HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AND

HONG KONG ASSOCIATION FOR BUSINESS EDUCATION

HONG KONG DIPLOMA OF SECONDARY EDUCATION
EXAMINATION 2021/22

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 (24 marks) and Section C (20 marks).

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

3. Show **all** your workings.

SECTION A (24 marks, weighting 30%)

Answer ALL questions in this section.

Question 1

(a) Define "Realisation concept". (1 mark)

(b) Under the realisation concept, name one situation about despatching goods to customers that the sales amount should not be recorded in the financial statements during the year. (1 mark)

Rachel started running a yoga centre in Kwun Tong Industrial Area on 1 July 2021 launching different yoga packages to customers, which financial year ends on 31 December.

(i) Rachel used a business bank cheque to buy a computer at a cost of $80,000 which was equipped with the latest advancements in technology. The market value of this special computer has increased to $110,000 because of its popularity. She instructed her accounting clerk to record the computer at its market price in the books in order to have a non-current asset gain.

(ii) As social media dominated largely nowadays, Rachel created business accounts in different social media. She has hired 10 yoga teachers. They not only conduct yoga classes, but also regularly share yoga practice and knowledge online in order to become influencers and promote business of the centre. As at 31 December 2021, there were total of 30,000 followers adding from all social media business accounts. Rachel wished to record the company's good online image in the financial statements.

(c) For each of the above independent situations, state and explain the most appropriate accounting principle or concept which has been violated. (6 marks)

<Total: 8 marks>

Question 2

Jenny Company manufactures and sells “Super” chocolate, which is currently sold at $100 per box. The variable manufacturing cost of a box of chocolates is $35. Finished chocolates are transferred to the packaging department. Packaging cost of $15 is incurred for each box of “Super” chocolate.

In December 2020, the management of the company considers extending its business by increasing more machine hours. “Super” chocolate is to be further processed into “Mocha” chocolate, which on average sells at $165 per box in the market.

Every 3 boxes of “Super” can be processed into 2 boxes of “Mocha”. In additions, further manufacturing cost and packaging cost of “Mocha” are $11 and $17.5 per box respectively. No additional fixed cost will be incurred for the production of “Mocha”.

You are required to:

(a) Explain with supporting calculations whether Jenny Company should produce and sell “Mocha” chocolate instead of “Super” chocolate. (4 marks)

Finally, the management of Jenny Company has decided to produce three types of chocolates, which are “Super” chocolate , “Mocha” chocolate and “Good” chocolate in order to provide more choices for customers in 2021. The contribution margin of each box of “Good” chocolate is $80.

Jenny Company has a maximum of 40,000 machine hours available each year due to the tight budget. The required machine hours of one box of “Super” chocolate , “Mocha” chocolate and “Good” chocolate are 0.4 hours, 0.8 hours and 1 hour respectively. The production cost of “Super” chocolate and “Mocha” chocolate and other fixed manufacturing costs remain unchanged.

The sales forecasts for 2021 are as follows:

Super Chocolate	**Mocha Chocolate**	**Good Chocolate**
70,000 boxes	14,000 boxes	20,000 boxes

In January 2021, Jenny Company has signed a non-cancellable contract with a loyal customer to sell 8,000 boxes of “Good” chocolate. This sales volume guaranteed in the contract has been included in the sales forecasts of 2021.

You are required to:

(b) Calculate the production quantity for each of the three products in 2021 in order to maximise the total contributions of Jenny Company at its full capacity (4 marks)

<Total: 8 marks>

Question 3

MW Hotel started renting out accommodation capacities and hotel conference rooms since 1 January 2017. In the year of coronavirus pandemic, the number of foreign tourists has significantly dropped. MW Hotel's business was severely affected and the management decided to offer a variety of staycation packages to reduce the heavy losses. Before preparing the financial statements for the year ended 31 December 2020, the accountant was asked to prepare journal entries for the following transactions:

(i) The allowance for doubtful accounts as at 1 January 2020 was $48,600. The accountant has prepared the following aging analysis to adjust for the allowance for doubtful accounts as at 31 December 2020:

Period outstanding	*Amount of trade receivables as at 31 December 2020*	*Estimated percentage of doubtful debts*
	$	%
Less than 1 month	532,000	1
1 month – Less than 3 months	98,000	8
3 months – Less than 6 months	-	20
6 months and over	90,000	50

In December 2020, the company received a cheque of $9,200 in settlement of a customer's account which had been written off in 2019. However, the account clerk only debit bank account and credit trade receivable account for this transaction. On 31 December 2020, the management decided to write off debts of $10,600 owing by customers for more than a year.

(ii) The company sold staycation packages and received reservation fees in advance. As at 31 December 2020, rental income totalling $190,250 was received in advance and recorded as rental income for services to be provided in early 2021.

(iii) The company acquired air-purifiers which were installed in all hotel rooms and public areas. The following expenditure were incurred in 2020 for the equipment by cheques:

	$
Purchase cost (with 10% trade discount)	2,500,000
Carriage inwards (delivered on 1 February 2020)	7,000
Installation charge (completed on 1 March 2020)	28,000
Safety test fee (completed on 31 March 2020)	90,000
Maintenance fee (for 2020)	25,000

The residual value of the equipment after its estimated useful life of 8 years is expected to $75,000.

On 1 January 2020, the management found that furniture costing $10,000,000, which was purchased at the commencement of the business, could only be used for 4 years further. No scrap value is expected. The company adopts straight-line depreciation method. The original estimated useful life of the furniture was 10 years.

You are required to:

Prepare necessary journal entries to record/correct the above transactions for the year ended 31 December 2020. Narrations are not required. (8 marks)

<Total: 8 marks>

SECTION B (24 marks, weighting 45%)

Answer **TWO** questions in this section.

Question 4

Happy Company commenced business on 1 October 2019. It produces a single product, Smile. The company has a maximum production capacity of 100,000 units per annum and the budgeted production for the year is 80% of its production capacity. During the year, the company has produced 80,000 units of which 2% is still unsold and stored in the warehouse. The Income Statement for the year ended 30 September 2020 was as follows:

		$	$
Sales			3,920,000
Less:	Cost of goods sold		
	Direct materials	200,000	
	Direct labour	304,000	
	Fixed production overheads	360,000	
		864,000	
	Less: Closing inventory	17,280	
		846,720	
	Less: Over-absorbed fixed production overheads	40,000	806,720
Gross profit			3,113,280
Less:	Selling and administrative overheads		
	- fixed	500,000	
	- variable (sales commission only)	290,080	790,080
Net profit			2,323,200

You are required to:

(a) Calculate the contribution margin per unit of Smile. (3 marks)

(b) Calculate the breakeven sales. (2 marks)

(c) Calculate the closing inventory on 30 September 2020 under marginal costing system. (2 marks)

(d) Based on the case above, explain the reasons and the effects for the difference in the net profit under marginal and absorption costing system. (2 marks)

In the second year of business, the number of budgeted production units was increased by 10% of the production capacity as there was an increasing demand of Smile.

Happy Company has received a special order from Joy Limited for 30,000 units at $40 each. Extra direct labour cost is needed which is triple than that under normal production but sales commission will be halved for this special order.

You are required to:

(e) Determine whether Happy Company should accept the offer. Show your calculations clearly to support your answers. (3 marks)

<Total: 12 marks>

Question 5

Shanice's firm sells different computer accessories. The accounting clerk records its cash and bank transactions in a three-column cash book. The balances in the cash book as at 1 March 2021 were: cash $5,640 and bank overdraft $4,500. It made the following transactions in the month of March 2021:

March	1	A cheque for $100,320 was received from Miss Lam, a customer, in full settlement of debts totaling $101,000.
	2	Purchased on credit 180 pieces of printers at $500 each from Jeff Company which is a long-term supplier of the firm. Jeff Company offered a trade discount of 6% and the term of payment is 5/15, net/30.
	3	A cheque of $5,000 issued to Miss Au, a supplier, in September 2020 was written back as a stale cheque.
	5	Sold 8 pieces of scanners to Mr Chan at $7,000 in cash.
	7	Ordered a motor vehicle at a cost of $100,000. A deposit of 20% was paid by cheque. The remaining balance is to be paid on delivery of the motor vehicle in April 2021.
	10	Withdrew $1,000 in cash from the bank, put half into the cash box for paying family lunch meeting of Shanice on 14 March 2021 and used the remaining amount for the purchases of goods.
	15	Settled all the debts by cheque to Jeff Company with an opening balance of $20,000 on 1 March 2021. This amount had been outstanding for over one month.
	25	Received a cheque of $24,000 from a customer, Apple Company to settle its debts. 4% cash discount was granted by Shanice.
	30	Received a cheque of $300 refund from Ocean Limited, a supplier, due to over payment of debts.
	31	All the cash was banked with the exception of $5,000 that was kept in the cash box.

You are required to:

(a) Prepare the three-column cash book for the month of March 2021. (8 marks)

Shanice's firm received a bank statement which shows a credit balance on 31 March 2021. An examination of the bank statement disclosed the following:

(i) The lodgement on 30 March 2021 had not yet recorded by the bank.

(ii) The overdraft interest of $45 was charged by the bank and shown in the bank statement.

(iii) The cheque deposited on 25 March 2021 was returned by the bank due to the wrong signature of the drawer.

(iv) An incorrect credit transfer of $4,400 had been made by the bank on 30 March 2021. The bank informed Shanice that the adjustment would be made in April 2021.

(v) The direct debit for electricity of $900 was shown in the bank statement.

(vi) A term deposit of $30,000 with annual interest rate of 5% was made on 1 August 2020 and matured on 28 February 2021. The bank deposited the principal and interest to the current account of Shanice's firm on 3 March 2021.

You are required to:

(b) Prepare a statement to calculate the bank statement balance, commencing with the bank account balance as at 31 March 2021 as calculated in part (a), before updating the above items of the bank statement.

(4 marks)

<Total: 12 marks>

Question 6

Alan, Ivan and Ken were in partnership sharing profits and losses equally. The partnership agreement states that: drawings will be charged at 5% per annum; Ken is entitled to a salary of $580,000 per quarter. On 31 December 2020, the post-closing trial balance is as follows:

	$	$
Office furniture, net, 31 December 2020	880,000	
Delivery trucks, net, 31 December 2020	964,800	
Buildings, net, 31 December 2020	5,210,000	
Trade receivables	88,400	
Allowance for doubtful accounts		9,600
Cash at bank	2,510,000	
Inventory as at 31 December 2020	731,000	
Trade payables		62,000
4% Loan from Ivan, repayable in 2029		110,750
Net profit before interest and appropriation		2,904,000
Capital accounts as at 1 January 2020		
Alan		3,000,000
Ivan		1,000,000
Ken		2,800,000
Current accounts as at 1 January 2020		
Alan		278,900
Ivan		998,460
Ken	89,850	
Drawings		
Ivan (withdrawn on 1 October 2020)	62,000	
Ken (withdrawn on 30 April 2020)	32,700	
Goodwill	594,960	
	11,163,710	11,163,710

Additional information:

(i) Subsequent to preparation of the post-closing trial balance, the following errors were discovered by the accountant: Inventory as at 31 December 2020 was overstated by $20,000 and a credit sale of $96,000 was omitted.

(ii) The loan from Ivan was made in 2019. Loan interest payable to Ivan for 2020 has not yet been recorded in the books. Salaries totaling $1,620,000 were paid to Ken during the year and included in the calculation of the net profit.

On 31 December 2020, Ken decided to retire early and the senior manager of the partnership, Eric, was admitted to the partnership. The partners have agreed the following arrangements:

(i) Buildings were to be revalued at $5,600,000 and delivery trucks was revalued downwards by $63,620. The allowance for doubtful accounts made should be adjusted to 5% of the trade receivables balance.

(ii) Goodwill was valued at $696,060 but it would not be maintained in the books of the new partnership. Adjustments for goodwill among partners were to be made in the capital accounts directly.

(iii) The partnership purchased a set of gift vouchers costing $60,000 to Ken as the recognition of service. It was equally borne by Alan and Ivan and charged to their current account.

Ken's current account balance was to be transferred to capital account. The final settlement of Ken's capital account balance was to be repaid by a cheque after he took over 90% of the office furniture.

(iv) Eric's initial capital was agreed to be $600,000 and was settled by cheque. His share of goodwill was settled by a personal loan from Alan to Eric, through a transfer between their capital accounts.

(v) The profit and loss sharing ratio of the new partnership is Alan 3: Ivan 2: Eric 1.

You are required to:

(a) Prepare the partners' current accounts and capital accounts in columnar form to record the retirement of Ken and the admission of Eric. (8 marks)

(b) Prepare the statement of financial position for the new partnership as at 1 January 2021. (4 marks)

<Total: 12 marks>

SECTION C (20 marks, weighting 25%)

Answer **ONE** question in this section.

Question 7

Sunshine Limited runs a supermarket in Kwun Tong. The following are the balances extracted from the books of Sunshine Limited as at 31 December 2020 after the accountant found that the trial balance failed to agree:

Trial Balance as at 31 December 2020

	Dr.	Cr.
	$	$
Motor vehicles	920,000	
Accumulated depreciation – Motor vehicles, 31 December 2020		440,000
Cash at bank	828,000	
Accounts payable		259,800
Accounts receivable	165,000	
12% Debentures		200,000
Other revenue		86,000
Selling and distribution expenses	143,000	
Retained profits		129,100
Sales		1 986,000
Purchases	1,344,000	
Inventory	168,000	
General reserves		250,000
Administrative expenses	406,000	
Finance expenses	36,000	
Ordinary share capital		684,000
2019 Final dividend	112,100	
Suspense		87,200
	4,122,100	4,122,100

Additional information:

(i) Based on the physical count conducted by a warehouse keeper as at 31 December 2020, inventory was valued at $212,000. After the physical count, the accountant conducted a review and found that a batch of goods which could be sold for $34,500 was obsolete. This batch of good was purchased in February 2020.

It was decided that the goods would no longer be used for sale and would be used as free samples for a promotion campaign in 2021. No entries had been made for this incident. The company maintained a standard mark-up of 50% during the year.

(ii) The accrued sales commission amounting to $31,000 as at 31 December 2019. On 31 December 2019, the expense was recorded properly except that the accrued sales commission was mistakenly brought down as the commission income of $3,800 on the credit side of the other revenue account as at 1 January 2020.

(iii) During 2020, Product Z costing $200,000 was sold at the standard mark-up and the sales were properly recorded in the books. One-tenth of these goods was returned by a credit customer. The accountant only debited the sales account by $60,000 and omitted other relevant entries.

After receipt of the returned product, it was found that the goods were damaged by an accident in the warehouse and could now only be sold at 50% of the normal selling price after the additional repair cost of $1,500. The insurance company agreed to compensate for 90% of the damage. The loss was abnormal and to be charged to selling and distribution expenses.

(iv) On 1 April 2020, a motor vehicle was purchased and was delivered on 1 July 2020. Due to the restructuring of the company, there were severe delays for the arrangement of payment. The accountant issued a cheque of $410,000 on 15 January 2021 to a service agent to settle the following charges:

	$
List price of the motor vehicle	340,000
Insurance premium for the delivery of the motor vehicle	38,000
Application fees for the import of the motor vehicle	10,000
Training fees for new motor vehicle drivers	22,000

It is the company's policy to charge depreciation on motor vehicles at a rate of 20% per annum on a straight-line basis and classified all the related expenses as administrative expenses.

No entry has been made for the acquisition of the motor vehicles.

(v) The debenture interest is payable on 31 March and 30 September every year.

(vi) On 31 December 2020, the board of directors resolved to declare final dividend of $136,000 and transfer $51,000 to the general reserve.

You are required to:

(a) Prepare the journal entries to correct the errors in (i) to (iv) above. Narrations are not required. (8 marks)

(b) Prepare for Sunshine Limited,

(i) the income statement for the year ended 31 December 2020; and (6 marks)

(ii) the statement of financial position as at 31 December 2020. (6 marks)

<Total: 20 marks>

Question 8

Supra Limited runs a toy wholesales business. The only records kept consisted of entries made in a notebook. On 31 December 2020, water leakage into their warehouse and some of inventories were destroyed. After investigation, Supra Limited was able to identify the following:

Supra Limited
Income statement
for the year ended 31 December 2019

	$	$
Sales (30% cash sales)		1,100,000
Less: Cost of goods sold		
Opening inventory	414,150	
Add: Purchases	591,925	
	1,006,075	
Less: Closing inventory	318,575	687,500
Gross Profit		412,500
Less: Expenses		
Administrative expense	199,610	
Selling and distribution expense	114,940	
Depreciation: Machinery	65,700	380,250
Net profit		32,250

Supra Limited
Statement of financial position
as at 31 December 2019

	$	$	$
Non-current assets			
Machinery			730,000
Less: Accumulated depreciation			138,700
			591,300
Current assets			
Inventory	318,575		
Prepaid administration expense	38,950		
Trade receivable	225,850		
Bank	62,550	645,925	
Less: Current liabilities			
Trade payable	350,000		
Accrued selling and distribution expense	44,038	394,038	
Net current assets			251,887
			843,187
Financed by:			
Capital and reserves:			
Ordinary share capital			600,000
General reserve			100,000
Retained profit			143,187
			843,187

Additional information:

(i) The following were the asset and liability balances extracted from Supra Limited's book:

	31 December 2020
	$
Machinery	?
Inventory	36,450
Trade receivables	305,000
Trade payables	225,000
Accrued administrative expense	22,500
Accrued selling and distribution expense	26,000
Bank	?

(ii) The following receipts and payments were extracted from bank statement:

	$
Receipts	
Cash sales	450,000
Receipts from trade debtors	799,850
Payments	
Payments to trade creditors	?
Administrative expenses	147,520
Selling and distribution expense	120,330
Machinery	280,000

(iii) All the purchases were made on credit. The average trade payables turnover ratio was 3 times.

(iv) The amounts received from trade receivables were all banked. Cash sales for 2020 included a special sales amounted to $80,000 which at cost to a customer.

(v) Company maintained the uniform mark-up rate of 60%.

(vi) The depreciation of machinery should be calculated at 10% of the net book value.

(vii) Insurance company agreed to claims for 90% of the inventory loss from water leakage.

(viii) On 31 December 2020, the board of directors resolved to transfer $20,000 to the general reserve.

You are required to:

(a) Prepare an income statement for the year ended 31 December 2020. (8 marks)

(b) Prepare the statement of financial position as at 31 December 2020. (6 marks)

(c) Calculate (to two decimal places) the following ratios for 2019 and 2020 (assume 365 days per year):

(i) Current ratio

(ii) Acid-test ratio

(iii) Returns on capital employed

(iv) Trade receivable collection period (4 marks)

(d) Based on the ratios calculated in (c) above, briefly comment on the liquidity of Supra Limited for the year 2020. (2 marks)

<Total: 20 marks>

~ End of Paper ~

