FANLING LUTHERAN SECONDARY SCHOOL
2019–2020 S6 MOCK EXAMINATION

BUSINESS, ACCOUNTING AND FINANCIAL STUDIES PAPER 2A
Accounting Module

Date : 22nd January, 2020
Time allowed: 10:15 am - 12:30 pm (2 hour 15 minutes)
This paper must be answered in English

INSTRUCTIONS:

1. There are three sections in this paper

2. All questions in Section A and B are **COMPULSORY**. You are required to answer **ONE** of the two questions in Section C.

3. Write your answers in the answer sheet. Start **EACH** question (not part of a question) on a **NEW** page.

4. This paper contains 9 pages.

SECTION A (24 marks)

Answer **ALL** questions in this section.

1. Juliana operates a manufacturing business which uses a machine for its production process. Fill in the blanks with the most suitable phrase:

variable cost	fixed cost	mixed cost
incremental cost	sunk cost	opportunity cost

(a) The purchase price of the machine was $100,000. When considering whether to sell the machine, the cost is a/an ____________________.

(b) The current market value of the machine is $25,000. When considering whether to continue using the machine, the market value is a/an ____________________.

(c) The operator of the machine earns a monthly salary of $10,000, plus wages of $1 per unit produced when he uses the machine. The cost of hiring the operator is a/an ____________________.

(d) Juliana hires a contractor to perform the maintenance work for the machine, which would cost $7,000 every year. This cost is a/an ____________________.

(e) The material cost of the machine to produce each unit is $22. Material cost is a/an ____________________.

(Total 5 marks)

2. Jenny Company sells Product A at a uniform price of $500 each. Information related to the production and sales of the product is shown below:

Direct materials	$120 per unit produced
Direct labour	$60 per unit produced
Variable production overheads	$200 per unit produced
Annual demand	15,000 units
Fixed production overheads	$400,000 per year
Fixed marketing expenses	$300,000 per year
Sales commission	$50 per unit sold

REQUIRED:

(a) Calculate the contribution margin for each unit of the product.

(b) Calculate the sales revenues of Product A at the breakeven point.

(c) If the price of Product A is increased to $700 per unit, it is estimated that the annual demand for the product would decrease to 12,000 units. Should Jenny Company increase the price? Show the calculations.

(Total 5 marks)

3. Lily Chan prepared a trial balance for her business as at 30 September 2019, the last day of the current financial year. The trial balance did not agree, and a suspense account was opened to record the difference. Errors were subsequently found by the accountant of the business.

Information related to those errors is as follows:

(i) On 12 August 2019, Lily bought goods of $50,000 (list price) on credit from Lam Kee Co. A trade discount of 10% was given. The following entries were made to record the purchases:
Dr Purchases $50,000; Cr Lam Kee Co $45,000; Cr Discounts received $5,000.

(ii) On 18 September 2019, goods of $5,900 (selling price) were sold to Eric Leung in cash. The following entries were made to record the sales:
Dr Erin Leung $2,000; Cr Sales $2,000

(iii) The purchases journal was undercast by $568.

(iv) Payment for rates of $12,000 was only recorded in the cash book.

REQUIRED:

(a) Show the journal entries to correct the above errors. No narrations are required.

(b) Prepare the suspense account.

(Total 6 marks)

4. The following are the balances extracted from the books of KK Company Limited as at 31 December 2017:

	$
Equipment	2,020,000
Retained profits, 1 January 2017	74,000

Additional information:

(i) On 31 December 2017, it was discovered that some goods costing $32,250 had been damaged and could only be sold for $22,200 after having them repaired for $2,600. No adjustment had been made in the closing inventory for the above.

(ii) All sales were made on credit with gross profit margin of 30%. Some goods were sent on a sale-or-return basis at a price of $17,000 in December 2017 and were recorded as credit sales. On 31 December 2017, all these goods were returned by the customer and were not included in the closing inventory of the company, but no entries were made in respect of this return.

(iii) On 1 May 2017, a piece of old equipment was sold for $21,000. The old equipment was purchased on 1 March 2015 at a cost of $50,000. The bookkeeper did not make any entries for the disposal of the equipment.

Besides, another piece of equipment which was purchased for $250,000 in 2012 was still in use during 2017.

It is the company's policy to charge depreciation on equipment at a rate of 20% per annum on a straight-line basis. A full year's depreciation on equipment is to be charged in the year of purchase but none in the year of disposal.

REQUIRED:

(a) Prepare the necessary journal entries to correct the above. Narrations are not required.

(b) Calculate the annual depreciation expenses of equipment for 2017.

(Total 8 marks)

SECTION B (36 marks)

Answer **ALL** questions in this section.

5. Judy Lau operates a trading business. The cash book of the business showed a credit balance of $23,456 as at 31 August 2019, which failed to agree with the balance shown on the bank statement.

   Upon investigation, the following information was found:

   (i) Louis Lam, a trade debtor, transferred $5,100 to the business bank account of Judy Lau without informing her. Thus, this event had not been entered in the cash book.

   (ii) Bank overdraft interest totalled $125 for the month ended 31 August 2019. This item was listed on the bank statement but not the cash book.

   (iii) HC Bank incorrectly debited bank charges totalling $998.

   (iv) A standing order for fire insurance of $30,000 was not entered in the cash book.

   (v) A cheque of $16,311 was drawn on 1 August 2018 to settle the account of Jane Leung, a non-trade creditor. This cheque had not been presented to the bank. It is the bank's practice not to honour cheques outstanding for more than six months.

   (vi) A cheque for $2,999 received from Connie Chan was wrongly recorded in the cash book as $2,331.

   (vii) A cheque of $12,000 to pay for purchasing equipment had been mistakenly recorded as $21,000 in the cash book.

   (viii) A cheque payment for $448 to a supplier had been entered in the cash book as $4,480.

   (ix) A cheque of $29,100, after deducting the cash discount of 3%, was received from a customer on 15 August 2019. The cashier recorded the gross amount in the cash book.

   (x) The following cheques drawn by the business had not been presented to the bank:

Cheque Number	Amount
	$
10583	9,180
10583	332
10583	17,190

   (xi) A cheque of $8,700 was received from Johnny Cheung, a customer, on 30 August 2019. The cheque was banked on the same day. This event was listed on the cash book but not in the bank statement.

   REQUIRED:

   (a) Update the cash book for Judy Lau's business, showing the adjusted balance on 31 August 2019.

   (b) Prepare a bank reconciliation statement as at 31 August 2019.

   (Total 11 marks)

6. Donald Ltd manufactures three products: 'Basic', 'Standard' and 'Professional'. The business plans to produce 30,000 units of Basic, 20,000 units of Standard and 10,000 units of Professional in the following year. The budgeted production cost for the items is as follows:

	Basic	Standard	Professional
Per unit	$	$	$
Direct materials	20	60	80
Direct labour	40	40	80
Variable production overheads	15	30	45

Budgeted fixed production overheads are as follows:

	$
Depreciation on equipment	800,000
Factory supervisor's salary	360,000
Factory rent and rates	40,000

Windy Ltd proposed to supply the three items for Donald Ltd. Details are as follows:

(i) Windy Ltd proposed to sell 30,000 units of Basic, 20,000 units of Standard and 10,000 units of Professional for a total sum of $8,000,000.

(ii) If Donald Ltd stops manufacturing the items, the current equipment used for production will be disposed of but the depreciation on equipment still incurred already. There would be no residual value.

(iii) The tenancy agreement for the factory of Donald Ltd can be terminated at any time without penalty.

(iv) The contract of the factory supervisor would be terminated if Donald Ltd stops its production. Compensation of $80,000 would be paid to the supervisor.

REQUIRED:

(a) Define 'sunk cost'. Identify a sunk cost for Donald Ltd.

(b) Should Donald Ltd accept the proposal? Show your calculations.

(c) Suppose the equipment had a market value of $800,000. Would the decision of Donald Ltd be the same?

(d) When deciding whether to produce or buy the three items, state one example of (i) relevant cost and (ii) irrelevant cost.

(Total 12 marks)

7. Amy, Barry and Carol have been in partnership, sharing profits and losses in the ratio of 2 : 3 : 5. The statement of financial position of the partnership as at 31 December 2018 is shown below:

Amy, Barry and Carol
Statement of Financial Position as at 31 December 2018

		$	$
Assets			
Goodwill			200,000
Furniture and fixtures, net			680,000
Motor vehicles, net			150,000
Inventory			65,808
Trade receivables			99,705
Bank			33,996
			1,229,509
Liabilities			
Trade payables		127,500	
Loan from Amy		60,000	187,500
			1,042,009
Financed by:			
Capital accounts:	Amy	350,000	
	Barry	425,000	
	Carol	200,000	975,000
Current accounts:	Amy	81,250	
	Barry	(7,386)	
	Carol	(6,855)	67,009
			1,042,009

The partnership was dissolved on 31 December 2018 upon a consensus among the partners. Details of the dissolution are as follows:

(i) Some furniture items were taken over by the following partners at net book value:

	$
Amy	120,000
Barry	70,000

The remaining furniture and fixtures were being sold at half of their net book value.

(ii) The motor vehicles were disposed of at a loss of $12,500

(iii) Trade receivables were realised for $95,000.

(iv) Amy took over the entire inventory at book value.

(v) Goodwill was written off.

(vi) The trade payables were taken over by Barry and settled with a 5% discount.

(vii) Dissolution expenses totalled $51,000.

(viii) As Carol was insolvent, her capital deficiency was borne by the remaining partners according to their profit and loss sharing ratio.

On dissolution, all partners' loan and current account balances were transferred to their respective capital accounts before adjustments were made.

REQUIRED:

Prepare the following accounts:

(a) Realisation

(b) Bank

(c) Capital

(Total 13 marks)

SECTION C (20 marks)
Answer **ONE** question in this section.

8. On 1 July 2018, Gary Lam started a trading business. He contributed cash of $1,000,000 as at the same date. He did not hire an accountant to keep proper accounting records. The following information related to the year ended 30 June 2019 was extracted from the bank statements:

	$
Payments:	
Drawings	150,000
Furniture and fixtures purchased on 1 July 2018	500,000
Rent	520,000
Wages and salaries	568,500
Payments to trade creditors	3,650,280
	5,388,780
Receipts:	
Contribution from Gary Lam	1,000,000
Receipts from trade debtors	5,101,760
12% bank loan	500,000
	6,601,760

Additional information:

(i) Included in receipts from trade debtors were deposits totalling $5,550. The goods were to be delivered during July 2019.

(ii) Wages and salaries for the month of June 2019 (totalled $45,000) were to be paid on 5 July 2019.

(iii) Rent for July 2019 (amounting to $40,000) was paid on 21 June 2019.

(iv) The residual value of furniture and fixtures was estimated to be $10,000. The expected useful life of non-current assets was 10 years. Depreciation was to be charged using the straight-line method.

(v) The bank loan was a one-year loan borrowed on 1 June 2019.

(vi) As at the year-end date, the amounts of trade receivables and trade payables were $21,549 and $124,319, respectively.

(vii) Cheques paid for purchases, totalling $52,125, were unpresented as at the year-end date; cheques received for sales, totalling $700, were not deposited into the business bank account as at the year-end date.

(viii) Inventory as at 30 June 2019 was valued at $61,250.

REQUIRED:

(a) Prepare an income statement for Gary Lam's business for the year ended 30 June 2019.

(b) Prepare a statement of financial position as at the same date.

(c) Calculate (to two decimal places) the following ratios:

(i) Total assets turnover for the year ended 30 June 2019

(iii) Net profit ratio for the year ended 30 June 2019

(Total 20 marks)

9. The accountant of Lily Limited has prepared the following financial statements for the company for the year ended 31 August 2019:

Lily Limited
Income Statement for the year ended 31 August 2019

		$	$
Sales			1,700,000
Less Returns inwards			25,000
			1,675,000
Less *Cost of goods sold:*			
	Opening inventory	35,000	
	Add Purchases	688,000	
		723,000	
	Less Closing inventory	135,000	588,000
Gross profit			1,087,000
Add *Other revenues:*			
	Discounts received		31,235
			1,118,235
Less *Expenses:*			
	Operating expenses	668,129	
	Loan interest	71,256	739,385
Net profit			378,850
Less Income tax expense			120,135
Profit after tax			258,715
Add Retained profits brought forward			329,877
			588,592
Less *Appropriations:*			
	Transfer to general reserve		500,000
Retained profits carried forward			88,592

Lily Limited
Statement of Financial Position as at 31 August 2019

	$	$	$
Non-current assets			
Furniture and fixtures, net book value			1,600,000
Office equipment, net book value			480,500
			2,080,500
Current assets			
Inventory		135,000	
Trade receivables	65,000		
Less Allowance for doubtful debts	650	64,350	
Bank		21,299	
Cash		17	
		220,666	
Less *Current liabilities:*			
Trade payables	32,875		
Tax payable	120,135		
10% bank loan, repayable on 1 June 2020	712,560		
Accrued expenses	690	866,260	
Net current liabilities			(645,594)
			1,434,906
Financed by:			
Capital and reserves			
Ordinary share capital			746,314
General reserve			600,000
Retained profits			88,592
			1,434,906

Additional information:

(i) Trade receivables and trade payables as at 1 September 2018 were $12,543 and $53,111, respectively.

(ii) Inventory as at 1 September 2018 amounted to $10,528.

(iii) All sales and purchased transactions were made on credit.

Required:

Calculate the following ratios (to two decimal places) for the year ended 31 August 2019:

(a) Return on capital employed

(b) Average trade payables repayment period

(c) Inventory turnover

(d) Gross profit ratio

(e) Trade receivables turnover

The industry averages for the same year are as follows:

Return on capital employed	7.5%
Average trade payables repayment period	65.11 days
Inventory turnover	4.71 times
Gross profit ratio	51.62%
Trade receivables turnover	10.89 times

Required:

(f) Comment on the profitability and liquidity of Lily Limited relative to its competitors in the industry.

(g) Briefly explain two limitations of ratio analysis.

(h) Suppose the board of directors of Lily Limited decided not to transfer any retained profits to the general reserve. How would this decision affect the ratios that you calculated above? Briefly explain.

(Total: 20 marks)

END OF PAPER