SKH Leung Kwai Yee Secondary School

First Term Examination 2009/10

F.4 CDE Business, Accounting and Financial Studies

11.1.2010

8:30 am – 10:30 am

Time allowed: 2 hours

This paper must be answered in English

Setter: WHF

Full Marks: 100

Instructions:

1. Answer **ALL** Questions.
2. Write your answers on the answer sheets provided.
3. Show your workings.

Section A

Multiple Choices (2 marks each)

1. What is double entry system?
   A. Each transaction is recorded twice in different accounts.
   B. Each transaction is recorded twice in the same accounts.
   C. Each transaction is to debit account(s) and credit account(s) with the same amount.
   D. Each transaction is recorded by two persons.

2. Which of the following best describes the meaning of 'Purchases'?
   A. Everything bought by the firm
   B. Items bought on credit
   C. Items bought by cash
   D. Items bought for resale

3. Unsold stock (closing stock) is recorded as follows:
   A. Debit Stock account, Credit Trading account
   B. Debit Stock account, Credit Sales account
   C. Debit Trading account, Credit Stock account
   D. Debit Purchases account, Credit Stock account

4. Which of the following is NOT true?
   A. A trial balance is a list of balances on the books
   B. The trial balance totals should agree
   C. The trial balance is not part of double entry system
   D. There would be no errors if the trial balance totals are in agreement

5. A statement of financial position (balance sheet) is ___________________.

   A. a list of debits and credits
   B. one of the accounts in the ledger
   C. prepared to find out how much profit or loss was made during a period
   D. a statement of outstanding balances after the preparation of profit and loss account

6. Which of the following accounts of BAFS Limited will be credited when there is an increase in amount?

   (1) Electricity expense
   (2) Loan from XYZ Company
   (3) Loan to ABC Company
   (4) Purchases returns
   (5) Rent received
   (6) Sales returns

   A. (1), (2) and (4) only
   B. (1), (3) and (6) only
   C. (2), (4) and (5) only
   D. (3), (5) and (6) only

7. The proprietor of a business draws cash from his private savings to settle the amount owed to a creditor of the business. The ledger entries should be:

   A. Dr Accounts Payable account ……… Cr Bank account
   B. Dr Accounts Payable account ……… Cr Capital account
   C. Dr Drawings account ………………. Cr Accounts Payable account
   D. Dr Drawings account ………………. Cr Bank account

8. On 14 February 2009, Biz Company issued a sales invoice to Tsang Ltd for 40 units of goods at $100 each, less 25% trade discount. Cash discount of 5% would be allowed for settlement within 7 days. Biz Company finally received the payment on 20 February 2009. Which of the following are the correct journal entries to be made in the books of Tsang Ltd for the above?

		Debit	Credit
		$	$
A.	Biz Company	3,000	
	Sales		3,000
	Bank	2,850	
	Discounts allowed	150	
	Biz Company		3,000

B.

Biz Company	4,000	
Sales		4,000
Bank	2,850	
Discounts allowed	1,150	
Biz Company		4,000

C.

Purchases	3,000	
Biz Company		3,000
Biz Company	3,000	
Bank		2,850
Discounts received		150

D.

Purchases	3,000	
Biz Company		3,000
Biz Company	3,000	
Bank		3,000

9. The going concern concept means that when preparing accounts, a firm is assumed to continue in operational existence for the foreseeable future ________________.
   A. and will not cease trading
   B. and has no intention to liquidate
   C. but at a level of activity significantly less than the current level of activity
   D. and had no intention to liquidate or reduce significantly the scale of operation

10. Mr Chan, a sole trader, purchased a specialized machine for the business and paid the purchase invoice by a personal cheque. The machine was listed on the statement of financial position at its original cost of $3,000,000 although it could only be realized for $800,000 if the business was discontinued.
    Which of the following accounting concepts is NOT applicable to the above situation?
    A. accrual
    B. business entity
    C. going concern
    D. historical cost

Section B Conventional Questions

Answer **ALL** questions from this section.

Question 1

On 1 December 2009, the books of Raymond included the following balances:

	$	
Yim	1,000	Dr
AB Co.	700	Cr
PQ Ltd.	1,200	Cr

Raymond had the following transactions in December 2009.

Dec	1	Cash in hand $5,000. Cash at bank $11,700.
	2	Bought goods on credit from AB Co. $8,500, PQ Ltd. $ 6,500
	4	Purchased typewriter for $4,230 on credit from Yau.
	5	Sold goods on credit to Yim $5,000 and Leung $4,000. Both of them received a 10% trade discount.
	8	Paid $780 for the costs of carriage inwards in cash.
	10	Returned goods of $1,500 to PQ Ltd.
	12	Bought goods by cheque for $2,000, less 10% trade discount.
	13	Half of the goods sold to Yim on 5th December was returned to us.
	17	Sold goods $2,700 to Chan for cash.
	20	Put $4,000 office cash into bank.
	21	Paid AB Co. a cheque of $8,800 in full settlement of his outstanding debt.
	22	Credit sales to Leung $6,000, less 10% trade discount.
	29	Both Yim and Leung settled their outstanding balances by cheque, deducting a 5% cash discount.

REQUIRED:

(a) Enter the above transactions in the **Sales Journal**, **Purchases Journal**, **Returns Inwards Journal**, **Returns Outwards Journal**, **Three-column Cash Book** and **General Journal** of Raymond for the month of December. (Balance off the cash book at the month end.)

(11 marks)

(b) Show the posting of entries to the relevant personal accounts and state in which Ledgers these accounts can be found. (11 marks)

(c) Show the transfer of monthly total to general ledger. (3 marks)

Question 2

The trial balance of Star Company at 31 December 2009 was as follows:

	$	$
Capital		3,220,962
Bank loan (repayable in 2012)		750,000
Office equipment	2,375,000	
Furniture and fittings	2,175,000	
Accounts receivables and accounts payable	910,500	574,908
Inventory, 1 Jan 2009	42,650	
Loan interest	30,000	
Purchases and Sales	2,235,614	6,062,500
Returns inwards and outwards	33,725	19,865
Carriage inwards	8,400	
Carriage outwards	13,000	
Discounts allowed and received	6,370	8,620
Wages and salaries	787,000	
Rent and rates	768,450	
Cash at bank	129,446	
Drawings	82,300	
Administrative expenses	597,100	
Selling and distribution expenses	442,300	
	10,636,855	10,636,855

Inventory as at 31 December 2009 amounted to $48,050.

REQUIRED:

(a) Prepare an income statement (in horizontal style) for the year ended 31 December 2009. (10 marks)

(b) Prepare a balance sheet (in horizontal style) as at 31 December 2009. (5 marks)

Question 3

The financial statements of LKY Company for the year ended 31 December 2009 and 2008 are as follows:

Balance sheet as at 31 December

	2009	2008
	$	$
Non-current assets	1,535,150	597,931
Current assets		
Inventories	1,346,000	1,094,000
Trade receivables	868,000	412,000
Other receivables	166,214	157,851
Bank	558,096	1,375,669
	2,938,310	3,038,520
Less: Current Liabilities		
Trade payables	(1,670,784)	(1,161,642)
Other payables	(1,486,676)	(1,325,269)
Net current assets / (liabilities)	(219,150)	551,609
	1,316,000	1,149,540
Less: Non-current Liabilities		
Bank loan	(312,597)	(368,491)
	1,003,403	781,049
Financed by:		
Capital		
Opening balance	781,049	602,143
Add: Net profit for the year	222,354	178,906
	1,003,403	781,049

Income statement for the year ended 31 December

	2009	2008
	$	$
Sales	2,743,000	2,038,000
Less: Cost of goods sold		
Opening inventory	1,094,000	1,124,072
Add: Purchases	2,222,567	1,399,000
	3,316,567	2,523,072
Less: Closing inventory	(1,346,000)	(1,094,000)
	(1,970,567)	(1,429,072)
Gross profit	772,433	608,928
Less: Operating expenses	(550,079)	(430,022)
Net profit	222,354	178,906

REQUIRED:

(a) Calculate the following ratios for the years 2008 and 2009 to one decimal place:

  (i) Gross profit ratio

  (ii) Net profit ratio

  (iii) Return on capital employed, using average of opening and closing capital balances

  (iv) Current ratio

  (v) Quick ratio (12.5 marks)

(b) Based on the ratios calculated in (a) above, briefly compare the profitability and liquidity for 2008 with that of 2009. (7.5 marks)

Question 4

For each of the independent situations described below, list the accounting principle or concept that has been violated and provide an explanation:

(a) Since 1 January 2009, the office had been sublet to a tenant for a monthly rent of $5,000. However, the rent for November and December had not been received yet. The accounts clerk recorded $50,000 as rental income in the profit and loss account. (4 marks)

(b) The property market is booming in 2009 and the accountant of the company believes the company's shop premises should worth $10 million now. He therefore updated the value of the shop premises to $10 million. The company bought the shop premises in 2007 for $8 million. (4 marks)

(c) The company has been adopting different methods to calculate depreciation on its motor vehicles for the past 4 years. (4 marks)

(d) The current liabilities of the company are much bigger than its current assets. In order to present a better liquidity position, the owner decides to include his personal bank account in the company's balance sheet. (4 marks)

(e) The company had been running at a loss during the past three years. Since costs of operation had been rising, the owner decided to close his business on 1 January 2010. In the balance sheet at 31 December 2009, the company listed the assets at their book values. (4 marks)

END OF PAPER

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Suggested Answers

Section A

Multiple Choices (2 marks each)

1. C
2. D
3. A
4. D
5. D
6. C
7. B
8. C
9. D
10. A

Section B Conventional Questions

<u>Question 1</u>

(a)

Sales Journal

2009		$	
Dec 4	Yim (5,000 × 90%)	4,500	
Dec 4	Leung (5,000 × 90%)	3,600	
Dec 22	Leung (5,000 × 90%)	5,400	
Dec 31	Total for the month	13,500	**1**

Purchases Journal

2009		$	
Dec 2	AB Co.	8,500	
Dec 2	PQ Ltd.	6,500	
Dec 31	Total for the month	15,000	**0.5**

Returns inwards Journal

2009		$	
Dec 13	Yim	2,250	**0.5**
Dec 31	Total for the month	2,250	

Returns outwards Journal

2009		$	
Dec 10	PQ Ltd	1,500	**0.5**
Dec 31	Total for the month	1,500	

Cash Book

		Dis. all.	Cash	Bank				Dis. rec.	Cash	Bank	
2009			$	$		2009			$	$	
Dec 1	Bal b/f		5,000	11,700	**1**	Dec 8	Carriage inwards		780		**0.5**
Dec 17	Sales		2,000		**0.5**	Dec 12	Purchases			1,800	**0.5**
Dec 20	Cash			4,000	**0.5**	Dec 20	Bank		4,000		**0.5**
Dec 29	Yim	162.5		3,087.5	**1**	Dec 21	AB Co.	320		8,800	**1**
Dec 29	Leung	450		8,550	**1**	Dec 31	Bal c/d		2,220	16,737.5	**1**
		612.5	7,000	27,337.5				320	7,000	27,337.5	

General Journal

		Dr	Cr	
2009		$	$	
Dec 4	Office Equipment (Typewriter)	4,230		**0.5**
	Yau		4,230	**0.5**

(b)

Purchases Ledger (**0.5**)

AB Co.

2009		$		2009		$	
Dec 21	Bank	8,880	**0.5**	Dec 1	Bal b/d	700	**0.5**
Dec 21	Discounts received	320	**0.5**	Dec 2	Purchases	8,500	**0.5**

Purchases Ledger (**0.5**)

PQ Ltd.

2009		$		2009		$	
Dec 10	Returns outwards	1,500	**0.5**	Dec 1	Bal b/d	1,200	**0.5**
				Dec 2	Purchases	6,500	**0.5**

General Ledger (**0.5**)

Yau

		$		2009		$	
				Dec 4	Office equipment	4,230	**0.5**

Sales Ledger (**0.5**)

Yim

2009		$		2009		$	
Dec 1	Bal b/d	1,000	**0.5**	Dec 13	Returns inwards	2,250	**0.5**
Dec 5	Sales	4,500	**0.5**	Dec 29	Bank	3,087.5	**0.5**
				Dec 29	Discounts allowed	162.5	**0.5**

Sales Ledger (**0.5**)

Leung

2009		$		2009		$	
Dec 5	Sales	3,600	**0.5**	Dec 29	Bank	8,550	**0.5**
Dec 22	Sales	5,400	**0.5**	Dec 29	Discounts allowed	450	**0.5**

(c)

General Ledger

Sales

		$		2009		$	
				Dec 31	Total	13,500	**0.5**

Purchases

2009		$				$
Dec 12	Bank	1,800				
Dec 31	Total	15,000	**0.5**			

Returns inwards

2009		$				$
Dec 31	Total	2,250	**0.5**			

Returns outwards

	$	2009		$	
		Dec 31	Total	1,500	**0.5**

Discounts allowed

2009		$			$
Dec 31	Total	612.5	**0.5**		

Discounts received

	$	2009		$	
		Dec 31	Total	320	**0.5**

Question 2

(a)

Star Company

Income statement for the year ended 31 December 2009

	$	$			$	$	
Opening Stock		42,650	**0.5**	Sales		6,062,500	**0.5**
Purchases	2,235,614		**0.5**	Less: Returns inwards		33,725	**0.5**
Less: Returns outwards	19,865	2,215,749	**0.5**				
Carriage inwards		8,400	**0.5**				
		2,266,799					
Less: Closing Stock		48,050	**0.5**				
Cost of goods sold		2,218,749	**0.5**				
Gross Profit c/d		3,810,026	**0.5**				
		6,028,775				6,028,775	
Loan interest	30,000		**0.5**	Gross Profit b/d		3,810,026	**0.5**
Carriage outwards	13,000		**0.5**	Discounts received		8,620	**0.5**
Discounts allowed	6,370		**0.5**				
Wages and salaries	787,000		**0.5**				
Rent and rates	768,450		**0.5**				
Administrative expenses	597,100		**0.5**				
Selling and distribution expenses	442,300	2,644,220	**0.5**				
Net profit		1,174,426	**1**				
		3,818,646				3,818,646	

(b)

Star Company

Balance sheet as at 31 December 2009

Non-current Assets	$	$		**Capital**	$	$	
Office equipment		2,375,000	**0.5**	Balance as at 1 Jan 2009		3,220,962	**0.5**
Furniture and fittings		2,175,000	**0.5**	Add: Net profit		1,174,426	**0.5**
		4,550,000				4,395,388	
				Less: Drawings		82,300	**0.5**
Current Assets						4,313,088	
Inventory	48,050		**0.5**	**Non-current Liabilities**			
Accounts receivable	910,500		**0.5**	Bank loan		750,000	**0.5**
Bank	129,446	1,087,996	**0.5**				
				Current Liabilities			
				Accounts payable		574,908	**0.5**
		5,637,996				5,637,996	

Question 3

(a)

(i)	Gross profit ratio	Gross profit ÷ Sales		**0.5**
	2009	772,433 ÷ 2,743,000 × 100%	28.2%	**1**
	2008	608,928 ÷ 2,038,000 × 100%	29.9%	**1**
(ii)	Net profit ratio	Net profit ÷ Sales		**0.5**
	2009	222,354 ÷ 2,743,000 × 100%	8.1%	**1**
	2008	178,906 ÷ 2,038,000 × 100%	8.8%	**1**
(iii)	Return on capital employed	Net profit ÷ Capital employed		**0.5**
	2009	222,354 ÷ [(781,049 + 1,003,403) ÷ 2] × 100%	24.9%	**1**
	2008	178,906 ÷ [(602,143 + 781,049) ÷ 2] × 100% × 100%	25.9%	**1**
(iv)	Current ratio	Current assets ÷ Current liabilities		**0.5**
	2009	2,938,310 ÷ 3,157,460	0.9	**1**
	2008	3,038,520 ÷ 2,486,911	1.2	**1**
(v)	Quick ratio	(Current assets – Inventory) ÷ Current liabilities		**0.5**
	2009	(2,938,310 – 1,346,000) ÷ 3,157,460	0.5	**1**
	2008	(3,038,520 – 1,094,000) ÷ 2,486,911	0.8	**1**

(b) Profitability

- The profitability has worsened. **(0.5)**
- The gross profit ratio has dropped from 29.9% to 28.2%. **(0.5)**
- The net profit ratio has dropped from 8.8% to 8.1%. **(0.5)**
- The return on capital employed has dropped from 25.9% to 24.9%. **(0.5)** The net profit increased by a smaller percentage than the capital employed. The owner's investment was less profitable. **(0.5)**

Reason(s) for decrease in gross profit ratio:

- Costs of goods increased by a greater percentage than sales.
- Reduced selling price to boost sales.

(Any ONE, **0.5**)

Reason(s) for decrease in net profit ratio:

- Decrease in gross profit ratio.
- Poor cost control, more expenses were incurred

(Any ONE, **0.5**)

Reason(s) for drop in return on capital employed:

- Decrease in net profit
- The owner contributes more capital.

(Any ONE, **0.5**)

Liquidity:

- The liquidity has worsened. (**0.5**)
- The current ratio had dropped from 1.2 to 0.9. (**0.5**)
- The quick ratio has dropped from 0.8 to 0.5. (**0.5**)
- The norm for current ratio is 2:1 while it's 1:1 for quick ratio. (**0.5**)
- The current ratio falling below 2 and quick ratio falling below 1 is a warning signal that the company has liquidity problems, the company would have difficulty in paying its short-term debts. (**0.5**)

Reasons for further deterioration of current ratio and quick ratio:

- The company had held more inventory, more funds were tide up.
- The company has granted more generous credit terms to customers.
- A significant decrease in bank balance, from $1,375,669 to $558,096.
- The company has to purchase more to meet up with the increase in sales, which leads to a greater creditor's balance.

(Any TWO, **0.5@**)

Question 4

(a) Accrual concept (**0.5**)

– Under the accrual concept, revenues and expenses are accrued, i.e. revenues and expenses are recognized and included in the financial statements when they are earned or incurred, not when they are received or paid in cash. (**1.5**)

– Rental income accrued for November and December should be included as revenues in the current accounting period. (**1.5**)

(b) Historical cost concept (**0.5**)

– Assets and expenses are entered into the book at their actual cost to the business. Market values are generally ignored. (**1.5**)

– The shop premises should not be recorded at its market value. It should be recorded as its purchase cost of $8 million. (**1.5**)

(c) Consistency (**0.5**)

– The accounting treatment of similar items within each accounting period and from one period to the next should be consistent/the same. (**1.5**)

– The same method of calculating depreciation on its motor vehicles should be adopted for the past 4 years unless there are changed in circumstances which warrant another method. (**1.5**)

(d) Business entity principle (**0.5**)

– A business is considered as a separate entity distinguishable from its owner and from all other entities. A separate set of financial records is maintained for the business and the financial statements represent the financial position and results of operations of the business only. (**1.5**)

– The bank account is a personal asset of the owner and should not be included in the financial statements of his business. (**1.5**)

(e) Going concern (**0.5**)

– A business is assumed to continue to operate in the foreseeable future. In particular, the financial statements have been drawn up on the assumption that there is no intention or necessity to liquidate or curtail significantly the scale of operations. (**1.5**)

– Since the business is going to wind up on 1 January 2010, the assets should be shown at their realisable values in the balance sheet as at 31 December 2009. (**1.5**)

END OF PAPER