2023-DSE
BAFS

PAPER 2A

HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY

HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION 2023

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 Section A are compulsory. You are required to **answer two of the three questions in Section B** and 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, weighting 30%)

Answer **ALL** questions in this section.

1. (A) A company has been awarded 'Corporate Social Responsibility Award' as a means of recognising its contributions to promoting environmental sustainability. The owner is thinking about recording this award in the books.

REQUIRED:

(a) Explain, with the most relevant accounting principle or concept, whether the award should be recorded in the books. *(3 marks)*

(B) The following are some measurement bases and accounting principles/concepts:

Measurement base

- Cost
- Fair value
- Liquidation value
- Net book value
- Net realisable value

Accounting principle/concept

- Business entity
- Going concern
- Historical cost
- Objectivity
- Prudence

	Situation	Measurement base	Accounting principle/concept
(i)	Due to spoilage, the net realisable value of the goods in the warehouse fell below its cost.	Net realisable value	(1)
(ii)	A company plans to cease trading next year. The liquidation value of its factory building is different from the net book value at current financial year end.	(2)	(3)
(iii)	The owner brought his photographic equipment, which was acquired two years ago, into the business. A professional valuer estimated that the fair value of the equipment was higher than its cost.	(4)	(5)

REQUIRED:

(b) Referring to the measurement bases and accounting principles/concepts given above, state the measurement base to be recorded in the books and identify the most relevant accounting principle/concept for the determination of the measurement base for each of the situations (i) to (iii).

Write your answers for items (1) to (5) in the answer book. (5 marks)

(Total: 8 marks)

2. Tim Limited made all purchases and sales on credit. The following information for 2022 is available:

	$
Inventory, 1 January 2022	280 000
Sales for 2022	930 000
Average trade payables for 2022	296 000
<u>Account balance as at 31 December 2022</u>	$
Non-current assets, net	1 690 000
Trade receivables	220 000
Bank	486 000
Inventory	320 000
<u>Ratio of Tim Limited for 2022</u>	
Trade payables turnover	4.5 times
Earnings per share	$2.6

On 31 December 2022, the market price of the ordinary shares of Tim Limited was $16 each.

The industry average of the total assets turnover for 2022 was 0.42 times.

REQUIRED:

(a) Calculate (to two decimal places) the following ratios for 2022:

(1) price-earnings ratio (2 marks)

(2) total assets turnover (in times) (2 marks)

(3) inventory turnover (in times) (2 marks)

(b) Based on the total assets turnover, briefly comment on the management efficiency of Tim Limited for 2022. (2 marks)

(Total: 8 marks)

3. Jacky Company is a watch manufacturer established on 1 January 2022. In its first year of operations, the production quantity and sales quantity of watches were 8 000 units and 6 500 units respectively. The information for the year ended 31 December 2022 is given below:

(i) The fixed manufacturing overheads for 2022 were budgeted at $1 728 000. The company uses the absorption costing system and absorbs the fixed manufacturing overheads based on direct labour hours.

(ii) It was estimated that 28 800 direct labour hours would be used in 2022.

(iii) The following actual data for the year ended 31 December 2022 is provided:

	$
Sales	5 200 000
Direct materials purchased	700 000
Inventory of direct materials, 31 December	164 000
Direct labour cost (hourly wage rate $50)	1 400 000
Fixed manufacturing overheads	1 920 000
Administrative overheads	493 000

REQUIRED:

(a) Calculate the under-absorption or over-absorption of fixed manufacturing overheads for 2022. (3 marks)

(b) Based on the predetermined fixed manufacturing overhead absorption rate, prepare for Jacky Company,

(1) a statement to calculate the unit cost of goods manufactured in 2022. (2 marks)

(2) an income statement for the year ended 31 December 2022, showing the under-absorption or over-absorption of fixed manufacturing overheads. (3 marks)

(Total: 8 marks)

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SECTION B (24 marks, weighting 45%)

Answer **TWO** questions in this section.

4. Candy is a sole trader operating a garment trading business. After preparing the closing entries, the firm drafted the following trial balance as at 31 December 2022:

	Dr	Cr
	$	$
Motor vans	420 000	
Accumulated depreciation - Motor vans		168 000
Inventory	136 000	
Trade receivables	290 000	
Trade payables		9 000
Cash	10 000	
Bank overdraft	8 000	
Capital, 31 December 2022		671 000
Suspense		16 000
	864 000	864 000

After investigation, the following errors were identified:

(i) The closing inventory value was wrongly calculated. The weighted average cost method should be used for inventory valuation. Information relating to the inventory is provided as below:

	Quantity	Purchase cost per unit
	Unit	$
Opening inventory	100	800
Total purchases for the year	250	835
Closing inventory (based on physical inventory count)	170	?

(ii) A store room of the office was sublet to Candy's friend. Total cash receipt for the rental period from 1 January 2022 to 31 March 2023 was $140 000, of which $20 000 was a rental deposit to be refunded at the end of the rental period. Candy mistakenly recorded the whole amount in the rental income account of 2022.

(iii) A water bill of $5 800 for the last quarter of 2022 was received in early January 2023. No record was made in the books of 2022.

(iv) In November 2022, Candy received a debit note of $7 000 for goods returned, but no entries were made for this return.

(v) Cash of $2 200 received from a credit customer was wrongly recorded as a settlement of outstanding amount to a supplier of stationery.

(vi) The bank overdraft balance was listed in the wrong column of the trial balance.

REQUIRED:

(a) Prepare the necessary journal entries to correct the above errors. Narrations are not required. (10 marks)

(b) With reference to item (iii) above, explain the difference in the recognition of expense between cash accounting and accrual accounting. (2 marks)

(Total: 12 marks)

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5. (A) The following are the account balances extracted from the books of Windy Limited as at 1 January 2022:

	$
Ordinary share capital (800 000 shares)	2 800 000
Retained profits	560 000
General reserve	250 000

Additional information:

(i) The company raised funds in 2022 for future expansion. Details are as follows:

Date	Transaction
2 April	Received subscriptions for 350 000 ordinary shares of $4.5 each and recorded in the 'share application and allotment account'.
8 April	Allotted 200 000 ordinary shares to successful applicants.
11 April	Refunded to unsuccessful applicants.
1 August	Issued a ten-year 3% debenture of $1 000 000.

(ii) Net profit before interest and tax for the year ended 31 December 2022 amounted to $540 000.

(iii) Profits tax for the year was estimated at $65 000.

(iv) The board of directors declared and paid an interim ordinary dividend of $0.15 per share in July 2022. Final ordinary dividend of $0.1 per share for 2022 was declared in January 2023.

(v) On 31 December 2022, the board of directors resolved to increase the general reserve to $380 000.

REQUIRED:

(a) Prepare for Windy Limited,

(1) the journal entries to record the allotment of ordinary shares and the refund to unsuccessful applicants in April 2022. Narrations are not required. (2 marks)

(2) a statement to calculate the retained profits as at 31 December 2022. (4 marks)

(B) The management of Windy Limited is considering replacing the existing delivery van with an electric van. The following information is available:

(i) The existing delivery van, with a net book value of $80 000, has a remaining useful life of four years. Additional cost of $70 000 would be incurred to extend its useful life to six years, with no expected residual value.

(ii) The list price of the new electric van and the trade-in value of the existing delivery van are $630 000 and $50 000 respectively. The estimated useful life of the new electric van is six years and its residual value is expected to be $30 000.

(iii) Using the new electric van will save a running cost of $90 000 per year.

REQUIRED:

(b) Define 'sunk cost', and give an example of a sunk cost from the above case. (2 marks)

(c) Briefly explain, with supporting calculations in statement form, whether Windy Limited should replace the existing delivery van with an electric van. (4 marks)

(Total: 12 marks)

6. (A) Super Company is a stationery producer. On 1 July 2021, it acquired four machines costing $36 000 each. The estimated useful life of the machines was five years and the residual value of each was $3 000. It is the company's policy to charge depreciation on machinery using the straight-line method on a monthly basis.

On 1 October 2022, one of the machines was traded in for a new model that costs $80 000 for the production of rulers. The trade-in value of the old model was $25 000. Depreciation of the new machine is to be provided based on production quantity. It was expected that the total production quantity of the new machine would be 500 000 units. The actual production quantity for the last quarter of 2022 was 75 000 units.

REQUIRED:

(a) Prepare the following accounts for the year ended 31 December 2022:

(1) Accumulated depreciation account – machinery (3 marks)

(2) Disposal account – machinery (2 marks)

(B) Super Company produces and sells two types of stationery: rulers and ball pens. The following is the budgeted data for June 2023:

	Ruler	Ball pen
Estimated demand	20 000 units	40 000 units
Selling price per unit	$3	$4.5
Production requirement per unit	0.4 machine minutes	0.8 machine minutes
Variable production cost per unit	$1.4	$2.2

Budgeted fixed production cost and fixed administrative cost are $50 000 and $13 400 respectively.

REQUIRED:

(b) Explain the meaning of 'margin of safety'. (1 mark)

(c) Assume the stationery is sold in packages, with one ruler and two ball pens in each package, calculate:

(1) the contribution margin per sales mix. (2 marks)

(2) the sales quantity of each type of stationery, to achieve a target profit of $66 800 for June 2023. (2 marks)

Assume there will be only 39 000 machine minutes available in June 2023 due to scheduled maintenance. To maximise the total contribution at its full capacity, Super Company decides to sell the rulers and ball pens separately rather than in packages.

REQUIRED:

(d) Calculate the production quantity for each type of stationery in June 2023. (2 marks)

(Total: 12 marks)

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SECTION C (20 marks, weighting 25%)

Answer **ONE** question in this section.

7. Chan and Chow have been in partnership, operating a retail shop for many years. The financial year of the partnership ends on 31 December.

   The partnership agreement includes the following terms:

   - Chan and Chow would share profits and losses in the ratio of 2:3.
   - Interest on capital of 8% per annum would be calculated on the opening balances of the capital accounts.
   - Interest on drawings of 5% per annum would be charged.
   - Chan was entitled to a monthly salary of $20 000.

   The following account balances were extracted from the books of the partnership as at 31 December 2022:

	Dr	Cr
	$	$
Furniture, net	950 000	
Delivery vans, net	650 000	
Inventory, 31 December 2022	230 000	
Trade receivables	257 000	
Trade payables		165 000
Long-term bank loan		360 000
Bank	346 000	
Net profit before appropriations		41 000
Capital accounts:		
– Chan		600 000
– Chow		900 000
Current accounts:		
– Chan		228 600
– Chow		348 400
Drawings:		
– Chow (withdrawn on 1 May 2022)	210 000	
	2 643 000	2 643 000

   Before preparing the appropriation account, the following errors were found:

   (i) Inventory as at 31 December 2022 was overstated by $21 000.

   (ii) The bookkeeper recorded credit sales of $40 000 twice.

   (iii) The interest on capital to partners and the annual salary to Chan were paid at the end of 2022, but they were recorded as operating expenses for the year.

   REQUIRED:

   (a) Prepare the appropriation account of the partnership for the year ended 31 December 2022. (5 marks)

On 1 January 2023, Chan retired and Chow invited his friend Ching to join the partnership with the following arrangements:

(iv) Chow and Ching would share profits and losses equally.

(v) Goodwill was to be valued at $250 000. The new partnership would not keep a goodwill account in the books. The adjustments for goodwill between partners would be made in the capital accounts directly.

(vi) The furniture was to be revalued at $980 000 while the delivery vans were to be revalued downwards by 10% of the net book value. The partnership paid a professional fee of $10 000 by cheque for revaluing the non-current assets, but this fee had not yet been recorded in the books.

(vii) Inventory was to be written down by $22 000.

(viii) To settle Chan's account, the partnership would issue a cheque for $320 000 to him on his retirement date. The remaining amount would be left as a half-year interest-free loan to the new partnership.

(ix) The agreed total capital balance of the new partnership would be $2 000 000, to be contributed by Chow and Ching equally. Any surplus or deficit of Chow's capital account would be adjusted through his current account. Ching had to repay the long-term bank loan on behalf of the partnership, and bring in a new delivery van valued at $270 000, together with sufficient funds by cheque so that his capital account would meet the agreed balance.

REQUIRED:

(b) Prepare the following to record the retirement of Chan and the admission of Ching:

(1) the revaluation account (2 marks)

(2) the partners' capital accounts in columnar form (6 marks)

(3) the statement of financial position for the new partnership as at 1 January 2023 (5 marks)

(c) Briefly explain whether the interest-free loan stated in (viii) above would affect the solvency of the new partnership. (2 marks)

(Total: 20 marks)

8. Mr Wong is a sole trader engaging in the computer accessories retail business. On 31 December 2022, a fire broke out in the warehouse. Except for goods costing $65 000 kept in the retail shop, all inventory was destroyed. Many accounting records were lost in the fire.

After investigation, the following information is available:

(i) Some account balances of the business as at 1 January 2022 were confirmed as follows:

	$
Equipment	830 000
Accumulated depreciation – equipment	298 800
Inventory	238 000
Trade receivables	360 000
Allowance for doubtful accounts	10 800
Trade payables	250 000

(ii) Based on the bank statements, a summary of receipts and payments for 2022 was prepared as follows:

	$	$
Balance as at 1 January 2022		380 500
Receipts		
Cash sales	350 000	
Cheques received from credit customers	930 000	1 280 000
		1 660 500
Payments		
Cheques issued to suppliers	810 700	
Administrative expenses	247 500	
Purchase of equipment	180 000	1 238 200
Balance as at 31 December 2022		422 300

(iii) On 31 December 2022, cheques totalled $38 100 issued to suppliers were not yet presented for payment. Cheques of $17 600 received from customers were also deposited but not yet credited by the bank.

(iv) A direct debit of $2 500 for management fee was mistakenly made by the bank on 30 December 2022. The bank should have debited the account of another customer. The bank informed Mr Wong that the adjustment would be made in early January 2023.

(v) Sales were made both in cash and on credit, while purchases were made on credit and settled by cheque. Goods were normally sold at a mark-up of 60%.

(vi) Cash sales for 2022 included some outdated goods, which were sold at cost of $5 000 to a customer. Cash sales were banked after deducting Mr Wong's drawings of $11 000 per month.

(vii) In October 2022, a customer who made a purchase for $8 800 in March 2022 was declared bankrupt.

(viii) During the year, goods returned by credit customers amounted to $26 000 whereas discounts received amounted to $1 500.

(ix) In November 2022, the business deposited a cheque of $4 000 received from a credit customer into the bank. The cheque was for settlement of the debt which had been written off in 2021.

(x) Mr Wong confirmed that the amount due from customers and the amount due to suppliers as at 31 December 2022 were $309 000 and $245 000 respectively. An allowance for doubtful accounts of 3% on the balance of the trade receivables account was to be provided on 31 December 2022.

(xi) Depreciation of 20% per annum is to be charged on equipment using the reducing-balance method. A full year's depreciation is to be provided in the year of acquisition.

(xii) The insurance company agreed to compensate 80% of the inventory destroyed in the fire.

REQUIRED:

(a) Prepare a bank reconciliation statement as at 31 December 2022, commencing with the balance as per bank statement. (3 marks)

(b) Prepare the following for the year ended 31 December 2022:

(1) trade receivables account (3 marks)

(2) allowance for doubtful accounts account (2 marks)

(3) an income statement (12 marks)

(Total: 20 marks)

END OF PAPER