2018-DSE
BAFS

PAPER 2A

HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY

HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION 2018

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 financial year for Mary's business ends on 31 December. The business keeps the following books of original entry: General Journal, Sales Journal, Purchases Journal, Returns Inwards Journal, Returns Outwards Journal and Cash Book.

During December 2017, the following transactions took place:

(i) Paid rent of $18 400 by autopay.

(ii) Bought goods from Amy Company on credit for $4 200.

(iii) Returned goods of $300 to Amy Company.

(iv) Goods amounting $560 were taken away by Mary for her personal use.

(v) Sold goods to Carmen Company on credit for $1 580.

(vi) Issued and sent a credit note for goods returned of $500.

(vii) Received an electricity bill of $5 600 for December 2017, which would be settled by cheque in January 2018.

(viii) Cash sales of $1 500 to Dick Company.

(ix) Issued and sent a debit note for goods returned of $600.

(x) Bought a motor van on credit for $17 000.

REQUIRED:

(a) Indicate which of Mary's books of original entry should be used to record transactions (i) to (x) above in December 2017. (5 marks)

(b) With reference to transaction (iii) above, state the accounts and the corresponding ledgers to be posted from the book of original entry. (2 marks)

(c) Give one function of keeping books of original entry. (1 mark)

(Total: 8 marks)

2. The cash at bank account of Sonic Company showed a debit balance of $50 000 as at 31 December 2017 and it did not agree with the balance in the bank statement on that date. The following information relating to the financial year ended 31 December 2017 was available:

(i) Cheque #245896 for $33 500 from a customer was dishonoured and returned by the bank. The bookkeeper recorded the amount as $3 500 when the cheque was returned.

(ii) The cash at bank account included a cheque #723958 for $6 300, dated 3 January 2018, which was a settlement to a supplier.

(iii) Cheque #723881 for $10 390, which was issued to a supplier on 18 July 2017, was recorded in the books, but had not been shown on the bank statements of 2017.

(iv) It was found that a cheque #465793 dated 28 April 2017 for $4 430, which was received from a customer, was still kept in the drawer of the bookkeeper on 31 December 2017. It had been recorded in the cash at bank account upon receipt in May 2017. It is the bank's practice not to honour cheques outstanding for more than six months.

(v) Cheque #723912 for $9 310 had been issued to a supplier on 22 November 2017. The cheque was lost in transit but no entries had been made in respect of its cancellation.

(vi) Cheque #325698 for $4 100 was deposited in the bank and recorded in the books on 29 December 2017, but it had not been credited by the bank on 31 December 2017.

REQUIRED:

(a) For Sonic Company,

(i) update the cash at bank account. (4 marks)

(ii) write up a bank reconciliation statement as at 31 December 2017. (2 marks)

(b) What is a post-dated cheque? Indicate the cheque number of the post-dated cheque from the above information. (2 marks)

(Total: 8 marks)

3. Sang Manufacturing Company commenced its business in 2017. It uses the absorption costing system. All finished goods were sold in 2017. The information for the year ended 31 December 2017 is given below:

Sales	$150 000
Net profit	$48 000
Prime cost	$49 920
Direct materials	$180 per metre, 100 metres are required
Direct expenses	$7 000
Direct labour cost	?
Manufacturing overheads absorbed	?
Administrative and selling expenses	20% of total manufacturing cost

REQUIRED:

(a) Prepare for Sang Manufacturing Company the income statement for the year ended 31 December 2017 using the absorption costing system. Show separately the components of the prime cost and the manufacturing overheads absorbed. (6 marks)

(b) Calculate the total amount of conversion cost of year 2017. (1 mark)

(c) Give one example of a direct expense. (1 mark)

(Total: 8 marks)

SECTION B (36 marks)

Answer **ALL** questions in this section.

4. Jay and Joe were in partnership sharing profits and losses in the ratio of 3:2, the balances of their capital accounts as at 1 January 2017 were $229 000 and $144 000 respectively. On the same date, Tom was admitted to the partnership with the following arrangements:

   (i) Jay, Joe and Tom would share profits and losses in the ratio of 3:3:4 and Tom would be paid a monthly salary of $22 000 by cheque at the end of each month.

   (ii) Goodwill was to be valued at $80 000. All other assets were to be revalued upwards by $120 000. The new partnership would not keep a goodwill account.

   (iii) Interest on drawings of 5% per annum would be charged while interest on capital of 4% per annum would be calculated on the beginning balances of the capital accounts.

   (iv) Tom had to bring in sufficient funds so that his capital account balance would amount to 40% of the total capital of the new partnership.

   (v) The new partnership would maintain fixed capital accounts.

   REQUIRED:

   (a) Prepare the partners' capital accounts in columnar form, showing the admission of Tom. (4 marks)

   After a year of operation, the following information was extracted from the books of the new partnership for the year ended 31 December 2017:

		$
Sales		4 002 600
Cost of goods sold		1 085 400
Operating expenses (including annual salary paid to Tom)		2 412 000
Interest expenses (including the interest on capital)		75 600
Drawings	- Jay (withdrawn on 1 May 2017)	180 000
	- Joe (withdrawn on 1 July 2017)	120 000

   REQUIRED:

   (b) Prepare the appropriation account of the partnership for the year ended 31 December 2017. (6 marks)

   (c) Briefly explain whether the balance of Tom's current account as at 31 December 2017 would include the annual salary he was entitled to for 2017. (1 mark)

(Total: 11 marks)

5. The account balances of Rocky Company Limited as at 31 December 2016 and 31 December 2017 are given below:

	2016	2017
	$	$
3% Long-term loan	753 800	180 000
5% Short-term loan	--	90 000
Accrued expenses	8 200	15 000
Cash at bank	33 500	128 000
Equipment, net	782 000	663 000
Inventory (31 December)	136 500	364 000
Ordinary share capital	200 000	700 000
Retained profits (31 December)	42 000	158 000
Trade payables	58 000	202 000
Trade receivables	110 000	190 000

Additional information:

(i) All sales were made on credit and total sales for the year 2017 were $780 000. 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 included in the closing inventory of the company, but no entries were made in respect of this return.

(ii) Total purchases for the year 2017 amounted to $778 050, of which 80% were credit purchases and 20% cash purchases.

REQUIRED:

(a) Calculate (to two decimal places) the following ratios for 2017 (365 days a year):

(i) working capital ratio

(ii) inventory turnover (in times)

(iii) average trade receivables collection period (in days)

(iv) average trade payables repayment period (in days)

(8 marks)

(b) (i) Calculate (to two decimal places) the gearing ratios of Rocky Company Limited for 2016 and 2017. (2 marks)

(ii) Comment on the solvency of Rocky Company Limited for 2017. (3 marks)

(Total: 13 marks)

6. Yummy Limited is a dim sum restaurant. Its monthly operation details for 2018 are as follows:

Average number of customers per month	35 000
Average sales revenue per customer	$100
Variable production cost	45% per revenue dollar

	$
Monthly fixed costs:	
Rent	350 000
Salary	741 000
Depreciation	81 970
Other operating expenses	316 000

The following changes in costs are expected for 2019:

- increase in variable production cost to 48% per revenue dollar
- increase in monthly rent by 15% when the lease contract is renewed at the beginning of 2019
- increase in salary and other operating expenses by 5%

REQUIRED:

(a) Calculate the monthly margin of safety for Yummy Limited in 2019 (in sales dollars). (4 marks)

The Hong Kong Government has invited investors to join the Food Truck Pilot Scheme. The trial period is two years. Yummy Limited has idle capacity and is considering joining this project in 2019. It has estimated the costs and revenues related to the project as follows:

(i) The cost of a new truck is $1 000 000, with an estimated residual value of $300 000 at the end of 2020.

(ii) Equip the truck with refrigerators, air-conditioning and new cooking facilities at a cost of $604 000.

(iii) Annual fixed costs include salary of $600 000 and other costs (excluding depreciation) of $528 000. A set of idled cooking stoves of the restaurant with a net book value of $20 000 as at 1 January 2019 will be installed in the food truck.

(iv) The variable production cost of the dim sum sold by both the restaurant and the food truck will be 48% per revenue dollar during the two-year trial period.

(v) It is estimated that the project would bring in monthly revenues as follows:

- sales revenue of the food truck: average sales revenue per customer $80, with a total of 3 000 customers
- sales revenue of the restaurant: attract additional 1 500 customers, average sales revenue of $100 per customer

REQUIRED:

(b) (i) Prepare for Yummy Limited a statement to calculate the incremental revenues and incremental costs for the whole project. (5 marks)

(ii) Based on the calculation in (b)(i), briefly explain whether Yummy Limited should join the Food Truck Pilot Scheme. (1 mark)

(c) Define 'sunk cost'. Identify one example of a sunk cost for Yummy Limited in respect of the food truck project. (2 marks)

(Total: 12 marks)

SECTION C (20 marks)

Answer **ONE** question in this section.

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

	$
Equipment	2 020 000
Accumulated depreciation - Equipment, 1 January 2017	1 060 000
Inventory, 1 January 2017	930 000
Sales	4 470 000
Returns inwards	60 000
Purchases	2 467 000
Operating expenses	757 000
General reserve	20 000
4% Debenture (Issued on 1 July 2017)	800 000
Retained profits, 1 January 2017	74 000

Additional information:

(i) In 2017, all sales were made at a mark-up of 50%.

(ii) On 1 May 2017, a piece of old equipment was traded in for a new model which cost $62 000, at a trade-in value of $21 000. The old equipment was purchased on 1 March 2015 at a cost of $50 000. The bookkeeper debited $62 000 in the equipment account and credited the same amount in the cash at bank account without making any other entries for the above trade-in arrangement.

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.

(iii) On 29 December 2017, the company received a purchase order from a customer for goods priced at $270 000. The bookkeeper recorded the order as credit sales for the year 2017, though the goods were to be delivered to the customer on 4 January 2018.

(iv) Operating expenses of $757 000 were paid during the year 2017, of which 45% were selling and distribution expenses while the rest were administrative expenses. Depreciation expenses, loss on disposal and directors' fees are classified as administrative expenses.

(v) Estimated profits tax of $12 500 for the year 2017 had not been recorded in the books. Besides, directors' fees of $130 000 for the year 2017 were to be paid in 2018.

(vi) On 31 December 2017, the board of directors resolved to increase the general reserve to $30 000.

(vii) Information on dividends for the years 2016 and 2017 is as follows:

Details	Declared and paid	$
2016 Final dividend	March 2017	48 000
2017 Interim dividend	September 2017	23 000
2017 Final dividend	March 2018	42 000

REQUIRED:

(a) Prepare for KK Company Limited,

(i) the income statement for the year ended 31 December 2017, showing all the necessary items including purchases, profit before tax and profit after tax. (10 marks)

(ii) a statement to calculate the retained profits as at 31 December 2017. (3 marks)

(b) Briefly explain, with a relevant accounting principle or concept, the accounting treatment of item (iii) above. (3 marks)

Having prepared the income statement, the directors of KK Company Limited have the following queries:

Director Ma: I was told that the depreciation policy could not be changed, otherwise the consistency principle would be violated. Is that right?

Director Lo: The balance of the general reserve has been increasing over the past few years. Will this affect our ability to pay dividends?

REQUIRED:

(c) With reference to Director Ma's query, state two reasons for adopting the consistency principle when preparing the financial statements. (2 marks)

(d) With reference to Director Lo's query, explain whether the increase in the balance of the general reserve would affect the company's ability to pay dividends. (2 marks)

(Total: 20 marks)

8.

(A) After the preparation of the income statement for the year ended 31 December 2017, Bright Company Limited had the following account balances:

	Dr	Cr
	$	$
Retained profits, 31 December 2017		777 060
Share capital		1 800 000
Trade payables		507 700
Accrued expenses		62 700
Motor vehicles, net	2 017 100	
Trade receivables, net	294 000	
Cash at bank	447 400	
Inventory	403 040	
Suspense (note iv)		14 080
	3 161 540	3 161 540

Additional information:

(i) Bad debts of $9 700 had not been recorded in the books.

(ii) The allowance for doubtful accounts, which had been provided at 2% on trade receivables, would be increased to 3% after a review of the economic environment.

(iii) On 31 December 2017, an invoice for a staff training programme of $80 000 for ten lessons was received and the amount was to be settled in January 2018. The first four lessons were conducted in December 2017 while the remaining six lessons would be conducted in January 2018. No entries were made in the books to record the above.

(iv) The balance of the suspense account related to an advance payment of management fees for January 2018. The bookkeeper wrongly debited the same amount both to the cash at bank account and the management fees account in 2017.

(v) A motor vehicle, which was purchased for $150 000 in 2013, was damaged in a traffic accident and then sold for $50 000 in December 2017. No entries were made in the books regarding the disposal except that the amount received was recorded as a cash sale.

It is the company's policy to charge depreciation on motor vehicles at a rate of 20% per annum on a reducing-balance basis. A full year's depreciation on motor vehicles 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. (8 marks)

(b) Prepare for Bright Company Limited the statement of financial position as at 31 December 2017. (8 marks)

(B) Fancy Limited will start manufacturing three products, Product A, Product B and Product C in June 2018. The monthly full capacity is estimated at 20 000 direct labour hours. In April 2018, Fancy Limited signed a non-cancellable sales contract with a customer to deliver 1 000 units of Product A in June 2018. This sales contract has been included in the sales forecasts of June 2018.

The sales forecasts and cost information for June 2018 are as follows:

	Product A	**Product B**	**Product C**
Sales forecasts	1 400 units	1 200 units	1 600 units
Unit price	\$220	\$660	\$480
Raw material price per kg	\$60	\$80	\$70
Raw material usage per unit	0.5 kg	0.5 kg	0.5 kg
Direct labour hours per unit	3 hours	8 hours	5 hours
Wage rate per hour	\$40	\$40	\$40
Variable overheads per unit	\$10	\$10	\$10

REQUIRED:

To maximise the total contributions of Fancy Limited at its full capacity, calculate the production quantity for each of the three products in June 2018. (4 marks)

(Total: 20 marks)

END OF PAPER