HONG KONG ASSOCIATION FOR BUSINESS EDUCATION
HONG KONG INSTITUTE OF VOCATIONAL EDUCATION (CHAI WAN & TUEN MUN)

HONG KONG ADVANCED LEVEL EXAMINATION 2009

MOCK EXAMINATION

PRINCIPLES OF ACCOUNTS

A-LEVEL PAPER 1

9:00am – 12:00am (3 hours)
This paper must be answered in English

Instructions:

1. Answer **FOUR** questions in this paper: TWO compulsory questions in Section A (60%), and any TWO of the three questions in Section B (40%).

2. Write your answers for Section A & B in the answer book provided.

3. Show **all** your workings.

SECTION A

Answer **ALL** questions in this section. Each question carries 30 marks. Write all your answers in the answer book provided.

Question 1

The preliminary balance sheets and income statements of Beauty Ltd and Yummy Ltd as at 31 December 2008 are shown below:

Balance Sheets as at 31 December 2008

	Beauty Ltd	**Yummy Ltd**
	$'000	$'000
Non-current assets		
Land (net)	5 000	6 000
Plant and machinery (net)	45 000	5 000
	50 000	11 000
Current assets		
Inventory	16 000	8 000
Accounts receivable	15 000	2 000
Cash at bank	3 000	1 000
	34 000	11 000
Current liabilities		
Accounts payable	(15 000)	(2 000)
Net current assets	19 000	9 000
Total assets less current liabilities	69 000	20 000
Non-current liabilities		
Long-term borrowings	(10 000)	–
Net assets	59 000	20 000
Capital and reserves		
Issued capital, fully paid		
Ordinary shares of $1 each	40 000	10 000
Reserves		
Retained profits	19 000	10 000
	59 000	20 000

Income Statements for the year ended 31 December 2008

	Beauty Ltd	Yummy Ltd
	$'000	$'000
Sales	40 000	20 000
Cost of sales	(25 000)	(12 000)
Gross profit	15 000	8 000
Distribution costs	(2 000)	(600)
Administrative expenses	(3 000)	(1 400)
Finance costs	(1 000)	–
Profit before tax	9 000	6 000
Taxation	(1 500)	(1 000)
Profit for the year	7 500	5 000

There are several important transactions regarding the acquisition of Yummy Ltd by Beauty Ltd which had not been recorded by Beauty Ltd during the year of 2008:

(i) Beauty Ltd acquired 8 000 000 ordinary shares of Yummy Ltd on 1 January 2008 when the retained profit of Yummy Ltd had a credit balance of $5 000 000. The cost of investment was $20 000 000 which was financed by a long-term borrowing of 10% per annum.

(ii) Apart from the land, the fair value at acquisition of all the assets and liabilities of Yummy Ltd was equal to their carrying amounts. The fair value of Yummy Ltd's land was $500 000 in excess of its carrying amount at the acquisition date. No accounting entries had been made in the books of Yummy Ltd.

(iii) During the year, Beauty Ltd sold goods with an invoiced value of $3 600 000 to Yummy Ltd. Of these, two-third of goods remained unsold and was held in Yummy Ltd's inventory on 31 December 2008. Beauty Ltd invoiced its goods to Yummy Ltd at cost plus 20%.

(iv) No dividends were declared for the year by both companies.

(v) The impairment of goodwill for the year of 2008 was $1 000 000 and is to be included under administrative expenses.

REQUIRED:

(a) Prepare a consolidated income statement for the Group of Beauty Ltd for the year ended 31 December 2008 and a consolidated balance sheet as at that date.

(20 marks)

(b) Calculate (to two decimal places) the following accounting ratios for (1) Beauty Ltd assuming that there was no acquisition and (2) the same accounting ratios for the Group of Beauty Ltd after the acquisition as at 31 December 2008:

(i) Gearing (based on year-end amounts) (3 marks)

(ii) Interest cover (in times) (3 marks)

(c) Explain the function of the two accounting ratios in (b) above and justify whether the two accounting ratios of Beauty Ltd are being improved after the acquisition. (4 marks)

Question 2

The financial statements of Maxine Ltd are as follows:

Income statement for the year ended 31 December 2008

	$
Sales	10 120 000
Cost of sales	(7 084 000)
Gross profit	3 036 000
Gain on disposal of plant and machinery and investment	157 000
Administrative expenses	(1 801 000)
Depreciation on buildings	(20 000)
Depreciation on plant and machinery	(90 000)
Interest expenses	(280 000)
Profit before tax	1 002 000
Tax	(130 000)
Profit for the year	872 000

Balance sheet as at 31 December

	2008	**2007**
ASSETS	$	$
Non-current assets		
Land and buildings (net)	4 570 000	3 300 000
Plant and machinery (net)	1 500 000	1 000 000
Investment	2 500 000	2 700 000
Development cost	400 000	–
Total non-current assets	8 970 000	7 000 000
Current assets		
Inventory	1 400 000	2 310 000
Trade receivables	1 120 000	1 100 000
Cash at bank	500 000	–
Total current assets	3 020 000	3 410 000
Total Assets	11 990 000	10 410 000

EQUITY AND LIABILITIES		
Equity		
Ordinary shares of $5 each	3 200 000	2 500 000
Share premium	500 000	750 000
Revaluation reserve	1 270 000	400 000
Retained profits	3 280 000	2 600 000
Total equity	8 250 000	6 250 000
Non-current liabilities		
8% Bank loan	1 500 000	1 200 000
Total non-current liabilities	1 500 000	1 200 000
Current liabilities		
Trade payables	1 168 000	1 500 000
Interest payable	370 000	500 000
Tax payable	510 000	560 000
Dividend payable	192 000	180 000
Bank overdraft	–	220 000
Total current liabilities	2 240 000	2 960 000
Total Equity and Liabilities	11 990 000	10 410 000

Additional information relating to the year ended 31 December 2008 was given below:

(i) The increase in revaluation reserve is entirely due to the company's land.

(ii) New building was acquired during the year.

(iii) New plant and machinery was acquired during the year at $800 000.

(iv) Investment of $200 000 was sold for $220 000 during the year.

(v) 50 000 ordinary shares were issued by way of bonus out of the share premium and all other ordinary shares were issued for cash.

(vi) Bank interest income amounted $12 000 was included in interest expenses.

(vii) During the year, research cost and development cost of $160 000 and $500 000 was paid by the company respectively. Research cost was charged as an expense and included under cost of sales, while development cost was capitalised as an asset and amortised over a five-year period including the current year.

(viii) Dividends declared during the year amounted to $192,000.

(ix) The company classifies interest paid as an operating activity, interest received as an investing activity and dividend paid as a financing activity.

REQUIRED:

(a) Prepare the journal entries necessary to record items in (iv) and (v) above. (5 marks)

(b) Prepare the cash flow statement of Maxine Ltd for the year ended 31 December 2008 using the indirect method. (20 marks)

(c) Based on the cash flow statement in (b) above, comment on the cash flow position of Maxine Ltd. (5 marks)

SECTION B

Answer any **TWO** questions from this section. Each question carries 20 marks.
Write all your answers in the answer book provided.

Question 3

Chan, Lam and Mok are in partnership operating retail store and selling electronic products. The partnership agreement states that the profit and loss sharing ratio among Chan, Lam and Mok is 2:2:1. Lam and Mok are entitled to an annual salary of \$120 000 and \$84 000 respectively. No interest is charged on partners' capital, but an interest of 4% per annum is charged on drawings.

Due to expansion of their business, the partnership was converted into a limited company, IVE Ltd. On 1 January 2009, IVE Ltd was set up with an authorised share capital of 65 000 000 ordinary shares of nominal value \$2 each, and 2 000 000 8% preference shares of nominal value of \$10 each.

A list of balances as at 31 December 2008, immediately before the conversion to IVE Ltd, of the partnership is given below:

	Dr	Cr
	\$	\$
Plant and equipment (net)	8 200 000	
Inventory	320 000	
Trade receivables	385 000	
Bank	283 000	
Capital accounts		
- Chan		2 500 000
- Lam		2 000 000
- Mok		1 500 000
Current accounts		
- Chan		620 000
- Lam		440 000
- Mok		250 000
Drawings		
- Chan (all drawn on 30 June 2008)	150 000	
- Lam (all drawn on 30 September 2008)	80 000	
- Mok (all drawn on 31 October 2008)	60 000	

8% Loan from Chan		1 350 000
Trade payables		275 000
Profit for the year		543 000
	9 478 000	9 478 000

Additional information is as follows:

(i) A piece of equipment with a net book value of $235 000 and an inventory of LCD TV at a cost of $50 000 were taken by Chan as settlement of his loan.

(ii) IVE Ltd took over the partnership's assets and liabilities (except bank) as follows:

Items	**Terms**
- Plant and equipment	Fair value of $8 500 000.
- Inventory	A mark down of 10% on the carrying amount.
- Loan from Chan	The outstanding amount was replaced by a new loan arrangement at 5% interest per annum.
- Others	At book value.

(iii) Lam and Mok paid the realisation expenses of $140 000 evenly on behalf of the partnership.

(iv) IVE Ltd settled the purchase consideration by an issue of 2 500 000 ordinary shares at $5 each. The shares were taken up by Chan: 1 500 000 shares, Lam: 600 000 shares, and Mok: 400 000 shares.

REQUIRED:

(a) Prepare the partnership's profit and loss appropriation account for the year ended 31 December 2008. (4 marks)

(b) Draw up the realisation account. (4 marks)

(c) Write up the partners' capital accounts in columnar form. (6 marks)

(d) Prepare the necessary journal entries in the books of IVE Ltd at 1 January 2009 to record the conversion of the partnership business. (6 marks)

Question 4

Alex Trading Company provides depreciation on its fixed assets at 20% per annum using the reducing balance method. A full year's depreciation is provided in the year of acquisition and none in the year of disposal. As regards goods for resale, the company adopts the perpetual inventory system.

The trial balance extracted from Alex Trading Company's books as at 31 December 2008 did not balance. A Suspense account was opened and debited with the difference of $23 960. After investigation, the following information relating to the year ended 31 December 2008 was revealed:

(i) A cheque of $27 400 paid to the supplier Wayer Ltd was correctly entered in the Cash Book but entered in Wayer Ltd's account as $2740. A cash discount received of $600 was overlooked.

(ii) A cash sale of $5500 was correctly entered in the Cash Book but entered twice in the Sales account.

(iii) Interest received of $3100 was entered to the debit side of the Interest expenses account.

(iv) Payment of $210 000 for the quarter of October 2008 to December 2008 to the landlord was correctly credited to the Cash Book but debited to the Salaries account. According to the two-year tenancy agreement which started from 1 October 2008, the monthly rental was $70 000. Two months' deposit was required to be paid with the first quarter payment and there was one-month rent free period for October 2008.

(v) A cheque of $35 600 for repairing the motor car had been correctly entered in the Cash Book but debited to the Motor Car account.

(vi) A cheque of $5680 was received from the customer Gin Ltd but entered in the Cash Book and Trade Receivables Ledger as $5860. Cash advance of $20 to the staff Mr Au was booked as $200 in the Cash Book.

(vii) Goods, sold at $12 000, were returned from the customer Peg Ltd, and was treated as returns outwards and debited to Peg Ltd. Alex Trading Company sold the goods at gross margin of 20%.

Profit for the year before taking into account the above information amounted to $500 240.

Required:

Prepare the following for Alex Trading Company:

(a) The journal entries necessary for correcting the errors and omissions in items (i) to (vii) above. (13 marks)

(b) The Suspense account, showing all relevant entries made in (a) above. (2 marks)

(c) A statement to show the calculation of revised profit for the year ended 31 December 2008. (5 marks)

Question 5

(a) Expressway Ltd purchased a motor vehicle to distribute goods to customers. The financial year of Expressway Ltd is on 31 December.

The following costs were incurred for the motor vehicle:

	$
Purchase price of the motor vehicle	300 000
Import tax	150 000
Annual insurance premium	4 000
Sign writing	1 200
Petrol cost	1 000
License fee (first registration)	5 000

REQUIRED:

(i) Explain the difference between capital expenditure and revenue expenditure. Give one example for each of them. (5 marks)

(ii) Calculate the cost of the motor vehicle to be capitalised. (3 marks)

(b) Planet Holiday owned the following fixed assets as at 1 October 2007:

	Photocopier Ricoh MPC5000	Motor Vehicle Mazda M6	Machinery
Date of purchase	1 April 2005	1 May 2006	1 August 2008
Cost	$60 000	$300 000	$150 000
Estimated residual value	-	$60 000	-
Expected useful life	10 years	8 years	4 years

It is the company's policy to depreciate all fixed assets on the straight line method and provide monthly depreciation.

During the financial year ended 30 September 2008 the following events occurred, but no entries had been made in the books:

(i) On 1 October 2007, the remaining useful life of Photocopier Ricoh MPC5000 was re-estimated to be 5 years only but there is no change in the estimated residual value.

(ii) On 31 July 2008, Motor Vehicle Mazda M6 was traded in and replaced by a new vehicle Lexus IS250. The new vehicle's list price was $450 000. The trade-in allowance was $180 000 and the balance due was paid by cheque. The estimated residual value and the expected useful life of the new vehicle Lexus IS250 were $30 000 and 5 years.

(iii) On 1 August 2008, the company leased a machine under a finance lease. The cash price of the machine was $150 000. Three yearly lease payment of $37 500 each is to be made, commencing on 1 August 2008. The implicit interest rate is 12% per annum.

REQUIRED:

In respect of the above events, prepare the journal entries necessary to make the year-end adjustments at 30 September 2008 for Planet Holiday.

(12 marks)

END OF PAPER