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

2 hours 15 minutes
This paper must be answered in English

INSTRUCTIONS:

1. There are three sections in this paper: Section A (24 marks), Section B (36 marks) and Section C (20 marks).

2. All questions in Section A and B are compulsory. You are required to answer one of the two questions in Section C.

3. Show **all** your workings.

SECTION A
Answer ALL questions in this section.

Question 1

With a sum of $40,000 at bank, Ken started to run his small wholesale firm providing various sorts of quality Swedish packed food items for the retail outlets on 1 January, 2015. All sales were made on credit at 5/10, net/30. Ken's records included the following transactions on during January:

2015		
January	1	Purchased thirty dozens of canned mussels from Swedish Life for a list price of $80 per item with a trade discount of 5% at 5/15, net/30.
	1	Purchased one cash register from Hong Kee Machinery at $14,000 by cheque.
	5	Sold 5 dozens of canned mussels to Tin Wing for a list price of $140 per item with a trade discount of 5%.
	9	Sold 10 dozens of canned mussels to Link Fat for a list price of $140 with a trade discount of 10%.
	10	Some items purchased on 1 January were found contaminated and 2 dozens of which were returned.
	12	Sold 15 dozens of canned mussels to Shu Ling for a list price of $140 with 10% trade discount.
	15	Shu Ling suffered from financial difficulties and was taken over. The financial institution returned half of the purchase and settled the outstanding amount in full.
	18	Link Fat settled the amount owed in full.
	22	Ken paid the purchase of goods made on 1 January.
	27	Purchased fifty tins of berries and mushrooms from Bonnie Brown for a list price of $200 each with a trade discount of 15% at 8/10, 30/net.
	30	Ken paid the purchase made on 27 January.

REQUIRED:

(a) Write up the following journals for the month of January 2015.

(i) Purchases journal;

(ii) Sales journal;

(iii) Returns outwards journal;

(iv) Returns inwards journal and

(v) Cash book with bank and discount columns. (6 marks)

(b) Name any two features of trade discount which help distinguish it from cash discount. (2 marks)

<Total: 8 marks>

Question 2

Cascade Company sold 40,000 units of product A and 10,000 units of product B during past year. The fixed costs and salesmen's salaries of Cascade Company as follows:

Fixed cost (exclude Salesmen's salaries)		\$2,500,000
Number of product sold	50,000	100,000
Salesmen's salaries	\$1,500,000	\$2,500,000

The unit selling prices, unit variable production costs are as follows:

Product	Unit selling prices	Unit variable production cost
A	\$900	\$700
B	\$1,400	\$900

REQUIRED:

(a) Separate the fixed cost portion and variable cost portion of salesmen's salaries. (2 marks)

(b) Calculate the break-even sales revenue based on the past year sales mix. (5 marks)

(c) Calculate the margin of safety in revenue. (1 mark)

<Total: 8 marks>

Question 3

Yoyo Company is a consultancy firm in Central. The financial information extracted as at 31 March 2014 was as follows:

	$
Prepaid insurance	8,000
Prepaid consultancy income	10,000

The additional information for the year ended 31 March 2015 was as follows:

(i) Insurance was paid by cheques in two instalments on 1 July 2014 and 1 January 2015 as follows:

	$
6 months to 31 December 2014	23,000
9 months to 30 September 2015	27,000
	50,000

(ii) The company received consultancy income amounted to $1 566 000 of which $45 000 was the deposit for service to Zita Company. The consultancy service would be provided on 15 April 2015.

(iii) The company has entered a two year tenancy agreement starting from 1 October 2014. The monthly rent was $48,000 and the company was entitled to two month rent-free period in October and November 2014. The accountant paid $336,000 including the two month rental deposit. The whole amount had been recorded in the rent account.

REQUIRED:

In the books of Yoyo Company, show the entries for the year ended 31 March 2015 in the following accounts:

(a) Consultancy income,

(b) Rent, and

(c) Insurance (8 marks)

<Total: 8 marks>

SECTION B
Answer ALL questions in this section.

Question 4

Peter, John and Thomas were in partnership sharing profits and losses in the ratio of 1:2:1 respectively. Thomas retired from the partnership with effect from 1 September 2015. The partners agreed that on the same day, the finance manager, Mark would be admitted as a new partner.

The statement of financial position as at 31 August 2015 was shown below:

	$	$
Non-current assets		
Goodwill		75,000
Machinery		65,100
Motor vehicles	,	60,000
		200,100
Current assets		
Inventory	18,530	
Accounts receivable	59,750	
Cash at bank	4,100	
	82,380	
Less: Current liabilities		
Accounts payable	13,900	
Net current assets		68,480
		268,580
Capital accounts		
- Peter	88,000	
- John	65,875	
- Thomas	58,625	212,500
Current accounts		
- Peter	25,000	
- John	(10,000)	
- Thomas	30,000	45,000
Non-current liabilities		
Loan from John		11,080
		268,580

In the course of the retirement and admission of partners, the partnership had the following arrangement on 1 September 2015:

(i) Profit and loss sharing ratio was Peter 1: John 2: Mark 2.

(ii) Mark would invest $120,000 to the partnership in addition to the contribution for his share of goodwill.

(iii) Goodwill was valued at $95,000 but no goodwill account was to be kept.

(iv) Some of the assets were revalued on 1 September 2015:

	$
Machinery	70,000
Motor vehicles	56,000

(v) Thomas took out part of the inventory amounting to $8,000 and cash $30,000 from bank. The rest owing to him was treated as a loan to the partnership.

(vi) The balances of all current accounts were to be transferred to the partners' respective capital accounts.

(vii) All partners were to maintain their capital balances in proportion to the profit and loss sharing ratio and based on the capital balance of Mark after goodwill adjustment. Any surplus capital balances were to be transferred to or from bank account.

REQUIRED:

Prepare

(a) the revaluation account and

(b) the partners' capital accounts in columnar form as at 1 September 2015, showing the retirement of Thomas and admission of Mark.

<Total: 11 marks>

Question 5

The financial statements of Johnny Ltd for the year ended 31 December 2015 are as follows:

Statement of Comprehensive Income for the year ended 31 December 2015

	$000	$000
Turnover		3,500
Cost of sales (including credit purchases of $2,000,000)		(2,660)
Gross profit		840
Administrative expenses	196	
Selling and distribution expenses	144	(340)
Operating profit		500
Finance expenses		(150)
Net profit		350

Statement of Financial Position as at 31 December 2015

	$000	$000
ASSETS		
Non-current assets		
Property, plant and equipment		2,800
Current assets		
Inventories	140	
Accounts receivable	308	
Bank	112	560
Total assets		3,360
EQUITY AND LIABILITIES		
Capital and reserves		
Share capital (1,500,000 ordinary shares, fully paid)		1,500
Reserves		684
Total equity		2,184
Non-current liabilities		
8% debentures (repayable in 2018)		840
Current liabilities		
Accounts payable	266	
Accrued expenses	70	336
Total equity and liabilities		3,360

The following points were noticed by the accountant after prepared the above final accounts:

i. At the end of the financial year, the closing inventory of Johnny Ltd cost $30,000 but had a market value of $50,000. The accountant of Johnny Ltd recorded the inventory at $50,000 in the books, as he wanted to show the real value of the inventory.

ii. The company performed poorly last year. The board of directors had changed the depreciation method this year from the straight-line method to the reducing-balance method so that the depreciation charge will be reduced by $65,000.

REQUIRED:

(a) State the accounting principle or concept that was violated in (i) and (ii) above and give explanations. (4 marks)

(b) Based on the financial statements above (including the adjustment in part a), compute the following ratios: (6 marks)

(i) Net profit ratio (Industry average: 12%)

(ii) Return on shareholders' equity (Industry average: 15%)

(iii) Current ratio (Industry average: 2:1)

(iv) Quick ratio (Industry average: 1.50:1)

(v) Accounts receivable turnover (Industry average: 13 times)

(vi) Accounts payable turnover (Industry average: 9 times)

(Calculations to two decimal places)

(c) Using the ratios calculated in (b) above, briefly comment the company's profitability, and liquidity.

(4 marks)

<Total: 14 marks>

Question 6

Marcus Tsang is about to take over the oil making factory of his father which is facing a business downturn due to the ever increasing competition from imported products. The factory of the Tsang's produces three types of cooking oil which are peanut oil, grapeseed oil and olive oil respectively. Marcus has conducted a market survey on oil consumption. With the data gathered from the survey, he has complied a budgeted income statement as follows:

	Peanut Oil	Grapeseed Oil	Olive Oil
Units (in standard bottle)	100,000	120,000	50,000
	$'000	$'000	$'000
Sales	8,000	5,000	3,000
Variable costs			
Materials (Oil)	(1,000)	(1,500)	(1,000)
Materials (Bottles)	(500)	(600)	(250)
Variable overheads	(200)	(240)	(100)
Labour	(1,300)	(1,160)	(400)
Contribution	5,000	1,500	1,250
Fixed Production overheads			
Unavoidable	(1,500)	(1,200)	(500)
Avoidable	(500)	(800)	(500)
Net profit/(Net loss)	3,000	(500)	250

Marcus had an idea in mind that Peanut Oil was not well received in the market along with the ever increasing concern in healthy food. However, he was surprised with the projected loss in selling Grapeseed Oil and the low profit margin in selling Olive Oil.

As part of a profit improvement plan, Marcus is considering whether the firm should drop the line of Grapeseed Oil.

REQUIRED:

(a) Should Marcus drop the line of Grapeseed Oil to improve the overall profit of the business? Support your answer with calculations. (4 marks)

Concerning the Olive Oil, the department head advised Marcus that the product should be better received in the market. After an endeavor to expand the market, the firm received a special order of 5,000 bottles of Olive Oil from an environmental organization at a reduced price of $50 each. To fulfill this order, the firm has to purchase a tailor made bottle making machine at $70,000 to turn recycled materials into the stipulated recycled bottles. The bottle making machine serves no other purposes and cannot be used in the course of normal production. As for the recycled materials, the firm has got sufficient old recycled materials in stock which cost the firm $40,000 but it has no alternative use.

As only minimum packing is needed, the variable production overheads could be reduced by 50% and there will be an additional fixed production overheads of $10,000 if the special order is accepted.

REQUIRED:

(b) Should the firm accept the special order to supply 5,000 bottle of Olive Oil at a reduced price of $50 each? (5 marks)

(c) Please state any two further considerations before taking your advice made in (b) above. (2 marks)

<Total: 11 marks>

SECTION C
Answer **ONE** question in this section.

Question 7

David Mo, the accountant at Kobe Computer Software Limited, prepared draft financial statements for the year ended 31 March 2015. After the preparation of financial statements, the following information was subsequently revealed:

(i) On 15 September 2014, the company drew a cheque of $3,270 to Daiwoo Store for the settlement of trade payable. The cheque was still not presented as at 31 March 2015. It is the bank's practice not to honour cheques which are outstanding for more than six months.

(ii) On 27 March 2015, the company sold goods to Venus for $13,000 by cheque, less 5% trade discount. The bookkeeper wrongly entered the gross amount in the cash book.

(iii) The company incurred a cash loss of $4,180 during the year ended 31 March 2015. The loss was not yet recorded in the books. A new piece of evidence allowed the company to receive $2,125 and $1,375 on 28 March 2015 and 15 April 2015 respectively from the insurance company. The cash receipt has been recorded in th cash book only.

(iv) The company issued a cheque of $7,390 to Mr. Hong on 30 March 2015. The transaction was recorded in the cash book. However, the cheque was returned by the bank due to insufficient fund and the bank charged $200 for handling fees. No records had been made in the cash book.

(v) $5,000 being dividends received had been paid directly into the bank. No entries were made in the cash book.

(vi) On 1 January 2015, a four-year 5% debenture of $900,000 in total had been issued at par. Debenture interest is payable on 30 June and 31 December each year. All the monies subscribed were duly received. However, entries regarding all the above transactions were omitted from the books.

(vii) Unearned rent revenue of $39,000 as at 31 March 2014 had not been carried forward to next year as an opening balance in the rent revenue account.

(viii) A batch of inventory costing $400 was found defective. It could be sold at 30% discount of the selling price after repair cost of $20 was to be incurred.

(ix) A carton of goods costing $600 was sent to a sales agent on sales or return basis. At 31 December 2014, the agent agreed to accept two-third of the goods. No records had been made for the transaction and the goods were not included in the inventory.

(x) On 17 March 2015, a deposit of $80,000 paid for future purchases of $400,000 of goods in April 2015 was wrongly treated as cash purchase of goods.

(xi) The standard mark-up of the company is 25%.

REQUIRED:

(a) Prepare the journal entries for correcting the above errors. (Narrations are not required.) (17 marks)

(b) Explain, with a relevant accounting principle and concept, the accounting treatment of (viii) above. (3 marks)

<Total: 20 marks>

Question 8

Oscar Au renovated a grocery inherited from his deceased father-in-law and turned it into a trading company selling model vehicles mainly to toy shops on 1 January 2013. To save manpower, he runs the business totally on his own from purchasing to customer services. Besides, though he has got only limited knowledge in bookkeeping, he keeps his own accounting records and a set of final accounts has been complied at the end of the year as follows:

Oscar
Income Statement for the year ended 31 December 2015

		$	$
Sale proceeds			65,500
Less:	Cost of goods sold		
	Opening inventory	5,120	
	Add: Cash paid for purchases	32,280	
		37,400	
	Less: Closing inventory	8,000	29,400
Gross profit			36,100
Add: Discount received			4,000
			40,100
Less:	Expenses		
	Insurance paid	2,380	
	Packing machine purchased	24,000	
	Rent and rates paid	14,000	
	Other operating expenses paid	1,520	41,900
Net Loss			(1,800)

Having checked the bills and invoices available, you found the following:

(i) There were still three sales invoices were not paid at the end of the year amounted to $8,300 and it is his practice to maintain a uniform mark up of 80%.

(ii) There were two purchases invoices totalled $9,000 were not paid at the end of the year and among the cash paid as indicated in the income statement above, $1,280 was paid for the amount owing at the end of the last year.

(iii) Inventory at the end of the year include an item purchased at $2000 but it could be sold only at $1,500 after an overhaul painting at $380.

(iv) Annual insurance was paid to 31 March 2016 and there was a 40% increase this year.

(v) The heavy duty packing machine bought this year has been used extensively and the old one bought when the business began at $10,000 is kept as a back-up machine. The firm writes off all non-current assets on cost at 20% and a full year's depreciation is provided in the year of purchase.

(vi) The monthly rent along with the rates is $1,500.

(vii) Oscar maintains a cash float of $100 and all excess cash was banked at the end of the year to reduce the overdraft to $3,000.

REQUIRED:

(a) Reconstruct the Income Statement for the year ended 31 December 2015 indicating the amount of the inventory loss. (12 marks)

(b) Prepare the Statement of Financial Position at 31 December 2015. (8 marks)

<Total: 20 marks>

~ End of Paper ~