

HONG KONG ASSOCIATION FOR BUSINESS EDUCATION

HONG KONG DIPLOMA OF SECONDARY EDUCATION

EXAMINATION 2011/12

BUSINESS, ACCOUNTING AND FINANCIAL STUDIES

MOCK EXAMINATION

PAPER 1

(SUGGESTED ANSWER)

Section A (60%)

Suggested Answers for Multiple Choices:

1	2	3	4	5	6	7	8	9	10
D	C	B	D	C	A	B	A	C	D
11	12	13	14	15	16	17	18	19	20
D	B	B	B	A	D	C	C	D	C
21	22	23	24	25	26	27	28	29	30
B	A	D	B	B	B	C	A	D	B

Section B (40%)**Question 1****(1)(a)**

- capable of sourcing goods that suits local situations / providing specialized goods and services for the needs of the local customers
- better customer relations with local community
- small in scale and their operating costs/overhead expenses are usually lower
- more flexibility in management such as encouraging better relationship with staff
- enabling faster decision making to cope with new changes
- smaller set-up costs or lower initial capital needed

(1)(b)

- Resources available / Scale of operation
Big firms have more resources to carry out programs to fulfill their social responsibilities but small firms may not fulfill their social responsibilities due to limited resources.
- Meeting public expectation
Big firms have more influence and thus the public has higher expectation on them to follow requirements of a higher standard. On the other hand, requirements on small firms may be compliance with the law only.

- Area of responsibilities / Variety of choices
Small firms may only be able to implement social responsibilities in limited aspects e.g. occupational safety, consumer protection.
Big firms may involve in more aspects such as community welfare, environmental concerns, and international issues.
- Willingness to fulfill social responsibilities
Large firms will be more conscious and willing to take up social responsibilities in order to build up better reputation/goodwill for long-term profitability.

(1)(c)

Conceptual skill – to integrate information for the situation, to set policies to carry out the requirement set by the CEO

Technical skill – to set measures for control of expenses / to formulate a better financial plan or budget needs high technical skills

Communication skill – cutting expenses including downsizing sometimes causes hardship to the front line staff, good communication skill is needed to explain company's policies as well as to motivate them. Or
communicate effectively with the CEO or outsiders such as suppliers to implement the tighter financial control.

At the middle level of management, all three managerial skills are equally important for John, a financial (functional) manager, to perform his duties.

Or

Technical skill to formulate a tighter financial control/budget is more important in this situation.

(1)(d)

Planning – After analyzing the accounting information, in particular, the operation costs, John will find out the room for tighter cost control and then set the target. He might also discuss with the front line managers and decide the measures to achieve the target.

or

Controlling – John will prepare budgets to evaluate how well the cost controlling measures are implemented. By comparing the actual results and the predetermined targets, he can see whether the measures are effective or whether improvements are needed.

Question 2

(2)(a)

Workings:

	<u>2010</u>	<u>2011</u>
Cost of sales	$\$3\,200\,000 \times (1 - 25\%) = 2,400,000$	$\$4\,500\,000 \times (1 - 15\%) = 3,825,000$
Expenses	$\$3\,200\,000 \times (25\% - 8\%) = 544,000$	$\$4\,500\,000 \times (15\% - 5\%) = 450,000$

- 1) The increase in cost of sales by $\$(3,825,000 - 2,400,000) = \$1,425,000$
i.e. $(3,825,000 - 2,400,000) / 2,400,000 = 59.38\%$
- 2) The decrease in operating expenses by $\$(450,000 - 544,000) = -\$94,000$
 $(450,000 - 544,000) / 544,000 = -17.28\%$

Although the operating expenses have improved by \$94,000 (or 17.28%) , the dramatic increase in unit cost of sales by \$1,425,000 (or 59.38%) finally causes the decrease in profitability for the café during the past 2 years .

Or

GP% dropped from 25% to 15% while NP% decreased from 8% to 5% .

However, the percentage of total expenses to sales in 2011 was 10% (15% - 5%) which is much lower than 17% (25% - 8%) in 2010.

It revealed that the major setback for the profitability of the firm was sharp increase of unit cost of sales despite the improvement in total expenses.

(2)(b)

Going concern concept

The going concern assumption does not hold when a business is going to liquidate.

The assets should no longer be valued at cost but at their net realizable value/current market/fair

value since they will be disposed of in the near future. For the assets like premises, professional valuation should be consulted for its market value.

(2)(c)

The bank may rely on the following to assess the credibility of Mr. Hong's application for a loan:

Payment history / Credit history – A payment history is an indication for lenders and creditors whether an individual is a lending risk due to a history of late or missed payments. Or

Past delinquency – A bank may judge the credibility of a business with reference to the past default rate.

Credit report by a credit reporting agency – Many credit reporting agencies gather information about payment practice, creditworthiness of different businesses and provide credit report on a fee basis for lenders to avoid credit risk.

Collateral for the bank loan – banks will often require an owner to pledge his or her own personal assets / company's assets as security for the loan to reduce the risk of bad debt.

Amount of outstanding debts relative to its capital – The bank would consider the proportion of debts to equity to control the level of credit risk.

Ratio or Trend Analysis – The bank would perform ratio or trend analysis of the recent financial statements of the business to assess the current liquidity and future profitability of the firm before granting the loan.

(2)(d)

- Competitors: how keen is the competition, is the market saturated?
- Substitutes : include other fast food substitutes such as ready made frozen meals
- Barrier of entry : ease of entry, such as getting licenses and safety regulations
- Power of suppliers : e.g. food suppliers
- Power of buyers : e.g. relative bargaining power of customers

(2)(e)

(i) The net present value (NPV) of Project A is:

$$\begin{aligned} & \$400,000/(1 + 12\%)^2 + 450,000/(1 + 12\%)^2 + 500,000/(1 + 12\%)^3 - \$1,021,000 \\ & = \$12,504.92 \end{aligned}$$

The net present value (NPV) of Project B is:

$$\begin{aligned} & \$580,000/(1 + 12\%)^2 - \$450,000 \\ & = \$12,372.45 \end{aligned}$$

Since the NPV of Project A is larger, Mr. Hong should invest in Location 1.

(ii) The rate of discount should be increased to cope with the increase in overall risk of investment.

The drastic increase in the rate of discount may reduce the NPV of Project A greater than Project B. Therefore, Location 2 will be chosen instead.

Project A will be affected more by the uncertainty of cash flows estimation because the time span is 3 years which is longer than Project B.

****END Of PAPER****