HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY

HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION 2017

BUSINESS, ACCOUNTING AND FINANCIAL STUDIES PAPER 2A

Accounting Module

10.30 am – 12.45 pm (2 hours 15 minutes)

This paper must be answered in English

INSTRUCTIONS

(1) There are three sections in this paper.

(2) All questions in Sections 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 book. Start **EACH** question (not part of a question) on a **NEW** page.

Not to be taken away before the end of the examination session

SECTION A (24 marks)

Answer **ALL** questions in this section.

1. The following are some accounting principles and conventions:

- Money measurement
- Consistency
- Going concern
- Business entity
- Timeliness
- Materiality
- Realisation

Situations:

(i) Owner's personal assets are not recorded in the books of his business.

(ii) A business discloses its financial information as soon as possible, so that it can be used by users for decision-making.

(iii) Assets are not recorded at their liquidation values in the statement of financial position when a business is not expected to liquidate in the foreseeable future.

(iv) The expertise of the top management is not recorded in the statement of financial position.

(v) Sales revenues are recognised when goods are delivered to and accepted by customers.

REQUIRED:

(a) Referring to the above table, identify the most appropriate accounting principle or convention for each of the situations. (5 marks)

In a multinational corporation, a calculator costing \$50, with an estimated useful life of 10 years, was purchased for office use. The whole amount of \$50 was recorded as an expense in the year of purchase.

REQUIRED:

(b) State and explain the accounting principle or convention that has been applied in this case. (3 marks)

(Total: 8 marks)

2. Tommy Company sells only one product and uses the weighted average cost method for inventory valuation. The following information for the month of March 2017 was available:

Date	Details	Units	Cost/unit
			$
March 12	Purchases	500	40
March 20	Purchases	1 500	36

Date	Details	Units	Selling price/unit
			$
March 8	Sales	250	45
March 28	Sales	1 600	39

The opening inventory as at 1 March 2017 included 400 units with an average cost of $43 each. Operating expenses for the month were $14 350.

REQUIRED:

(a) Compute the value of closing inventory as at 31 March 2017. Show your workings. (2 marks)

(b) Prepare the income statement for the month ended 31 March 2017, showing clearly the values of opening inventory, purchases and closing inventory. (3 marks)

(c) If the net realisable value of the closing inventory as at 31 March 2017 was $35 per unit, explain the impact, with supporting calculations, on the amount of gross profit for the month of March 2017. (3 marks)

(Total: 8 marks)

3. Star Manufacturing Company acquired a production machine for $432 000 on 1 January 2013. The expected total production hours of the machine are 8000 hours during its useful life of four years. No residual value is expected and annual depreciation is to be provided based on the usage of the machine.

The actual annual hours used for production were as follows:

Year	Actual production hours
2013	1 800
2014	2 300
2015	2 400
2016	2 500

REQUIRED:

(a) Calculate the annual depreciation expenses of the machine for 2015 and 2016. (2 marks)

KM Company is a manufacturer producing a single product, Y. The following information for its three types of manufacturing overheads is available. Each overhead type demonstrates different cost behaviour. The maximum annual production capacity of KM Company is 600 000 units.

Production level (units)	360 000	420 000	480 000	540 000	600 000
Manufacturing overheads:	$	$	$	$	$
- Type P	400 000	400 000	400 000	(i)	400 000
- Type Q	180 000	210 000	(ii)	270 000	300 000
- Type R*	77 000	(iii)	101 000	113 000	125 000

*Type R includes fixed manufacturing overheads and variable manufacturing overheads.

REQUIRED:

(b) Compute the amounts for items (i) to (iii) in the above table. (3 marks)

(c) With reference to cost behaviour, identify the type of manufacturing overheads that Type R belongs to. (1 mark)

KM Company is considering a one-off special order from a customer. It has sufficient production capacity to cope with this order.

REQUIRED:

(d) With reference to cost behaviour, when KM Company decides whether to accept the order, which of the above three types of manufacturing overheads (P, Q or R) is irrelevant? Briefly explain your answer. (2 marks)

(Total: 8 marks)

SECTION B (36 marks)

Answer **ALL** questions in this section.

4. The cash at bank account of PP Limited showed a debit balance of $105 468 as at 31 December 2016, which did not agree with the balance shown in the bank statement on that date.

   Subsequent checking of the cash at bank account with the bank statement found that:

   (i) The following cheques had been issued and recorded in the books but had not yet been presented to the bank:

Cheque Number	Payee	Issue date	$
408226	K&K Limited	22 June 2016	15 236
450998	Coco Company	4 August 2016	35 060
482118	Sunny Limited	30 October 2016	7 850

   It is the practice of the bank not to honour cheques outstanding for more than six months.

   (ii) A direct debit for electricity of $900 had not yet been recorded in the books.

   (iii) PP Limited was notified that an adjustment of $8755 would be made by the bank in January 2017 for a debit entry made in error on 26 December 2016.

   (iv) Bank charges of $794, shown in the bank statement, had not been recorded in the books.

   (v) On 27 December 2016, dividend income of $3160 was credited by the bank but no entry had been made in the books.

   (vi) On 29 December 2016, a cheque received from a customer for $11 630 was returned by the bank due to insufficient funds. No entries had been made in the books for the returned cheque.

   (vii) A cheque for payment of rent and rates of $21 350 was wrongly recorded as $21 530 in the books.

   (viii) Cheques deposited on 31 December 2016 amounting to $81 425 were recorded in the books but had not been credited by the bank.

   (ix) During 2016, a term deposit of $60 000 was made and recorded in the term deposit account. The bank credited an amount of $61 200, the principal and interest, to the account of PP Limited when the term deposit matured on 2 January 2017, but PP Limited recorded the receipt on 31 December 2016.

   REQUIRED:

   (a) Update the cash at bank account of PP Limited. (6 marks)

   (b) Prepare a bank reconciliation statement as at 31 December 2016, commencing with the updated balance of the cash at bank account. (4 marks)

   (Total: 10 marks)

5. ABC Limited drafted a trial balance as at 31 December 2016, before the preparation of the closing entries. As the trial balance did not agree, a suspense account was opened.

Subsequent investigation revealed the following errors and omissions:

(i) Discounts allowed of $3400 had not been recorded in the books.

(ii) A cash sale of $28 050 to Pearl Limited was recorded in the sales journal as $28 500 and posted to the ledgers accordingly. No entry for the receipt was made in the books.

(iii) An invoice for credit purchase was overstated by $270.

(iv) Goods returned to a supplier for $440 were debited to both trade payables account and returns inwards account.

REQUIRED:

(a) Prepare the necessary journal entries to correct the above. Narrations are not required. (5 marks)

On 31 December 2016, the following balances were extracted from the ledgers of ABC Limited, before recording the adjustments in (a) above:

	$
Ordinary share capital	1 305 000
Preference share capital	760 000
Retained profits, 1 January 2016	10 000
Loans, repayable in June 2018	320 000

The draft net profit for the year ended 31 December 2016 was $7700. No dividends were declared for 2016.

REQUIRED:

(b) Prepare a statement to calculate the retained profits as at 31 December 2016, showing all necessary adjustments and the adjusted net profit for 2016. (4 marks)

(c) Calculate the gearing ratio of ABC Limited for 2016. (2 marks)

(d) Explain two differences in terms of the right to dividends for ordinary shareholders and preference shareholders. (2 marks)

(Total: 13 marks)

6. Nice Company commenced business on 1 January 2016. It produces a single product, M1. The income statement for the year ended 31 December 2016 was as follows:

	$	$
Sales (9600 units)		2 400 000
Less: Cost of goods sold		
Direct materials	300 000	
Direct labour	600 000	
Fixed production overheads	930 000	
	1 830 000	
Less: Closing inventory (2400 units)	366 000	
	1 464 000	
Add: Under-absorbed fixed production overheads	15 000	1 479 000
Gross profit		921 000
Less: Selling and administrative overheads		
- fixed	360 000	
- variable (include sales commission only)	240 000	600 000
Net profit		321 000

REQUIRED:

(a) Calculate the contribution margin per unit of M1. (4 marks)

(b) Calculate the breakeven sales amount for 2016. (4 marks)

Nice Company is considering producing an advanced model 'Super-M' in 2018. If Nice Company produces both M1 and 'Super-M', the production information is estimated as follows:

	M1	Super-M
Annual production	5 000 units	7 000 units
Direct labour hour required per unit	$\frac{1}{10}$ hour	$\frac{1}{6}$ hour
Machine hour required per unit	$\frac{4}{5}$ hour	$\frac{2}{3}$ hour

Fixed production overheads of 2018 are budgeted at $988 000, which mainly covers factory rent, machine maintenance and depreciation for machinery.

REQUIRED:

(c) Calculate the predetermined fixed production overhead absorption rate (to 2 decimal places) for each unit of M1 and 'Super-M' respectively, using the following cost absorption bases:

(i) direct labour hours

(ii) machine hours (3 marks)

(d) Briefly explain which cost absorption basis, direct labour hours or machine hours, would you recommend to Nice Company. (2 marks)

(Total: 13 marks)

SECTION C (20 marks)

Answer **ONE** question in this section.

7. Mark started his business as a sole proprietor on 1 January 2015. All purchases and sales were made on credit.

   On 31 December 2016, a fire broke out in the warehouse. All inventory, except some goods costing $15 000, was destroyed. Although many of the records were destroyed in the fire, the following information was available after investigation:

   (i) Information on assets and liabilities was confirmed as follows:

	31.12.2015	31.12.2016
	$	$
Motor van, net	24 000	?
Inventory	143 000	15 000
Trade receivables	12 100	13 700
Trade payables	149 700	135 000
Accrued sundry expenses	2 440	2 180
Cash at bank	61 800	?

   (ii) The balance as per bank statement as at 31 December 2016 was $99 180.

   (iii) During 2016, receipts from customers $1 404 900 were banked, after payments of part-time staff salaries $89 400 and Mark's drawings $29 500.

   (iv) The bank statements of 2016 showed that total payments made to trade suppliers amounted to $987 970. A cheque of $1200 issued in December 2016 for purchase of goods in 2016 was not presented until 10 January 2017.

   (v) Sales were made at a gross profit margin of 30% in 2016, except for some outdated goods, costing $50 000, which were sold at cost.

   (vi) A 2% term deposit was made by transferring $20 000 from the cash at bank account on 1 July 2016. The term deposit will mature on 1 July 2019.

   (vii) The payment for rent and rates of $127 750 in 2016 included a rental deposit of $8000 for a short-term tenancy agreement.

   (viii) During 2016, full-time staff salaries and sundry expenses of $129 000 and $42 800 respectively were paid.

   (ix) In 2016, Mark injected $10 000 cash into the business and withdrew $70 000 from the bank for his personal use.

   (x) The motor van was brought in by Mark at the commencement of the business. Depreciation is to be provided on the motor van at 20% per annum on cost.

REQUIRED:

(a) For Mark's business, prepare

(i) an income statement for the year ended 31 December 2016, and (10 marks)

(ii) a statement of financial position as at 31 December 2016, showing the change in capital during the year. (7 marks)

(b) Briefly explain the meanings of normal loss and abnormal loss of inventory. Identify the type of inventory loss caused to Mark's business by the fire. (3 marks)

(Total: 20 marks)

8. Bill and Ben have been in partnership sharing profits and losses in the ratio of 1:3. On 1 January 2016, Bill retired from the partnership and Tom was admitted as a new partner. Profits and losses were to be shared equally in the new partnership.

Upon the retirement of Bill and admission of Tom, the partners agreed on the following terms:

(i) Tom had to bring in $240 000 cash as capital and was entitled to a monthly salary of $2000.

(ii) Equipment was to be revalued at $248 000.

(iii) Goodwill was to be valued at $96 000 and no goodwill account was to be maintained in the books. The adjustments for goodwill were to be made in the capital accounts directly.

(iv) The amount due to Bill by the partnership was to be left in a loan account, bearing an interest of 2% per annum.

The new partnership continued to use the books without making any entries in respect of the retirement of Bill and admission of Tom. The trial balance as at 31 December 2016 was prepared as follows:

		Dr	Cr
		$	$
Capital accounts at 1 January 2016	– Bill		162 000
	– Ben		466 000
Current accounts at 1 January 2016	– Bill		42 000
	– Ben	20 000	
Equipment, net		120 000	
Trade receivables		70 000	
Inventory		98 000	
Cash at bank		21 000	
Trade payables			30 000
Net loss before interest		371 000	
		700 000	700 000

Depreciation had been provided on equipment till 31 December 2016 at 20% on its net book value.

REQUIRED:

(a) Prepare the partners' capital accounts in columnar form, showing the necessary adjustments for the retirement of Bill and admission of Tom.
(6 marks)

(b) (i) Prepare the appropriation account of the partnership for the year ended 31 December 2016.
(3 marks)

(ii) Update the partners' current accounts of Ben and Tom in columnar form.
(2 marks)

(c) State any two items, other than those appearing in (b)(ii) above, that would be recorded in a partner's current account.
(2 marks)

The partnership was not operated well and heavy losses resulted. The partnership was dissolved on 1 January 2017. The following arrangements were made:

(i) Equipment was taken over by Ben at $174 000.

(ii) Total amounts received from trade receivables and sales of inventory were $96 000.

(iii) Trade payables were settled in full at $29 000.

(iv) Expenses for realisation of assets $6000 were paid.

(v) After negotiation, the loan interest due to Bill was waived and the loan from Bill was settled in full.

REQUIRED:

(d) Prepare the realisation account. (4 marks)

(e) Prepare the partners' capital accounts in columnar form, showing the necessary adjustments for the dissolution. (3 marks)

(Total: 20 marks)

END OF PAPER