

HONG KONG ASSOCIATION FOR BUSINESS EDUCATION

**HONG KONG DIPLOMA OF SECONDARY EDUCATION
EXAMINATION 2016/17**

**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

The following is the bank statement of Raymond Wong Ltd. for December 2016:

<i>Bank Statement</i>				
		Dr.	Cr.	Balance
		\$	\$	\$
2016				
Dec	1 Balance b/d			5,000 Cr.
Dec	5 Credit transfer from Luna's Co.		4,200	9,200 Cr.
Dec	8 Adam's Co.	7,500		1,700 Cr.
Dec	20 Direct debit— Electricity	2,920		1,220 Dr.
Dec	29 Robert's Co		3,000	1,780 Cr.
Dec	31 Referred to drawer	3,000		1,220 Dr.

Bank transactions of Raymond Wong Ltd. during December 2016 were as follows:

- Dec 1 There was \$5,000 debit balance in the cash book at the beginning of the month.
- Dec 5 Issued a cheque of \$7,500 to Adam's Co.
- Dec 25 Issued a cheque of \$4,500 to Tommy for rental.
- Dec 28 Received a cheque of \$3,000 from Robert's Co.
- Dec 31 Deposited \$7,000 cash into the bank account.

You are required to:

- (a) Prepare the cash book. (2 marks)
- (b) Update the cash book. (2 marks)
- (c) Prepare a bank reconciliation statement as at 31 December 2016, commencing with the updated cash book balance. (2 marks)

<Total:6 marks>

Question 2

Johnson Ltd is a fitness center in Hong Kong. In the year of 2016, it failed to fulfil the demand from customers and incurred a huge operating loss. It may be forced to liquidate. On 31 December 2016, the following information was obtained:

- (i) The net book value of the fitness equipment amounted to \$1,400,000 on 31 December 2016. However, if Johnson Ltd is wound up, only 20% of the equipment can be realized.
- (ii) Accrued rental fee amounted to \$80,000. If Johnson Ltd is wound up, it will never be repaid.

You are required to:

- (a) Name and define the accounting concepts you have employed in treating the above situations. (2 marks)
- (b) The accounting treatment of (i) and (ii) above. (2 marks)

<Total:4 marks>

Question 3

Yummy ice-cream makes and sells three different taste of ice-cream: Chocolate, Mango and Vanilla. Budgeted information of the three taste for the following year is as follows:

	Chocolate	Mango	Vanilla
Estimated demand	15,000 units	25,000 units	50,000 units
Unit selling price	\$90	\$80	\$70
Cost per unit:			
Direct labour (\$50 per hour)	\$20	\$15	\$10
Direct materials (\$15 per kg)	\$30	\$20	\$15

Additional information:

- Part of variable production overheads are estimated to be 50% of the direct labour cost.
- Budgeted marketing expenses total \$1,950,000 of which 30% is variable. Variable costs are to be absorbed on the basis of units produced.
- Budgeted fixed production overheads amount to \$3,500,000, which are to be absorbed on the basis of units produced.
- There is a maximum of 20,000 labour hours available per year due to labour shortage.

You are required to:

- Show the priority of production for the three products with calculation support. (6 marks)
- Determine the optimum production plan which will maximize the yearly profit. (2 marks)

<Total:8 marks>

Question 4

John commenced a business on 1 January 2014 and its financial year ends on 31 December. The following table shows year-end accounts receivable balances, bad debts written off and percentages of allowances for doubtful accounts for the years 2014 to 2016.

Year ended 31 December	Year-end accounts receivable (before writing off bad debts)	Bad debts for the year	Percentage of allowance for doubtful accounts
	\$	\$	
2014	40,000	4,000	8%
2015	65,000	10,000	5%
2016	30,000	500	10%

You are required to:

Prepare the allowance for doubtful accounts account from 2014 to 2016.

(6 marks)

<Total:6 marks>

Section B

Answer ALL questions in this section.

Question 5

Anna and Elsa were partners sharing the profit and loss in the ratio of 2:1 respectively. The balances were extracted from their books of account as at 31 December 2016:

	Dr. \$	Cr. \$
Capital - Anna		64,000
Capital - Elsa		58,490
Drawings - Anna	10,000	
Drawings - Elsa	5,000	
Inventory	34,280	
Trade receivable	15,000	
Rental income receivable	4,000	
Bank overdraft		43,890
Net loss available for appropriation	17,233	
Allowance for doubtful debts		500
Vans at cost (all purchased in 2014)	16,600	
Fittings at cost	5,200	
Accumulated depreciation:		
- Vans		8,300
- Fittings		1,796
Trade payable		3,100
Accruals		750
Rental deposit received		3,000
Cash at bank	76,513	
	<u>183,826</u>	<u>183,826</u>

Before the preparation of appropriation account for the partnership, the following accounting issues have to be considered:

- After the year end, it was discovered that one of the tenants who had owed his rent for four months went bankrupt and the relevant receivable rental income amounted to \$4,000 would not be recovered. To cover part of the loss, it was agreed that the relevant 1-month rental deposit would be forfeited and not be refunded.
- According to the company's accounting policies, vans should be depreciated by reducing balance method at 25% per annum. However, the accountant had mistakenly depreciated them by straight-line method at the same depreciation rate.
- Cash drawings were made by Anna and Elsa as follows during the year:

	\$	Date of drawings
Anna	7 000	1 January 2016
	3 000	1 September 2016
Elsa	5 000	1 April 2016

- 10% per annum of interest on drawings for each partner was to be charged.

You are required to:

- (a) Prepare the appropriation account of the partnership for the year ended 31 December 2016. (5 marks)

After the recognition of loss for the year, Elsa decided to withdraw from the partnership and Rose was admitted to become a new partner. Upon the change in the partnership, the following adjustments were to be made:

- i. Profits and losses were to be shared in the ratio of: Anna 60% and Rose 40%. Due to heavy operating loss, no goodwill was identified.
- ii. Vans were revalued to 120% of their costs while fittings were revalued to 50% of their net book value.
- iii. Some of the inventory amounting to \$3,000 were considered obsolete and to be written off.
- iv. Allowance for doubtful account was to be increased to 15% of the trade receivable.
- v. Elsa agreed to leave 40% of the total amount owed to her as a long-term loan to the new partnership. The remaining balance was to be settled by cheque.
- vi. Except for the adjustments of goodwill and the revaluation of vans and inventory, all the revalued assets were written back to their original values.

You are required to:

- (b) Prepare the revaluation account in the books of the partnership. (6 marks)

(Calculations to the nearest dollar.)

<Total:11 marks>

Question 6

In spite of the economic downturn in recent years, a leading supplier of prepacked cured meats is still able to make profits. You and your friends are interested in identifying the strategies of the business attributable to the generation of profits. Below are summarized financial statements of the business:

Income Statement for the year ended 31 December 2016 and 2015

	2016	2015
	\$	\$
Sales	622,557	540,320
Cost of goods sold	(219,467)	(167,470)
Gross Profit	403,090	372,850
Other revenue	62,090	50,040
Administrative expenses	(129,500)	(115,780)
Gain from operations	335,680	307,110
Finance costs	(12,000)	(15,000)
Profits before tax	323,680	292,110
Dividend	(150,000)	(100,000)
Retained profit for the year	173,680	192,110

Statement of Financial Position as at 31 December 2016 and 2015

	2016	2015
	\$	\$
Non-Current Assets	940,980	868,170
Current Assets		
Inventories	54,800	49,750
Trade receivables	96,540	85,570
Cash and Bank	70,050	68,310
	221,390	203,630
Current Liabilities		
Trade payables	37,880	50,190
Accruals	5,700	6,500
	43,580	56,690
Net current assets	177,810	146,940
	1,118,790	1,015,110
Financed by:		
Ordinary share capital	500,000	500,000
Reserves	388,790	215,110
Proposed dividend	150,000	100,000
Long term liabilities		
Bank Loan	80,000	200,000
	1,118,790	1,015,110

Notes:

1. Opening inventories for the year ended 31 December 2015 was \$55,180.
2. Included in the closing inventories as at 31 December 2016 was 20 boxes of cured ham costing \$1,200 each which had its best consumption period of no more than 3 months. The sales manager considered that it could only be sold at half of its normal selling price with a mark-up of 80%.
3. The bookkeeper had entered into the Sales Journal an urgent order from Philip's Company amounted \$50,000 for banquet supplies to be delivered on 14 January 2017.

You are required to:

- (a) Complete the table below by computing the eight ratios each in the year 2016 and 2015, and
(8 marks)
- (b) Give a brief comment for each ratio marked with an asterisk with a reason for the changes from 2015 to 2016.
(4 marks)

Ratios	2016	2015	Comments with a reason for the changes
Profitability			
(i) Return on capital employed			
(ii) Net Profit Margin*			
(iii) Dividend cover (times)			
Liquidity			
(iv) Current ratio			
(v) Liquid ratio*			
Asset management			
(vi) Inventory turnover period (days)*			
(vii) Average collection period (days)*			
(viii)Total Assets Turnover			

<Total:12 marks>

Question 7

Stark Industries manufactures air-conditioners. It is currently manufacturing 54,000 units of air-conditioner per year, which is 90% of their full capacity. The costs and pricing information for an air-conditioner is as follows:

Per unit	\$
Direct materials	3,000
Direct labour	1,000
Variable manufacturing overheads	1,000
Fixed manufacturing overheads	<u>1,500</u>
Total manufacturing costs	6,500
Mark-up (50%)	<u>3,250</u>
Targeted selling price	<u>9,750</u>

Tony Ltd has approached Stark Industries for a one-off-only special order for 6,500 units of the air-conditioners. Tony Ltd offers a price of \$5,500 each and will incur additional inspection cost of \$100 per unit.

You are required to:

- (a) Determine whether Stark Industries should accept this special order? (4 marks)

Stark Industries is considering purchasing 54,000 units of air-conditioners from the OEM (Original Equipment Manufacturer) company instead of manufacturing them. This will reduce the fixed manufacturing cost of Stark Industries by 70%. The purchase price offer by OEM company is \$5,900 per unit. This purchase price does not include the ordering, receiving and inspection costs, which Stark estimates to be \$300 per unit.

You are required to:

- (b) Determine whether Stark Industries should produce its air-conditioners or purchase them externally. Assume that Stark Industries' facilities will remain idle if they do not manufacture its own air-conditioner. (4 marks)
- (c) Determine whether Stark Industries should produce its air-conditioners or purchase them externally. Assume that Stark Industries' facilities can be rented out for \$9,000,000 per year. (2 marks)
- (d) Show three non-financial factors that may influence Stark Industries' decision. (3 marks)

<Total:13 marks>

SECTION C

Answer ONE question in this section.

Question 8

Nelson Brown is a sole trader selling an imported red wine on credit to different retail outlets. Apart from the wholesale business, Nelson also runs a small sidewalk shop selling drinks mainly for the expatriates in Central. He is an expert in logistic and he, thus, maintains a complete inventory record. However, he has little knowledge in bookkeeping.

The following was the inventory record of imported wine:

Month		Number of bottles	Cost Price per Unit \$	Selling Price per Unit \$
2016				
January	Purchased	5,000	30	
April	Sold	2,000		78
July	Purchased	5,000	34	
September	Sold	4,100		85
October	Sold	4,000		90
December	Purchased	3,000	40	

The following balances were extracted at 31 December 2015 and 2016:

	<u>31 Dec 2015</u> \$	<u>31 Dec 2016</u> \$
Equipment at cost	70,000	?
Fixtures	20,000	20,000
Inventory (1200 boxes)	42,800	?
Trade receivables	24,500	23,200
Trade payables	10,800	36,000
Accrued rent	11,750	14,000
Prepaid water and electricity	400	550

The following cash receipts and payments were made in the year ended 31 December 2016:

	\$
Receipts	
Received from credit customers	80,800
Payments	
Wages	54,000
Drawings	12,600
Carriage outwards	9,550
General expenses	900

The bank statements showed the following transactions:

	\$
Receipts	
Receipts from credit customers	?
Cash banked	?
Equipment	700
Payments	
Suppliers	?
Rent and rates	21,500
Drawings	246,500
Water and electricity	1,350
Carriage inwards (\$1 per bottle)	10,000
Equipment	50,000

Notes:

1. The company employs weighted average method in the valuation of closing inventories. On 31 December 2016, a physical stock check showed that 3,300 bottles of wine were held and after negotiation with the insurance company, only half of the loss could be claimed.
2. Bank balance at 1 January 2016 was \$26,030 and Nelson managed to maintain a cash float of \$1,000.
3. All non-current assets were bought on 1 January 2014 when the business commenced. Depreciation on equipment and fixtures were to be provided at the rate of 20% per annum on net book value and 10% per annum on cost respectively. A full year's depreciation is charged in the year of purchase of any assets and none in the year of disposal.
4. The business had two items of equipment costing \$35,000 each. One of which was damaged during the year and was replaced by a new one. The remaining old item of equipment, however, was outdated and could be sold only at \$500.
5. Cash discounts allowed to credit customers were \$4,020 and discounts received from suppliers were \$3,080. As Nelson was told that one client owing \$2,000 was facing financial difficulties and he decided to create a special doubtful debts allowance for that and 5% general provision for the remaining trade receivables.

You are required to prepare for Nelson Brown:

- (a) An income statement for the year ended 31 December 2016 (9 marks)
- (b) A statement of financial position at 31 December 2016. (8 marks)
- (c) Name the accounting concepts you have employed in treating items 3 to 5 above. (3 marks)

<Total:20marks>

Question 9

The following trial balance was extracted from the books of Master Limited as at 31 December 2016:

Master Limited		
Trial Balance as at 31 December 2016		
	Dr.	Cr.
	\$	\$
Purchases and Sales	3,530,000	4,430,000
Returns inwards and outwards	76,500	77,800
1 500 000 Ordinary shares, fully paid		2,250,000
Retained profits		600,920
General reserve		900,000
8% Debentures (issued in 2014)		300,000
Inventory, 1 January 2016	136,000	
Administrative expenses	178,000	
Distribution expenses	101,000	
Finance costs	142,000	
Interim dividends	50,000	
Other revenue		600,000
Trade receivables and payables	1,477,000	662,300
Allowance for doubtful accounts		42,000
Bank	1,626,000	
Office equipment and furniture, cost	2,320,000	
Motor vehicles, cost	1,480,000	
Accumulated depreciation: Office equipment and furniture		689,000
Accumulated depreciation: motor vehicles		564,480
	<u>11,116,500</u>	<u>11,116,500</u>

Additional information:

- (i) The company had a standard mark-up of 25% for the year.
- (ii) On 31 December 2016, a fire happened and destroyed most of the inventory. After the physical count, the remaining inventory was \$18,000. The inventory loss was to be included in the administrative expenses.
- (iii) A purchase order amounted to \$40,000 was received from a customer for a batch of goods to be delivered on 6 January 2017. All the monies were properly received and recorded as cash sales.
- (iv) Allowance for doubtful accounts was to be maintained at 5% of trade receivables. The expenses should be included in distribution expense.
- (v) On 1 July 2016, 100 000 ordinary shares were issued at \$1.5 per share. Subscription was received for \$225 000. All subscription monies were credited to 'General reserve' account. Shares were allotted to successful applicants on 30 December 2016. Excess subscriptions were refunded to unsuccessful applicants on 5 January 2017.

- (vi) The debenture interests were payable on 31 March and 30 September every year. All the interest expenses were included in finance costs.
- (vii) On 31 December 2016, the board of directors resolved to transfer \$80,000 to general reserve.
- (viii) Profit tax for the year was estimated to be \$55,000.
- (ix) Depreciation was to be charged as follows:
 - Office equipment and furniture: 10% per annum using the straight-line method
 - Motor vehicles: 20% per annum using the reducing balance method
 Depreciation expenses were to be charged to administrative expense.

You are required to prepare for Master Limited:

- (a) The income statement for the year ended 31 December 2016; and (10 marks)
- (b) The statement of financial position as at that date. (7 marks)
- (c) Explain, with a relevant accounting concept or principle, the accounting treatment of (iii) above. (3 marks)

<Total:20marks>

~ End of Paper ~