SECTION A

Answer **ALL** questions in this section.

1. The following information for the year ended 31 December 2011 was extracted from the books of Kong's Company:

		$
Sales ledger control account	– 1 January 2011	33 500
Allowance for doubtful debts	– 1 January 2011	2 500
	– 31 December 2011	27 600
Cash sales		64 530
Credit sales		742 070
Credit sales returns		3 200
Cheques received from trade debtors		602 120
Discounts allowed		3 500
Bad debts written off		650
Cheques from trade debtors dishonoured		12 420
Set-off against purchases ledger control account		1 000

REQUIRED:

(a) Prepare a sales ledger control account for the year ended 31 December 2011. (5 marks)

(b) Give one reason why a company would like to prepare control accounts. (2 marks)
(Total: 7 marks)

2. The non-current assets of Moody Company as at 31 December 2010 were as follows:

	Cost	Accumulated depreciation
	$	$
Machinery (all purchased in 2007)	3 600 000	3 455 000
Lorries (all purchased in 2008)	1 850 000	1 200 000

The following were transactions relating to the non-current assets of the company during 2011:

(i) On 1 March 2011, a piece of machinery was bought at a price of $2 400 000. On the same date, a component costing $60 000 was installed into the machinery to increase its productivity over the coming four years.

(ii) On 1 January 2011, a lorry was bought at a price of $1 900 000. The price included an insurance premium of $36 000 covering the year ended 31 December 2011.

It is the company's policy to depreciate machinery at a rate of 25% per annum on cost, and lorries at a rate of 20% per annum using the reducing balance method.

REQUIRED:

(a) For Moody Company,

(1) calculate the depreciation expenses of the machinery for the year ended 31 December 2011; and (3 marks)

(2) prepare the accumulated depreciation account of lorries for the year ended 31 December 2011. (3 marks)

(b) Different methods are used to depreciate the non-current assets of Moody Company. Explain whether such a difference in accounting treatments violates the consistency principle. (2 marks)
(Total: 8 marks)

3. The profits of one of the Art Group's stores have been declining. The Group's Board of Directors then resolved that any net loss of the store in 2011 would result in layoffs of its senior management in 2012.

In a meeting, Terry Ma, a board member, said, "The allowance for doubtful debts of the store was 5% over the past 6 years but was only 1% in 2011. As the business environment in 2011 was similar to that in the previous years, I think the reduction in the allowance was not justified."

Susan, the store manager, argued, "This reduction was fair as it was the result of our customers' improved credit records." However, she presented little evidence to support her argument.

As Terry had a number of relatives working as the senior management of the store and he didn't want to have a personal confrontation with Susan, he decided to agree with her in the end.

REQUIRED:

(a) What is corporate governance? (2 marks)

(b) With reference to the above situation, suggest two ways to improve Art Group's corporate governance. (4 marks)

(Total: 6 marks)

4. Magic Company manufactures and sells a single product, Product X. For the purpose of preparing the budget for Product X for the month of November 2012, the following information is provided:

(i) The budgeted production and budgeted sales for the month are 5000 and 4400 units respectively.

(ii) The expected selling price is $300 per unit.

(iii) The direct material cost of the product is $40 per unit. An additional transportation cost of $2 per unit is to be incurred for the purchase of the direct materials.

(iv) Each unit of product requires 2 hours of direct labour. The hourly rate of direct labour is $60.5.

(v) The production overheads of the product comprise a fixed and a variable element. It is the company's policy to apportion variable production overheads in relation to the number of units produced.

Assuming the monthly fixed production overheads of the company remain the same in 2012, the annual budgeted production overheads will be $1 159 000 if 58 000 units are produced each year, and $1 203 000 if 66 000 units are produced each year.

(vi) Selling and distribution expenses consist of a sales commission of $8 per unit sold and a fixed monthly distribution expense of $50 000.

REQUIRED:

Magic Company adopts the marginal costing system. Assume it does not keep any inventories as at 31 October 2012, calculate the following for Product X for the month ended 30 November 2012:

(a) the budgeted total value of closing inventories (4 marks)

(b) the budgeted total amount of contribution (3 marks)

(c) the budgeted total amount of net profit (2 marks)

(Total: 9 marks)

SECTION B

Answer **ALL** questions in this section.

5. The following information was extracted from the cash book of Doris Ltd for the month ended 31 December 2011:

Cash at bank

2011		$	2011		Cheque No.	$
Dec 4	Cindy Ltd	125 000	Dec 1	Balance b/d		10 500
5	Connie Fashion Co	25 300	12	Electricity	532018	2 820
20	Chloe Ltd	72 530	13	Yuki Co	532019	24 500
28	Carmen Co	7 235	22	Zoey & Co	532020	31 600
31	Cherry Ltd	8 005	22	Salaries	532021	109 420
31	Balance c/d	9 530	31	Clara Co	532022	68 760
		247 600				247 600

Doris Ltd received the following bank statement for the month of December 2011:

Bank statement as at 31 December 2011

Date		Description	Withdrawal	Deposit	Balance
2011			$	$	$
Dec	1	Balance b/d			(10 000)
	4	Cheque deposit		125 000	115 000
	5	Cheque deposit		23 500	138 500
	8	Cheque 532010	300		138 200
	12	Cheque 532018	2 820		135 380
	13	Cheque 532019	24 500		110 880
	20	Cheque deposit		72 530	183 410
	22	Cheque 532021	109 420		73 990
	23	Refer to drawer	72 530		1 460
	30	Credit transfer		46 250	47 710
	31	Direct debit – management fees	5 025		42 685
	31	Bank charges	25		42 660
	31	Cheque 982277	105 660		(63 000)

Additional information:

(i) A cheque for $23 500 received from Connie Fashion Co was wrongly recorded in the cash book as $25 300. Also, it was discovered that the cheque received from Carmen Co on 28 December 2011 was dated 2 January 2012.

(ii) The credit transfer on 30 December 2011 shown on the bank statement was made by a customer of Doris Ltd.

(iii) Doris Ltd had been informed by its bank that Cheque 982277 was an incorrect debit entry and the correction would be made by the bank on 5 January 2012.

(iv) The reason for the difference in the opening balances of the cash at bank account and the bank statement was due to two cheques, 532009 and 532010, issued in November 2011 remained unpresented on 30 November 2011.

REQUIRED:

(a) Update the cash at bank account of Doris Ltd. (7 marks)

(b) Prepare a bank reconciliation statement as at 31 December 2011, commencing with the updated cash at bank balance. (5 marks)

(c) List two possible reasons why the cheque deposit made on 20 December 2011 was returned by the bank on 23 December 2011. (2 marks)

(Total: 14 marks)

6. Albert Manufacturing Company specialises in the production of mobile phones. It has two products, MP1 and MP2. MP1 only passes through production department A while MP2 only passes through production department B. There are two service centres, Maintenance and Product Design, in its factory providing support to both production departments. The following budgeted information for the year ended 31 December 2013 is available:

(i) Total budgeted fixed production overheads for the two production departments and the two service centres for 2013 are $5 548 000:

	$	$
Departmental production overheads:		
Department A		96 000
Department B		32 000
Maintenance		14 000
Product Design		6 000
		148 000
Other production overheads:		
Air-conditioning and lighting	1 056 000	
Insurance for machinery	280 000	
Rent and rates	3 080 000	
Salaries of supervisors	480 000	
Machinery depreciation	504 000	5 400 000
		5 548 000

(ii) Data relating to the operation of each production department and service centre for 2013:

	Department A	Department B	Maintenance	Product Design
Floor area occupied (square metres)	2800	4400	1000	600
Cost of machines	$1 200 000	$500 000	$300 000	$800 000
Number of supervisors	15	10	2	3
Maintenance cost apportionment	20%	80%	–	–
Product design cost apportionment	70%	30%	–	–

(iii) Production and sales information relating to MP1 and MP2 for 2013:

		MP1	MP2
Annual production and sales level		80 000 units	40 000 units
Direct material cost per unit		$210	$250
Direct labour cost per hour		$28	$40
Direct labour hours per unit	– Department A	2.5 hours	–
	– Department B	–	3 hours
Machine hours per unit	– Department A	1 hour	–
	– Department B	–	15 hours

The company adopts absorption costing and establishes a predetermined fixed production overheads absorption rate for each production department. Direct labour hour and machine hour are used as the bases for the allocation of fixed production overheads for Department A and Department B respectively.

REQUIRED:

(a) What are the meanings of direct costs and indirect costs? Explain with an example for each cost from the information provided above. (4 marks)

(b) (1) Prepare a statement, in columnar form, to calculate (to the nearest dollar) the total budgeted fixed production overheads for each of the two production departments in 2013. (7 marks)

(2) Calculate (to two decimal places) the predetermined fixed production overhead absorption rate for each production department. (2 marks)

(c) Prepare a statement to calculate (to two decimal places) the respective budgeted unit production costs of MP1 and MP2. (3 marks)

(d) If it is the company's practice to price every product at a mark-up of 25%, calculate (to the nearest dollar) the unit selling price of MP1. (2 marks)

(Total: 18 marks)

7. Andy, Bob and Carol were in partnership sharing profits and losses in the ratio of 2:3:5. The summarised balance sheet as at 31 December 2011 was as follows:

Andy, Bob and Carol
Balance Sheet as at 31 December 2011

	$	$
Assets		
Plant and machinery, net		129 000
Office equipment, net		134 500
Inventories		92 000
Trade receivables		40 500
Cash at bank		2 200
		398 200
Liabilities		
Loan from Andy	60 000	
Loan from Bob	50 000	
Trade payables	50 200	
Accrued expenses	11 500	171 700
		226 500
Financed by		
Capital accounts:		
– Andy	178 000	
– Bob	22 000	
– Carol	12 000	212 000
Current accounts:		
– Andy	14 300	
– Bob	6 500	
– Carol	(6 300)	14 500
		226 500

As profits of the partnership had been declining, the partners decided to dissolve the partnership on 1 January 2012.

On the date of dissolution,

(i) Andy took over all the office equipment as full settlement of his loan to the partnership.

(ii) Carol took over half of the inventories at $11 500.

(iii) Bob had collected from customers a total of $36 100 after deducting bad debts of $4400. He agreed that the amount collected would be used as part of the settlement of his loan to the partnership.

In the course of dissolution, all the remaining assets were sold for $285 700 and all the liabilities were settled by cheque. Cash discounts amounting to $720 were allowed by suppliers and realisation expenses of $4920 were paid.

For the purpose of dissolution, all the balances of the partners' current accounts were to be transferred to their respective capital accounts before any adjustment was to be made.

REQUIRED:

(a) Prepare the following accounts of the partnership to record the above:

(1) realisation account (7 marks)

(2) cash at bank account (5 marks)

(3) the partners' capital accounts in columnar form (4 marks)

(b) Explain one advantage of maintaining both current accounts and capital accounts in a partnership. (2 marks)

(Total: 18 marks)

SECTION C

Answer **ONE** question in this section.

8. Lucky Company is a local manufacturer selling a single product, DC. The company plans to produce and sell at its maximum capacity of 80 000 units in 2013. The following estimates relating to DC have been made for 2013:

	$
Manufacturing costs:	
Direct materials	480 000
Direct labour	320 000
Production overheads	1 000 000
Non-manufacturing costs:	
Selling expenses	900 000
Administrative expenses	528 500

Additional information:

(i) 20% of the production overheads are variable costs.

(ii) Two-thirds of the selling expenses are fixed while the remaining balance is the sales commission, which varies with the number of units sold.

(iii) Administrative expenses are all fixed.

REQUIRED:

(a) Calculate

(1) the total fixed costs of 80 000 units of DC; and (2 marks)

(2) the total variable costs of 80 000 units of DC. (2 marks)

At a regular meeting of the company, the sales manager reports that one of its competitors is going to launch a product similar to DC. As a result, he expects that the sales volume of DC will drop to 48 000 units in 2013 if its selling price is maintained at $49.5 per unit. The management prefers not to have any price deduction in the local market, and is considering adopting one of following alternatives in 2013 to solve the problem:

Alternative A
The company pays an additional sales commission of 10% on the selling price, and increases advertising expenses by $52 500 per annum. By doing so, the expected sales volume of DC is 76 000 units.

Alternative B
The company produces and sells 48 000 units in the local market, and uses its excess capacity to accept an offer from a mail-order house to sell at most 40 000 units of DC to overseas markets at a unit selling price of $37.5. Under the agreement, no sales commission is to be paid to the mail-order house but a total of $25 000 per month is to be paid by Lucky Company to cover the cost of producing the mail-order catalogue.

REQUIRED:

(b) Calculate the respective breakeven point (in units) of DC under Alternative A and Alternative B. (5 marks)

(c) Suppose Lucky Company has to choose one of the alternatives. Explain which alternative you would recommend to the management based on the respective total profits calculated under each alternative. (6 marks)

(d) Other than total profit, explain one financial factors that Lucky Company should consider if it decides to adopt Alternative B. (2 marks)

Suppose the Company adopts Alternative A and considers reducing the cost of production through production process automation. If a piece of equipment with a rental cost of $125 000 per annum is hired, the direct labour cost is expected to be reduced by 40%.

(e) Should Lucky Company hire the equipment? Support your answer with calculations. (3 marks)

(Total: 20 marks)

9. After closing all the nominal accounts and preparing the draft income statement, the ledger balances of Dragon Ltd as at 31 December 2011 are as follows:

	Dr.	Cr.
	$	$
$2 Ordinary shares, fully paid		4 000 000
Share premium		319 000
Retained profits as at 31 December 2011		996 500
Inventory as at 31 December 2011	545 000	
Property, plant and equipment		
– Cost	4 800 000	
– Accumulated depreciation as at 31 December 2011		1 240 000
Trade receivables and trade payables	716 400	691 500
Prepayment [note (vi)]	424 800	
Cash at bank	760 800	
	7 247 000	7 247 000

During the internal audit process, the following items were discovered:

(i) The management of the company decided to provide allowance for doubtful debts starting from 2011. An allowance of 5% on outstanding trade receivables should be provided for the year ended 31 December 2011, but no entries had been made in the books.

(ii) To finance the expansion of the business, the authorised share capital of $5 000 000 was increased to $15 000 000 on 15 December 2011. On the same date, 600 000 ordinary shares of $2 each had been issued at $6 each. All the monies subscribed had been received and shares had been allotted on 28 December 2011. However, no entries had been made in the books.

(iii) On 1 December 2011, a five-year 2% debenture of $900 000 in total had been issued at par. Debenture interest is payable on 31 March and 30 September each year. All the monies subscribed were duly collected. In order to obtain the cash discount of 4% from a supplier, one-quarter of the monies collected was used to pay the supplier during the discount period as the full settlement of its account. However, entries regarding all the above transactions were omitted from the books.

(iv) A piece of equipment with both cost and accumulated depreciation of $726 000 on 1 January 2011 was sold for $156 000 on the same date. The transaction was recorded in the books as cash sales of $165 000.

(v) On 31 December 2011, the board of directors of the company resolved to transfer $135 000 to the general reserve. However, no entries had been made in the books.

(vi) During the year 2011, advertising expenditure amounting to $424 800 had been incurred and paid. The company estimated that the sales volume could be increased by 5% and 15% in 2012 and 2013 respectively as a result of the advertising. The book-keeper had therefore recorded the payment for advertising as a prepayment in 2011, to be written off as expenses in 2012 and 2013.

REQUIRED:

(a) Prepare for Dragon Ltd

(1) the journal entries necessary for correcting the errors and the omission in (i) to (vi) above (narrations are not required); and (10 marks)

(2) the statement of financial position as at 31 December 2011 after taking into the account the above adjustments. (7 marks)

(b) Comment on the accounting treatment of advertising expenditure in item (vi). (3 marks)

(Total: 20 marks)

END OF PAPER