HONG KONG ASSOCIATION FOR BUSINESS EDUCATION

HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION 2015/16

BUSINESS, ACCOUNTING AND FINANCIAL STUDIES MOCK EXAMINATION

PAPER 2A ACCOUNTING MODULE

(SUGGESTED ANSWER)

SECTION A

1
(a)
(i)

Purchases Journal

Date	Details	Amount	
2015		$	
Jan1	Swedish Life (30 x 12 x $80 × 95%)	27,360	
Jan 27	Bonnie Brown (50 x $200 × 85%)	8,500	
Jan 31	Total credit purchases for the month	35,860	**1**

(ii)

Sales Journal

Date	Details	Amount	
2015		$	
Jan 5	Tin Wing (5 x 12 x $140 x 95%)	7,980	
Jan 9	Link Fat (10 x 12 x $140 x 90%)	15,120	
Jan 12	Shu Ling (15 x 12 x $140 x 90%)	22,680	
Jul 31	Total credit sales for the month	45,780	**1**

(iii)

Returns Outwards Journal

Date	Details	Amount	
2015		$	
Jan 10	Swedish Life (2 x 12 x $80 × 95%)	1,824	
Jan 31	Total returns outwards for the month	1,824	½

(iv)

Returns Inwards Journal

Date	Details	Amount	
2015		$	
Jan 15	Shu Ling (7.5 x 12 x $140 x 90%)	11,340	
Jan 31	Total returns outwards for the month	11,340	½

(v)

Cash Book

	Date	Details	Dis	Bank	Date	Details	Dis	Bank	
	2015		$	$	2015		$	$	
½	Jan 1	**Capital**		40,000	Jan1	Equipment		14,000	½
½	Jan 15	Trade Rec (Shu Ling)	567	10,773	Jan 22	Trade pay (S Life)		27,360	½
½	Jan 18	Trade Rec (Ling Fat)	756	14,364	Jan 30	Trade pay (BB)	680	7,820	½
					Jan 31	Balance c/d		15,957	
			1,323	65,137			680	65,137	
	2015								
	Feb 1	Balance b/d		15,957					

(b) Trade discount is not recorded in books while cash discount is recorded in books as expense or revenue. **(1)** Besides, trade discount is used to encourage bulk purchase and cash discount is used to encourage prompt payment. **(1)**

<Total: 8 marks>

Question 2

(a) The High-low method for variable cost portion

$$= \frac{\$2{,}500{,}000 - \$1{,}500{,}000}{100{,}000-50{,}000} \quad \begin{matrix}½\\ ½\end{matrix}$$

$$= \frac{\$1{,}000{,}000}{50{,}000} \quad \begin{matrix}½\\ ½\end{matrix}$$

= $20/unit **(1 mark)**

Fixed cost portion
= $1,500,000 - $20*50,000 ½
= $500,000 **(1 mark)**

(b)

Unit contribution
Product A = $900 - $700 - $20 = $180 **(½)**
Product B = $1,400 - $900 - $20 = $480 **(½)**

Batch Contribution
= $180*4 + $480
= $1,200 **(1)**

Breakeven point

$$= \frac{\$2{,}500{,}000 + \$500{,}000}{\$1{,}200} \quad \begin{matrix}\textbf{(1)}\\ \textbf{(2)}\end{matrix}$$

= 2,500 batches

Breakeven sales revenue
= 2,500*(4*$900 + 1*$1,400) **(1)**
= $12,500,000 **(5 marks)**

OR

Contribution margin ratio

$$= \frac{\$1{,}200 \ \textbf{(2)}}{\$5{,}000 \ \textbf{(1)}} *100\%$$

= 24%

Breakeven sales revenue

(1) **(3)**
= ($2,500,000 + $500,000) ÷ 24%
= $12,500,000 **(5 marks)**

(c)

Margin of safety

(1)
= (40,000*$900 + 10,000*$1,400) - $12,500,000
= $50,000,000 - $12,500,000
= $37,500,000 **(1 mark)**

<Total: 8 marks>

Question 3

Yoyo

Consultancy income

	2015	$	2014	$	
½	Profit and loss	1,531,000	Balance b/d	10,000	½
½	Balance c/d	45,000	Bank	1,566,000	½
		1,576,000		1,576,000	

Rent

	2014	$	2014 ½	$	
½	Bank	336,000	Rental deposit ($48,000 x 2)	96,000	1
½	Balance c/d	24,000	2015		
			Profit and loss	264,000	1½
			($48,000 x 22/24 x 6)		
		360,000	½ ½ ½	360,000	

Insurance

	2014	$	2015	$	
½	Balance b/d	8,000	Profit and loss	40,000	½
½	Bank	50,000	Balance c/d ($27,000 x 6/9)	18,000	1
			½ ½		
		58,000		58,000	

(8 marks)

<Total: 8 marks>

Question 4

(a)

Peter, John, Thomas
Revaluation

			$		$	
½	Motor vehicles (60,000 -56,000)		4,000	Goodwill (95,000- 75,000)	20,000	1
	Gain on revaluation			Machinery (70,000-65,100)	4,900	½
	- Peter (1/4)	*5,225*				
1	- John (2/4)	*10,450*				
	- Thomas (1/4)	*5,225*	20 900			
	(ratio ½)		24,900		24,900	

(3 marks)

(b)

Capital

		Peter	John	Thomas	Mark		Peter	John	Thomas	Mark	
		$	$	$	$		$	$	$	$	
½	Current account		10,000			Balance b/d	88,000	65,875	58,625		½
½ , ½ , ½	Goodwill w/o	19,000	38,000		38,000	Current account	25,000		30,000		½
½	Inventory			8,000		*Revaluation*	*5,225*	*10,450*	*5,225*		½
½	Bank			30,000		Bank				158,000	1
½	Loan from Thomas			55,850		Bank		91,675			½
½	Bank	39,225									
1	Balance c/d	60,000	120,000		120,000						
		118,225	168,000	93,850	158,000		118,225	168,000	93,850	158,000	

(8 marks)

<Total: 11 marks>

Alternative Answer:

Peter, John, Thomas
Revaluation

			$		$	
½	Motor vehicles (60,000 -56,000)		4,000	Machinery (70,000-65,100)	4,900	½
	Gain on revaluation					
	- Peter (1/4)	225				
1	- John (2/4)	450				
	- Thomas (1/4)	225	900			
	(ratio ½)		4,900		4,900	

<2 marks>

Capital

		Peter $	John $	Thomas $	Mark $		Peter $	John $	Thomas $	Mark $	
½	Current account		10,000			Balance b/d	88,000	65,875	58,625		½
½, ½, ½	***Goodwill adj***	***19,000***	***38,000***		***38,000***	Current account	25,000		30,000		½
½	Inventory			8,000		*Revaluation*	225	450	225		½
½	Bank			30,000		***Goodwill adj***	***5,000***	***10,000***	***5,000***		1
½	Loan from Thomas			55,850		Bank				158,000	1
½	Bank	39,225				Bank		91,675			½
1	Balance c/d	60,000	120,000		120,000						
		118,225	168,000	93,850	158,000		118,225	168,000	93,850	158,000	

<9 marks>

Question 5

(a)

(i) The historical cost principle was violated. (½ mark) Under the historical cost principle, the assets of a company should be recorded in the books at their original cost of purchase. Any changes in their market value should be ignored unless the going concern assumption is no longer valid. (½ mark)

The inventory of Johnny Ltd should therefore be recorded as $30,000 and not $50,000. **(1 mark)**

(ii) The company should not do so because this would violate the consistency principle. (½ mark) This principle requires that once an accounting practice has been adopted, it should be followed from period to period. A change is allowed only if the existing accounting practice is no longer appropriate. (½ mark)

Changing the depreciation method for the purpose of improving net profit is not a valid reason. The depreciation charge should increase $65,000 and net profit decrease $65,000. **(1 mark)**

(b)

(i) Net profit ratio = Net profit ÷ Turnover = $265,000 ÷ $3,500,000
= 7.57% **(1 mark)**

(ii) Return on shareholders' equity = Net profit ÷ Shareholders' equity
= $265,000 ÷ $1,966,500 <u>**OR**</u> $265,000 ÷ $2,099,000
= 13.48% <u>**OR**</u> 12.63% **(1 mark)**

(iii) Current ratio = Current assets ÷ Current liabilities = $540,000 ÷ $336,000
= 1.61:1 **(1 mark)**

(iv) Quick ratio = (Current assets – Inventories) ÷ Current liabilities
= ($540,000 – $120,000) ÷ $336,000
= 1.25:1 **(1 mark)**

(v) Accounts receivable turnover = Turnover ÷ Accounts receivable
= $3,500,000 ÷ $308,000
= 11.36 times **(1 mark)**

(vi) Accounts payable turnover = Net purchases ÷ Accounts payable
= $2,000,000 ÷ $266,000
= 7.52 times **(1 mark)**

(c)

Profitability

Johnny Ltd was much less profitable than its competitors in the industry. As its net profit ratio of 7.57% was much lower than the industry average of 12%. It implies that the <u>expenses of Johnny Ltd are much higher than its competitors</u>. **(1 mark)**

The company's <u>lower profitability</u> was also reflected in its return on shareholders' equity (12.63% vs. 15%) **(1 mark)**

Liquidity

Johnny Ltd was less liquid than its competitors in the industry. Its current ratio (1.61:1) and quick ratio (1.25:1) were lower than the industry averages of 2:1 and 1.5:1, respectively. This indicates a higher risk of being unable to meet short-term obligations when due. **(1 mark)**

Its accounts receivable turnover of 11.36 times was worse than the industry average of 13 times, the company should collect its debts more quickly to improve its liquidity. **OR**

Its accounts payable turnover of 7.52 times was worse than the industry average of 9 times., it needs to pay its accounts payable more promptly or its suppliers may stop supplying it with goods and services. **(1 mark)**

<Total: 14 marks>

Workings:

Statement of Comprehensive Income for the year ended 31 December 2015

	$000	$000
Turnover		3,500
Cost of sales		(2,680)
Gross profit		820
Administrative expenses	196	
Selling and distribution expenses	209	(405)
Operating profit		415
Finance expenses		(150)
Net profit		265

Statement of Financial Position as at 31 December 2015

	$000	$000
ASSETS		
Non-current assets		
Property, plant and equipment		2,735
Current assets		
Inventories	120	
Accounts receivable	308	
Bank	112	540
Total assets		3,275
EQUITY AND LIABILITIES		
Capital and reserves		
Share capital (1,500,000 ordinary shares of $1 each, fully paid)		1,500
Reserves		599
Total equity		2,099
Non-current liabilities		
8% debentures (repayable in 2018)		840
Current liabilities		
Accounts payable	266	
Accrued expenses	70	336
Total equity and liabilities		3,275

Question 6

(a) Income statements:

	Production of all three types of oils		Line of Grapeseed oil dropped	
	$'000		$'000	
Contribution	7,750	½	6,250	½
Fixed cost	(5,000)	½	(4,200)	½
Net profit/(Net loss)	2,750	½	2,050	½

By dropping the line of Grapeseed Oil, the company's net profits will reduce by $700,000. Therefore, Marcus Tsang should continue with the production of Grapeseed oil. **1**

Alternative Answer:

	Line of Grapeseed oil dropped	
	$'000	
Decrease in contribution	(1,500)	1
Decrease in fixed cost	800	1
Decrease in net profit	(700)	1

By dropping the line of Grapeseed Oil, the company's net profits will reduce by $700,000. Therefore, Marcus Tsang should continue with the production of Grapeseed oil. **1**

(b)

	Order rejected	*Order accepted*	
	$'000	$'000	
Sales revenue (5,000 × $50)	—	250	½
Less Direct materials (5,000 × $20)	—	(100)	½
Direct labour (5,000 × $8)	—	(40)	½
Variable production overheads (5,000 × $1)	—	(5)	½
Fixed production overheads		(10)	½
Purchase cost of the bottle making machine		(70)	½
Net profit	—	25	1

The firm should accept the special order as this will increase the net profit by $25,000. **1**

(c) Marcus should consider the <u>response from regular customers</u> who may request a price cut as well.
Marcus should consider <u>whether the production capacity could accommodate the volume and delivery requirements</u> of the order.
Marcus should consider whether selling to environmental organization will <u>enhance or deteriorate the image of the product</u>.
There may also be <u>hidden costs or limiting factor</u> issue to consider before accepting the order.

(any two points, 2)

<Total: 11 marks>

Question 7

(a)

The Journal

Date	Details	Dr. $	Cr. $	
(i)	Bank	3,270		½
	Trade payable / Daiwoo Store		3,270	½
(ii)	Profit and loss - Sales	650		½
	Bank		650	½
(iii)	Profit and loss - Cash loss	4,180		½
	Cash		4,180	½
	Suspense	2,125		1
	Profit and loss - Cash loss		2,125	½
(iv)	Bank	7,390		½
	Trade payable / Mr. Hong		7,390	½
	Profit and loss - Bank charges	200		½
	Bank		200	½
(v)	Bank	5,000		½
	Profit and loss - Dividend received		5,000	½
(vi)	Bank	900,000		½
	5% Debentures		900,000	½
	Profit and loss - Debenture interest	11,250		½
	Accrued interest / Interest payable		11,250	½
(vii)	Suspense	39,000		1
	Profit and loss - Rent Revenue / Rental income		39,000	½
(viii)	Profit and loss – Inventory loss	70		½
	Inventory		70	½
(ix)	Inventory	200		1
	Profit and loss – Cost of goods sold		200	1
	Trade receivable	500		1
	Profit and loss – Sales		500	1
(x)	Deposit for purchase	80,000		½
	Profit and loss - Purchases		80,000	½
				(17)

(b) Prudence concept **(1)**

Inventory should be valued at the lower of cost and net realiszable value. **(1)**

As the realizable value of the inventory ($330 = $400 * 1.25 * 70% - 20) is lower than the cost by $70, the net book value should be written down from $400 to $330 or inventory loss of $70 should be recorded. **(1)**

(3)

<Total: 20 marks>

Question 8

Oscar Company

Income Statement for the year ended 31 December 2015 ½

	½	$	$	
Sales ($65,500+$8,300)			73,800	**1**
Less:	<u>Cost of goods sold</u>			
	Opening inventory ½ ½ ½	5,120		½
	Add: Purchases ($32,280+$4,000+$9,000-$1,280)	44,000		**2**
		49,120		
	Less: Inventory Loss ½ ½ ½	1,000		½
	Less: Closing inventory {$8,000-[$2,000-($1,500-$380)]}	7,120	41,000	**2**
Gross profit	or $1,120 **1**		32,800	
Add: Discount received			4,000	½
			36,800	
Less:	Expenses			
	Inventory Loss ½ ½	1,000		½
	Insurance ($2380 - <u>$2380/4</u> + <u>$2380/1.4/4</u>)	2,210		**1½**
	Depreciation (34,000/5)	6,800		**1**
	Rent and rates ($1,500x12)	18,000		**1**
	Other operating expenses	1,520	29,530	½
Net profit			7,270	½

(12 marks)

Oscar Company

Statement of Financial Position as at 31 December 2015 ½

		$	$	$	
<u>Non-current assets</u> ½ ½					
Machinery ($34000 - $4,000-$6,800)				23,200	**1½**
<u>Current assets</u>					
Inventory			7,120		½
Accounts receivable			8,300		½
Prepaid insurance			595		**1**
Cash			100		½
			16,115		
Less:	<u>Current liabilities</u>				
	Bank overdraft	3,000			½
	Accounts payable	9,000			½
	Accrued rent and rates	4,000	16,000		**1**
Net current assets				115	
				23,315	
Financed by:					
<u>Capital</u>					
Balance at 1 January 2016 (Balancing figure)				16,045	**1**
Add: Net profit				7,270	½
				23,315	

(8 marks)

<Total: 20 marks>

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