 hour	1.5 hours

In September 2015, the budgeted output for Product A and Product B were 6000 units and 5000 units respectively. The budgeted production overheads of the Machining Department and Assembly Department were $200 000 and $350 000 respectively.

The company adopts absorption costing. The production overhead absorption rates of the Machining Department and Assembly Department are based on machine hours and direct labour hours respectively.

REQUIRED:

Calculate (to two decimal places) the predetermined production overhead absorption rates for each production department. (7 marks)

SECTION B (36 marks)

Answer **ALL** questions in this section.

5. Dora Limited has its financial year ending on 31 December. On 1 January 2014, it had the following account balances:

Office Equipment		
–	cost	$400 000 (Note 1, 2)
–	accumulated depreciation	$250 000 (Note 3)

Note

(1) Except one piece of equipment costing $140 000 which was acquired in 2008, the others were acquired in 2010 and after.
(2) The cost of equipment WB of $100 000 was included.
(3) The accumulated depreciation of equipment WB of $10 000 was included.

On 1 April 2014, equipment WB was traded in for a new equipment Zeon from Eva Limited. The trade-in value of equipment WB was $80 000 and Dora Limited further paid $70 000 in cash to Eva Limited for acquiring equipment Zeon.

The accounting policies of Dora Limited include:

(i) depreciation on office equipment is provided at 20% on cost per annum by straight line method on a monthly basis;

(ii) a depreciation expense account is maintained to record depreciation of non-current assets; and

(iii) a disposal of office equipment account is used to ascertain the gain or loss on disposal.

REQUIRED:

(a) Prepare necessary journal entries for the trade-in of equipment WB for equipment Zeon. Narrations are not required. (7 marks)

(b) Calculate the depreciation expense of office equipment for the year ended 31 December 2014. (3 marks)

(c) In addition to the purchase cost, state two other outlays that are treated as capital expenditure on acquisition of equipment. (1 mark)

(Total: 11 marks)

6. Mr. Fabian So is a manager of a professional firm which provides accounting services to other companies in Hong Kong. He noticed the following cases in reviewing clients' draft financial statements for the year ended 30 June 2015:

Client 1: A court order has declared the bankruptcy of Mr. Gary Lam, a longtime credit customer of Client 1. The process of winding-up began in June 2015. It was expected that the outstanding balance with Gary could not be fully recovered in the next accounting year. No adjustment has been made in the draft financial statements with respect to Gary's outstanding balance.

Client 2: Since the operating result for current year was poor when compared with last year, the management proposed to switch the depreciation method of office furniture from reducing balance method to straight line method.

REQUIRED:

(a) (i) State and explain the accounting principle or concept that Client 1 has violated and suggest the correct accounting treatment to this client.

(ii) With reference to a relevant accounting principle or concept, explain whether the proposed accounting treatment of Client 2 is proper.

(7 marks)

Max Company uses periodic inventory system to account for its inventory items. The accountant was checking the books and discovered the following errors:

(1) Paid $170 by cheque for delivery of goods to a credit customer, Sam Ho. It was correctly recorded in the bank account, but entered into the corresponding account as $710.

(2) Paid $800 by cheque for transportation of goods purchased from a credit supplier, Bryan Limited. The transaction had not yet recorded in the books.

(3) Before posting year end adjustments, the closing inventory was overcasted by $8800.

REQUIRED:

(b) Prepare necessary journal entries to correct (1) to (3) above. Narrations are not required. If no journal entry is required, state "No entry is required" in your answer book.

(4 marks)

(Total: 11 marks)

7. Terry Limited manufactures two computer components, X and Y, at the following unit costs:

	Component X	Component Y
	$	$
Direct materials	180	240
Direct labour ($80 per hour)	200	300
Overheads*	350	400
	730	940

* The above overheads include:

Fixed production overheads	45%
Variable production overheads	30%
Apportioned fixed administrative overheads	25%
	100%

A supplier offered to sell components, X and Y, to Terry Limited at $600 per unit and $640 per unit respectively.

REQUIRED:

(a) What is relevant cost? (2 marks)

(b) Explain, with supporting calculations, whether Terry Limited should produce internally or purchase from the supplier for:

(i) Component X

(ii) Component Y

(6 marks)

Terry Limited expects that there will be a shortage of labour in the near future. The direct labour for production of Component X can be shifted to the production of Product A when necessary. Product A sells at $32 500 per unit with budgeted unit production costs as follows:

	$
Direct materials	4 000
Direct labour ($80 per hour)	10 000
Production overheads #	15 000
	29 000

70% of the overheads are variable costs.

REQUIRED:

(c) Considering the limiting factor above, explain whether the decision of produce internally or purchase from the supplier of Component X taken in (b) should change. Support your answer with calculations. (6 marks)

(Total: 14 marks)

SECTION C (20 marks)

Answer **ONE** question in this section.

8. The trial balance of Ivory Limited as at 31 December 2014 was as follows:

	Dr $	Cr $
Furniture, 1 January 2014		
– cost and accumulated depreciation	80 000	24 000
Motor vehicles, 1 January 2014		
– cost and accumulated depreciation	280 000	140 000
Inventory, 1 January 2014	258 000	
Trade receivables and payables	192 000	72 000
Allowance for doubtful debts, 1 January 2014		18 000
Bank	322 750	
15% Bank loan		500 000
Ordinary share capital		50 000
Retained profits, 1 January 2014		680 000
General reserve		122 000
Interim dividend paid	30 000	
Purchases and sales	705 000	1 340 000
Returns	120 000	12 000
Carriage outwards	37 000	
Carriage inwards	54 000	
Bank interest income		1 500
Discounts		500
Audit fee	5 000	
Bank loan interests	56 250	
Rent and rates	80 000	
Salaries, including directors' remuneration	740 000	
	2 960 000	2 960 000

Additional information:

(1) As at 31 December 2014:

(i) the inventory was $600 000;
(ii) prepaid rent was $7000; and
(iii) allowance for doubtful debts was estimated at $16 000.

(2) The following items were shown in bank statement but not yet recorded in the accounts for December 2014:

(i) bank charges of $150; and
(ii) credit transfer from a trade receivable of $3000.

(3) Annual depreciation was to be provided as follows:

Furniture	–	15% on cost
Motor vehicles	–	20% on net book value

(4) Board of Directors proposed no final dividend and resolved to transfer $20 000 to general reserve.

(5) A bank loan was taken in 2012. It was agreed that loan interests would be paid every three months since the date of grant and the principal should be repaid in five equal annual instalments with the first repayment on 1 July 2015.

REQUIRED:

(a) Prepare (in vertical format) the statement of comprehensive income for the year ended 31 December 2014 and the statement of financial position as at that date for internal use. (18 marks)

(b) State two differences between ordinary shares and preference shares.
(2 marks)
(Total: 20 marks)

9. The summarised financial statements of Heidi Limited were as follows:

Statement of Comprehensive Income for the year ended 31 December

	2014	2013
	$'000	$'000
Turnover	4 600	4 300
Cost of sales	(2 245)	(2 135)
Gross profit	2 355	2 165
Operating expenses	(1 582)	(1 491)
Interest expense	(90)	(160)
Profit before tax	683	514
Income tax expense	(113)	(84)
Profit for the year	570	430

Statement of Financial Position as at 31 December

	2014		2013	
	$'000	$'000	$'000	$'000
ASSETS				
Non-current assets		5 534		6 347
Current assets				
Inventories	566		544	
Trade receivables	655		597	
Bank	228	1 449	104	1 245
Total assets		6 983		7 592
EQUITY AND LIABILITIES				
Equity				
Ordinary share capital		2 635		2 450
Retained profits		1 710		1 140
Total equity		4 345		3 590
Non-current liabilities				
Bank loan, due in 2020	1 824		3 210	
Total non-current liabilities		1 824		3 210
Current liabilities				
Trade payables	701		708	
Tax payable	113		84	
Total current liabilities		814		792
Total liabilities		2 638		4 002
Total equity and liabilities		6 983		7 592

REQUIRED:

(a) Calculate (to one decimal place) the following ratios for the each of the years of 2013 and 2014:
(i) net profit ratio
(ii) return on capital employed
(iii) quick ratio
(iv) gearing ratio

(12 marks)

The management obtained relevant industry average ratios as follows:

	2014
Net profit ratio	14.6%
Return on capital employed	11.3%
Quick ratio	1.3 : 1
Gearing ratio	33%

REQUIRED:

(b) Based on the ratios calculated in (a) and the industry average ratios above, comment on Heidi Limited's company performance and comparison with the industry average in each of the three aspects, (i) profitability, (ii) liquidity and (iii) solvency for the year of 2014. (8 marks)

(Total: 20 marks)

END OF PAPER

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Fundamentals of Financial and Management Accounting

Suggested Answers

SECTION A (24 marks)

1. **(a)** Net realisable value per unit of inventory as at 30 November 2015
= $150 x 90%
= $135 **(1 mark)**

(b) Weighted average unit cost for the month ended 30 November 2015 **Marks**

$$= \frac{\$100 \times 50 + \$122.5 \times 40}{50 + 40}$$

= $110 **[1.5]**

Since the net realisable value per unit exceeds the weighted average unit cost, $110 should be used to measure the closing inventory. **[0.5]**

Value of closing inventory as at 30 November 2015
= $110 x 44
= $4840 **[1]**

(3 marks)

(c) Gross profit for the month of November 2015
= ($150 – $110) x (30 + 16)
= $1840 **(2 marks)**

(Total: 6 marks)

2. **(a)**

		Marks
i	unpresented cheque	**[0.5]**
ii	dishonoured cheque	**[0.5]**
iii	direct deposit of cheque	**[0.5]**
iv	stale cheque	**[0.5]**

(2 marks)

(b) A bank reconciliation statement is prepared to account for the discrepancy between the bank account balance as per the accounting record and the balance as stated in the bank statement at a particular point in time.

(2 marks)

(Total: 4 mark)

3. **(a)** **Marks**

(i)	20.0%	**[0.5]**
(ii)	37.5%	**[0.5]**
(iii)	33.3%	**[1]**
(iv)	150.0%	**[1]**
		(3 marks)

(b)

	$	$	
Inventories as at 31 May 2015		500 000	
Add:			
Goods purchased and received from 1 June 2015 to 7 June 2015 (before fire)		2 080 000	**[0.5]**
		2 580 000	
Less:			
Cost of goods sold from 1 June 2015 to 7 June 2015 (before fire) :			
Sales	2 400 000		**[0.5]**
Less: Profit margin (2 400 000 x 20/120)	(400 000)	(2 000 000)	**[0.5]**
Inventories as at 7 June 2015 before fire		580 000	
Less:			
Value of inventories in warehouse after fire		(555 000)	**[0.5]**
Cost of goods sent on sale or return basis:			
Invoiced amount	12 000		**[0.5]**
Less: Profit margin (12 000 x 20/120)	(2 000)	(10 000)	**[0.5]**
Inventory loss before insurance compensation		15 000	
Less: Insurance compensation (15 000 x 70%)		(10 500)	**[0.5]**
Inventory loss after insurance compensation		4 500	**[0.5]**

(4 marks)

(Total: 7 mark)

4. **<u>Machining Department</u>** **Marks**

Budgeted total machine hours
= 2.5 machine hours x 6 000 + 4.5 machine hours x 5 000
= 37 500 machine hours **[2]**

Predetermined overhead absorption rate
= $200 000 / 37 500 machine hours
= $5.33 per machine hour **[1]**

<u>Assembly Department</u>

Budgeted total direct labour hours
= 128/32 direct labour hours x 6 000 + 96/32 direct labour hours x 5 000
= 39 000 direct labour hours **[3]**

Predetermined overhead absorption rate
= $350 000 / 39 000 direct labour hours
= $8.97 per direct labour hour **[1]**

(Total: 7 mark)

SECTION B (36 marks)

5. **(a)**

General Journal

		Dr	Cr	**Marks**
2014		$	$	
Apr 1	Depreciation expense (100 000 x 20% x 3/12)	5 000		**[0.5]**
	Accumulated depreciation – Office Equipment		5 000	**[0.5]**
	Office Equipment – cost (Zeon)	150 000		**[1]**
	Accumulated depreciation – Office Equipment (10 000 + 5 000)	15 000		**[2]**
	Disposal of Office Equipment	5 000		**[0.5]**
	Cash		70 000	**[0.5]**
	Office Equipment – cost (WB)		100 000	**[1]**
Dec 31	Profit and loss	5 000		**[0.5]**
	Disposal of Office Equipment		5 000	**[0.5]**

(7 marks)

(b)

	$	
Cost of Office Equipment as at 1 January 2014	400 000	
Less: Cost of WB disposed in 2014	(100 000)	**[0.5]**
Cost of equipment acquired in 2008 (note)	(140 000)	**[0.5]**
Cost of equipment acquired between 1 Jan 2010 to 31 Dec 2013	160 000	
Depreciation expense for the year ended 31 December 2014		
– on equipment acquired between 1 Jan 2010 to 31 Dec 2013 (160 000 x 20%)	32 000	**[0.5]**
– on WB before disposal (a)	5 000	**[0.5]**
– on Zeon acquired on 1 April 2014 (150 000 x 20% x 9/12)	22 500	**[1]**
	59 500	

(3 marks)

Note

Depreciation at 20% under straight-line method denotes that the useful life of the equipment is five years. Accordingly, the equipment acquired in 2008 has been fully depreciated by the end of 2013 and no depreciation should be provided for 2014.

(c) Outlays which are treated as capital expenditure on acquisition of equipments for business use include:

– transportation cost
– agent's commission
– import duties
– installation cost
– fee for testing

(Any other relevant answers)

(Any two, 0.5 mark each, maximum 1 mark)

(Total: 11 marks)

6.	(a)	(i)	Client 1	**Marks**

Prudence principle or concept was violated. **[1]**

Prudence principle or concept requires the inclusion of a degree of caution in valuing assets, so as to ensure assets are not overstated. **[1]**

Applying to trade receivables, prudence principle or concept calls for measuring trade receivables at the estimated collectible amount (or net realisable value). Typically, trade receivables are listed under current assets which entail that the debt owners expect to recover trade receivables no more than 12 months after the end of the current reporting period.

Since Gary's outstanding balance cannot be fully recovered in the next 12 months, an adjustment should be made in the draft financial statements, either, at least, by creating an allowance for the doubtful debt to estimate the uncollectible amount or, if confirmed irrecoverable, writing off the outstanding debt as bad debt. **[2]**

(ii) Client 2

Consistency principle or concept was violated. **[1]**

Consistency principle or concept advocates that once an accounting treatment has been adopted by a reporting entity for recording or presentation purpose, the same treatment should be adhered to and followed for similar accounting items within the same accounting period and from one period to the next. **[1]**

Change of an accounting treatment is allowed only if it can provide more useful information to the users of financial statements, but not for the sole purpose of boosting up profits. Thus, change of depreciation method is not allowed in the present case. **[1]**

(7 marks)

(b) **General Journal**

		Dr $	Cr $	
(1)	Suspense	540		**[0.5]**
	Carriage outwards (710 – 170)		540	**[1]**
(2)	Carriage inwards	800		**[1]**
	Bank		800	**[0.5]**
(3)	No entry is required.			**[1]**

(4 marks)

(Total: 11 marks)

7. (a) Relevant costs are those expected incremental and avoidable cash flows which must be considered in making (short-term) decisions.

(2 marks)

(b)

	(i) Component X $	(ii) Component Y $	**Marks**
Marginal production cost per unit			
Direct materials	180	240	**[1]**
Direct labour cost	200	300	**[1]**
Variable production overheads (30%)	105	120	**[1]**
	485	660	**[1]**
Quoted price per unit from external supplier	600	640	**[1]**
Decision	Make	Buy	**[1]**

(6 marks)

(c) In view of the constraint in direct labour hours, the company needs to buy Component X externally if it will produce Product A.

Incremental benefit from producing Product A:

Contribution per unit of Product A (32 500 – 4 000 – 10 000 – 15 000 x 70%)	$8 000		**[2]**
÷ Direct labour hours per unit (10 000 ÷ 80)	÷ 125 hours		**[1]**
Contribution per direct labour hour		$64	

Incremental cost on purchasing Component X:

Extra cost per unit if Component X is bought externally [600 – 485 (b)]	$115		**[0.5]**
÷ Direct labour hours per unit (200 ÷ 80)	÷ 2.5 hours		**[1]**
Extra cost per direct labour hour		($46)	
Incremental benefit over incremental cost		$18	**[0.5]**

Since direct labour can contribute more for the production of Product A, Component X should be bought from the supplier. **[1]**

(6 marks)

(Total: 14 marks)

SECTION C (20 marks)

8. **(a)** **(i)**

Ivory Limited

Statement of Comprehensive Income for the year ended 31 December 2014

	$	$	**Marks**
Sales	1 340 000		**[0.5]**
Less: Returns inwards	(120 000)	1 220 000	**[0.5]**
Cost of sales			
Inventories as at 1 January 2014	258 000		**[0.5]**
Add: Purchases	705 000		**[0.5]**
Carriage inwards	54 000		**[0.5]**
Less: Returns outwards	(12 000)		**[0.5]**
	1 005 000		
Less: Inventories as at 31 December 2014	(600 000)	(405 000)	**[0.5]**
Gross profit		815 000	
Other income			
Bank interest income	1 500		**[0.5]**
Discounts received	500		**[0.5]**
Allowance for doubtful debts (decrease) (16 000 – 18 000)	2 000	4 000	**[0.5]**
		819 000	
Expenses			
Carriage outwards	37 000		**[0.5]**
Audit fee	5 000		**[0.5]**
Bank loan interests (500 000 x 15%)	75 000		**[0.5]**
Rent and rates (80 000 – 7 000)	73 000		**[0.5]**
Salaries, including directors' remuneration	740 000		**[0.5]**
Bank charges	150		**[0.5]**
Depreciation – furniture (80 000 x 15%)	12 000		**[0.5]**
Depreciation – motor vehicles [(280 000 – 140 000) x 20%]	28 000	970 150	**[0.5]**
Loss for the year		(151 150)	

(9 marks)

(ii)

Ivory Limited
Statement of Financial Position as at 31 December 2014

	$	$	$	**Marks**
Non-current assets				
Furniture at cost		80 000		**[0.5]**
Less: Accumulated depreciation				
(24 000 + 12 000)		(36 000)	44 000	**[0.5]**
Motor vehicles at cost		280 000		**[0.5]**
Less: Accumulated depreciation				
(140 000 + 28 000)		(168 000)	112 000	**[0.5]**
			156 000	
Current assets				
Inventories		600 000		**[0.5]**
Trade receivables (192 000 – 3 000)	189 000			**[0.5]**
Less: Allowance for doubtful debts	(16 000)	173 000		**[0.5]**
Prepayment		7 000		**[0.5]**
Bank (322 750 – 150 + 3 000)		325 600	1 105 600	**[0.5]**
Total assets			1 261 600	
Equity				
Ordinary share capital			50 000	**[0.5]**
General reserve (122 000 + 20 000)			142 000	**[0.5]**
Retained profits				
(680 000 – 151 150 – 30 000 – 20 000)			478 850	**[1.5]**
			670 850	
Non-current liabilities				
15% Bank loan (500 000 x 4/5)			400 000	**[0.5]**
Current liabilities				
Trade payables			72 000	**[0.5]**
Accrued bank loan interest (75 000 – 56 250)			18 750	**[0.5]**
15% Bank loan (500 000 x 1/5)			100 000	**[0.5]**
			190 750	
Total equity and liabilities			1 261 600	

(9 marks)

(b)

	Ordinary Shares	**Preference Shares**
Voting Right	Usually with voting right	Usually no voting right
Dividend Right	Receive dividends after preference shareholders	Receive dividends before ordinary shareholders
Dividend Return	Variable, or even nil, depending on decision of the board of directors	Fixed
Return of Capital on Liquidation	Receive return of capital only after preference shareholders have received their return of capital	Have prior right in receiving return of capital, including any dividend in arrears

(Any two, 1 mark each, maximum 2 marks)

(Total: 20 marks)

9. (a)

i. Net profit ratio

2014	**Marks**	**2013**	**Marks**
$= \dfrac{683\ 000}{4\ 600\ 000} \times 100\%$		$= \dfrac{514\ 000}{4\ 300\ 000} \times 100\%$	
$= 14.8\%$	**[1]**	$= 12.0\%$	**[1]**

ii. Return on capital employed

2014		**2013**	
$= \dfrac{683\ 000 + 90\ 000}{1\ 824\ 000 + 4\ 345\ 000} \times 100\%$		$= \dfrac{514\ 000 + 160\ 000}{3\ 210\ 000 + 3\ 590\ 000} \times 100\%$	
$= 12.5\%$	**[2]**	$= 9.9\%$	**[2]**

iii. Quick ratio

2014		**2013**	
$= \dfrac{1\ 449\ 000 + 566\ 000}{814\ 000} \times 100\%$		$= \dfrac{1\ 245\ 000 + 544\ 000}{792\ 000} \times 100\%$	
$= 1.1{:}1$ (or 1.1 times)	**[1.5]**	$= 0.9{:}1$ (or 0.9 times)	**[1.5]**

iv. Gearing ratio

2014		**2013**	
$= \dfrac{1\ 824\ 000}{1\ 824\ \ 000 + 4\ 345\ 000} \times 100\%$		$= \dfrac{3\ 210\ 000}{3\ 210\ 000 + 3\ 590\ 000} \times 100\%$	
$= 29.6\%$	**[1.5]**	$= 47.2\%$	**[1.5]**

(12 marks)

(b) Profitability

Net profit ratio

Net profit ratio increased from 12.0% in 2013 to 14.8% in 2014, which means that Heidi Limited was able to generate increasing profit from sales. **[1]**

When compared with the industry average, Heidi Limited had its net profit ratio (14.8%) slightly above the industry average (14.6%). It meant that Heidi Limited's profitability of each dollar of sales was slightly above the industry average. **[1]**

Return on capital employed

Return on capital employed (ROCE) improved from 9.9% in 2013 to 12.5% in 2014, which implied a more than 26% improvement in ROCE and that Heidi Limited could generate more profit from available capital employed. **[1]**

When compared with the industry average, the ROCE of Heidi Limited (12.5%) was above the industry average (11.3%). It indicated that Heidi Limited could generate a higher return on each dollar of capital than the industry average. **[1]**

Liquidity

Quick ratio

Quick ratio jumped from 0.9:1 in 2013 to 1.1:1 in 2014, which indicates that Heidi Limited’s liquid assets (trade receivables and bank) were inadequate to meet immediate debts in 2013, but were adequate to do so in 2014. **[1]**

When compared with the industry average, Heidi Limited’s quick ratio (1.1:1) was below the industry average (1.3:1) in 2014. It represented that the liquidity of Heidi Limited (in repaying short term debts) was weaker than the industry average. **[1]**

Solvency

Gearing ratio

Gearing ratio declined from 47.2% in 2013 to 29.6% in 2014, which represented a drastic drop exceeding 37% and that the financial risk of Heidi Limited was much reduced. **[1]**

When compared with the industry average, the gearing ratio of Heidi Limited (29.6%) was below the industry average (33%) in 2014. It showed that Heidi Limited was less rely on debt financing than the industry average. **[1]**

(8 marks)

(Total: 20 marks)

END

HKICPA Examination in BAFS

December 2015 / January 2016 Session

Examiner's Report of Paper 2

General Comments

Candidates' overall performance in this paper was satisfactory. However, they were weak in answering essay-type questions, such as those relating to accounting concepts or principles and comments on a company's performance based on accounting ratios.

Section A – Compulsory Short Questions

Question 1

This question tested candidates' ability in valuating inventories using the weighted average method under periodic inventory system. In general, candidates' performance was not satisfactory.

It is disappointing that around half of the candidates failed to calculate the net realisable value per unit. Many wrongly calculated the weighted average cost per unit as net realisable value per unit. Some even wrongly added 10% sales commission when calculating the net realisable value.

Many candidates also mistakenly used unit purchase prices ($100 and $122.50) to calculate the value of closing inventories. These candidates simply followed the sequence of transactions and failed to apply the weighted average method under periodic inventory system. Candidates should note that under a periodic inventory system, cost of goods sold and value of closing inventory should be calculated periodically (e.g. at the month end as in this question), not at the time when inventory items are purchased or sold.

Amongst those who could calculate the weighted average cost, many failed to apply the lower of cost and net realisable value in valuing the closing inventory.

Question 2

This question tested candidates' ability in distinguishing different types of cheques and stating the purpose of preparing a bank reconciliation statement. Candidates generally performed satisfactorily.

Many, however, wrongly indicated that "a cheque was returned as it had been deposited on a date after six months since its issue date" was a post-dated cheque.

Question 3

This question required candidates to (a) convert mark-up to profit margin, and vice versa; and (b) work out the amount of inventory loss after a fire. Candidates' general performance was fair.

Not many candidates seemed to be very clear about the conversion between mark-up and profit margin.

Also, many failed to convert sales and the invoiced price of goods sent on sale or return back to cost (by deducting the profit element) before ascertaining the inventory loss. Candidates are reminded that sales, with an embedded profit element, cannot be deducted from inventories which are valued at cost.

Section B – Compulsory Application Questions

Question 4

This question tested candidates' ability in calculating predetermined production overhead absorption rate for a capital intensive production department and a labour intensive production department. The performance in this question was not satisfactory.

Many candidates did not read the given information and instructions carefully and selected wrong absorption base or overlooked the key words, "each" "department" in the question requirement.

Candidates should note that predetermined departmental overhead absorption rate should be calculated as follows:

$$\frac{\text{Budgeted total departmental production overheads}}{\text{Budgeted total quantity of the absorption base}}$$

Question 5

This question tested candidates' knowledge of preparing journal entries to record disposal of non-current asset with trade-in of the old one. Candidates' performance in this question was fair.

Most candidates could handle this type of questions well. However, some had difficulty mainly because they failed to:

(1) calculate the depreciation expense of the disposed non-current asset from beginning of the period to the date of disposal;
(2) diagnose that certain non-current assets had already been depreciated fully at the beginning of the period; and
(3) use disposal of office equipment account, as required by the question.

Question 6

This question tested candidates' competence in (a) figuring out the accounting concepts or principles that had been violated; and (b) preparing necessary journal entries to correct the errors related to the inventory set out in the question under periodic inventory system. In general, candidates' performance was not satisfactory.

Most candidates could identify that prudence and consistency concepts or principles had been violated, though many could not fully depict the underlying rationale at issue.

In preparing journal entries for correction purpose, many candidates wrongly recorded in the personal accounts of trade receivables or trade payables, instead of doing the corrections through the carriage outwards account and carriage inwards account.

Nearly all candidates failed to recognise that, under periodic inventory system, no entry was required for overcasting inventory before posting the year-end adjustments.

Question 7

This question tested candidates' ability in making a make-or-buy decision under the scenarios with and without limiting factors. Candidates' performance in this question was fair.

In the case of without limiting factors, many candidates came to the correct decision by comparing the unit marginal production cost with the quoted price from the supplier.

However, in the case of having a limiting factor of shortage in labour supply, only few were able to compare the incremental benefit with the incremental cost per unit of the limiting factor (labour hour).

Section C – Optional Case/Theory Questions

Question 8

This question tested candidates' competence in (a) preparing a statement of comprehensive income and a statement of financial position of a limited company; and (b) stating the differences between ordinary shares and preference shares. Candidates' performance was good.

Common errors committed by candidates included:

(1) mixing up the treatment of carriage inwards with that of carriage outwards;
(2) mixing up the amounts of returns inwards with return outwards;
(3) treating the interim dividend paid as an expense;
(4) treating the discount received as discounts allowed;
(5) failing to accrue the unpaid bank loan interest;
(6) failing to split the bank loan into current and non-current portions; and
(7) failing to adjust the bank account balance with respect to those unrecorded bank statement items.

Question 9

This question tested candidates' competence in calculating specified key accounting ratios and their ability to comment on the performance of the business concerned, including making comparisons with the industry average. In general, candidates' performance in this question was satisfactory.

Many scored high marks in calculating ratios but could not give proper comments on the performance of the business and make appropriate comparisons with the industry average. Candidates are advised to study more and prepare better for answering essay-type questions like this one, because they have been frequently found in previous examination sessions.

[END]