GENERAL PRINCIPLES

Where applicable,

– deduct ½ mark for each omitted/improper account or statement title
– deduct ½ mark for omitted indication of $ (or $'000) from the relevant amount columns in each question
– deduct ½ mark for each omitted heading in the balance sheet
– deduct 1 mark for journal entries without narration
– the last-answered excess question(s) will not be marked

Section A

Question 1

Suggested Solution:

(a)

Group of Beauty Ltd

Consolidated income statement for the year ended 31 December 2008

	$'000
Sales [($40 000 + $20 000) – $3 600]	56 400
Cost of sales [($25 000 + $12 000) – $3 600 + $3 600 x (20/120) x 2/3]	(33 800)
Gross profit	22 600
Distribution costs ($2 000 + $600)	(2 600)
Administrative expenses [($3 000 + $1 400) + $1 000]	(5 400)
Finance costs [($1 000 + $20 000 x 10%) + $0]	(3 000)
Profit before tax	11 600
Taxation ($1 500 + $1 000)	(2 500)
Profit for the year	9 100
Profit Attributable to:	
Equity holders of the Company	8 100
Minority interest ($5 000 x 20%)	1 000
	9 100

(7)

Consolidated balance sheet of the group of Beauty Ltd as at 31 December 2008

	$'000	$'000
Non-current assets		
Land [($5 000 + $6 000) + $500]		11 500
Plant and machinery ($45 000 + $5 000)		50 000
Goodwill ($7 600 (working) – $1 000)		6 600
		68 100
Current assets		
Inventory [($16 000 + $8 000) – $400]	23 600	
Accounts receivable ($15 000 + $2 000)	17 000	
Cash at bank ($3 000 + $1 000)	4 000	
		44 600
Total assets		112 700
Equity and Liabilities		
Equity attributable to equity holders of the Company		
Ordinary shares of $1 each		40 000
Retained profits (working)		19 600
		59 600
Minority interest (working)		4 100
Total equity		63 700
Non-current liabilities		
Long-term borrowings [($10 000 + $20 000) + $0]	30 000	
Current liabilities		
Accounts payable ($15 000 + $2 000)	17000	
Accrued interest expenses ($20 000 x 10%)	2 000	
	19000	
Total liabilities		49 000
Total equity and liabilities		112 700

(7)

Workings:

Goodwill at 1 January 2008	$'000	$'000
Cost of investment		20 000
Less: Fair value of net assets:		
Ordinary shares ($10 000 x 80%)	8 000	
Pre-acquisition profits ($5 000 x 80%)	4 000	
Fair value adjustment – Land ($500 x 80%)	400	
		(12 400)
Goodwill arising from acquisition of Yummy Ltd		7 600

Retained profits c/f	$'000
Retained profits b/f	
Beauty Ltd ($19 000 – $7 500)	11 500
Yummy Ltd [($10 000 – $5 000) – $5 000] x 40%	0
Profit attributable to equity holders of the Company	8 100
	19 600

Minority interest	$'000
Fair values of net assets	
Ordinary shares ($10 000 x 20%)	2 000
Fair value adjustment – Land ($500 x 20%)	100
Retained profits ($10 000 x 20%)	2 000
	4 100

(b) **(1) Gearing** (based on year-end amounts)

$$\frac{\text{Long-term borrowings}}{\text{Shareholders' equity}} \times 100\%$$

Beauty Ltd (no acquisition):

$$\frac{\$10\ 000}{\$59\ 000} \times 100\% = \underline{\underline{16.95\%}}$$

Group of Beauty Ltd after acquisition:

$$\frac{\$30\ 000}{\$63\ 700} \times 100\% = \underline{\underline{47.10\%}}$$

(2) Interest cover

$$\frac{\text{Profit before interest and tax}}{\text{Interest}}$$

Beauty Ltd (no acquisition):

$$\frac{(\$9\ 000 + \$1\ 000)}{\$1\ 000} = \underline{\underline{10 \text{ times}}}$$

Group of Beauty Ltd after acquisition:

$$\frac{(\$11\ 600 + \$3\ 000)}{\$3\ 000} = \underline{\underline{4.87 \text{ times}}}$$

(3)

(c) The gearing ratio measures the long-term borrowing and preference share capital (if any) of the business to the total shareholders' equity. If a company is highly geared, there is a greater risk that there will be insufficient profit generated to cover the interest and preference dividend, the profit available for distribution to ordinary shareholders will fall.

The gearing ratio of Beauty Ltd (no acquisition) increases from 16.95% to 47.10% in consolidation after acquisition implies that the risk for not sufficient profit to pay interest and preference dividend is higher.

The interest cover measures the times of interest that are covered by operating profit before interest and tax. The lower the level of interest cover, the greater the risk to lenders that interest payments will not be met if profits fall. If interest payments and capital repayments are not paid when they fall due, there can be serious consequences for a business.

The interest cover of Beauty Ltd (no acquisition) decreases from 10 times to 4.87 times in consolidation after acquisition implies the pressure for paying interest is higher.

(4)

Total : 30 marks

Question 2

Suggested Solution:

(a)

Journal

		Dr	Cr
		$	$
(iv)	Cash at bank	220 000	
	Investment		200 000
	Profit on disposal of investment		20 000
	Being disposal of investment.		
(v)	Share premium ($50 000 x 5)	250 000	
	Cash at bank	450 000	
	Ordinary share capital ($3 200 000 – $2 500 000)		700 000
	Being issue of new shares and bonus shares		

(b)

Maxine Ltd

Cash flow statement for the year ended 31 December 2008

	$	**$**
Cash flows from operating activities		
Profit before tax	1 002 000	
Adjustments for:		
Depreciation – Buildings	20 000	
Depreciation – Plant and machinery	90 000	
Amortisation – Development cost	100 000	
Profit on disposal of plant and machinery and investment	(157 000)	
Interest income	(12 000)	
Interest expenses ($280 000 + $12 000)	292 000	
	1 335 000	
Decrease in inventory ($2 310 000 – $1 400 000)	910 000	
Increase in trade receivables ($1 120 000 – $1 100 000)	(20 000)	
Decrease in trade payables ($1 500 000 – $1 168 000)	(332 000)	
Cash generated from operations	1 893 000	
Interest paid ($500 000 + $292 000 – $370 000)	(422 000)	
Tax paid ($560 000 + $130 000 – $510 000)	(180 000)	
Net cash from operating activities		1 291 000

Cash flows from investing activities		
Purchase of buildings (W1)	(420 000)	
Purchase of plant and machinery (W2)	(800 000)	
Proceeds from sale of plant and machinery	347 000	
[$210 000 + ($157 000 – $20 000)] (W2 & W3)		
Proceeds from sale of investment	220 000	
Development cost	(500 000)	
Interest received	12 000	
Net cash used in investing activities		(1 141 000)
Cash flows from financing activities		
Issued of ordinary shares	450 000	
($3 200 000 – $2 500 000 – 50 000 x $5)		
Bank loan obtained ($1 500 000 – $1 200 000)	300 000	
Dividend paid ($180 000 + $192 000 – $192 000)	(180 000)	
Net cash from financing activities		570 000
Net increase in cash and cash equivalents		720 000
Cash and cash equivalents at 1 January 2008		(220 000)
Cash and cash equivalents at 31 December 2008		500 000

(20)

Workings

W1

Land and buildings

	$		$
Balance b/f	3 300 000	Depreciation	20 000
Revaluation reserve	870 000	Balance c/f	4 570 000
($1 270 000 – $400 000)			
Cash at bank	420 000		
(balancing figure)			
	4 590 000		4 590 000

W2

Plant and machinery

	$		$
Balance b/f	1 000 000	Depreciation	90 000
Cash at bank	800 000	Disposal	210 000
		Balance c/f	1 500 000
	1 800 000		1 800 000

W3

Profit on disposal of investment

= $220 000 – $20 000

= $20 000

Profit on disposal of plant and machinery

= $157 000 – $20 000

= $137 000

(c) Profit before tax is $1 002 000 but the net increase in cash and cash equivalent just increased by $720 000. It is caused by several major factors:

- The purchase of non-current assets such as plant and machinery and buildings had used up $1 220 000.

- $500 000 was paid for the development cost.

- Even some cash had been raised from new issue of shares and bank loan but it still could not cover the amount required for the purchase of non-current assets and development cost incurred.

- Decrease in inventory had good effect on the cash flows but decrease in trade payable offset part of this effect.

Total: 30 marks

Section B

Question 3

Suggested Solution

(a)

Chan, Lam and Mok

Profit and Loss Appropriation Account for the year ended 31 December 2008

	$	$
Profit for the year		543 000
Add: Interest on drawings		
- Chan ($150 000 x 4% x 6/12)	3 000	
- Lam ($80 000 x 4% x 3/12)	800	
- Mok ($60 000 x 4% x 2/12)	400	
		4 200
		547 200
Less: Partners' salaries		
- Lam	120 000	
- Mok	84 000	
		204 000
		343 200
Balance of profit shared		
- Chan (2/5)	137 280	
- Lam (2/5)	137 280	
- Mok (1/5)	68 640	
		343 200

(4)

(b)

Realisation

	$		$
Plant and equipment	8 200 000	8% Loan – Chan	1 350 000
Inventory	320 000	Trade payables	275 000
Trade receivables	385 000	IVE Ltd – purchase consideration ($2 500 000 x 5)	12 500 000
Capital – realisation expenses	140 000		
Capital – profit on realisation			
- Chan	2 032 000		
- Lam	2 032 000		
-Mok	1 016 000		
	14 125 000		14 125 000

(4)

(c)

Capital

	Chan	Lam	Mok		Chan	Lam	Mok
	$	$	$		$	$	$
Drawings	150 000	80 000	60 000	Balance b/f	2 500 000	2 000 000	1 500 000
Profit and loss appropriation				Current account	620 000	440 000	250 000
- Interest on drawings	3 000	800	400	Profit and loss appropriation			
Ordinary shares in IVE Ltd	7 500 000	3 000 000	2 000 000	- Partners' salaries	-	120 000	84000
Bank	-	1 718 480	928 240	- Share of profit	137 280	137 280	68 640
				Realisation			
				- Realisation expenses	-	70 000	70 000
				- Profit on realisation	2 032 000	2 032 000	1 016 000
				Bank	2 363 720	-	-
	7 653 000	4 799 280	2 988 640		7 653 000	4 799 280	2 988 640

(6)

Alternative answer:

Capital

	Chan	Lam	Mok		Chan	Lam	Mok
	$	$	$		$	$	$
Ordinary shares in IVE Ltd	7 500 000	3 000 000	2 000 000	Balance b/f	2 500 000	2 000 000	1 500 000
Bank	-	1 718 480	928 240	Current account	604 280	616 480	342 240
				Realisation			
				- Realisation expenses	-	70 000	70 000
				- Profit on realisation	2 032 000	2 032 000	1 016 000
				Bank	2 363 720	-	-
	7 500 000	4 718 480	2 928 240		7 500 000	4 718 480	2 928 240

(4)

Current

	Chan	Lam	Mok		Chan	Lam	Mok
	$	$	$		$	$	$
Drawings	150 000	80 000	60 000	Balance b/f	620 000	440 000	250 000
Profit and loss appropriation				Profit and loss appropriation			
- Interest on drawings	3 000	800	400	- Partners' salaries	-	120 000	84 000
Capital account	604 280	616 480	342 240	- Share of profit	137 280	137 280	68 640
	757 280	697 280	402 640		757 280	697 280	402 640

(2)

(d)

Journal

Date	Particulars	Dr	Cr
2009		$	$
1 Jan	Plant and equipment	8 500 000	
	Inventory ($320 000 – $50 000) x 90%	243 000	
	Trade receivables	385 000	
	Goodwill (balancing figure)	4 712 000	
	Trade payables		275 000
	5% Loan from Chan		1 065 000
	($1 350 000 – $235 000 – $50 000)		
	Chan, Lam and Mok		12 500 000
	Being assets and liabilities taken over from the partnership of Chan, Lam and Mok.		
1 Jan	Chan, Lam and Mok	12 500 000	
	Ordinary share capital (2 500 000 x $2)		5 000 000
	Share premium [2 500 000 x ($5 – $2)]		7 500 000
	Being 2 500 000 ordinary shares issued at $5 as the purchase consideration for the assets and liabilities taken over from the partnership of Chan, Lam and Mok.		

(6)

Total: 20 marks

Question 4

Suggested Solution:

(a)

Alex Trading Company

Journal

Date	Particulars		Dr	Cr
2008			$	$
31 Dec.	(i)	Trade payables – Wayer Ltd	25 260	
		($27 400 – $2 740 + $600)		
		Suspense		24 660
		Discount received		600
		Correct: posting error and omission of discount received.		
	(ii)	Sales	5 500	
		Suspense		5 500
		Correct duplicate entry in sales.		
	(iii)	Suspense ($3 100 x 2)	6 200	
		Interest income		3 100
		Interest expenses		3 100
		Correct: interest received wrongly booked as interest expense.		
	(iv)	Rent expenses ($70 000 x 23/24 x 3)	201 250	
		Deposit for rental	140 000	
		Salaries		210 000
		Accrued rental expenses		131 250
		Correct: rental and deposit payment wrongly treated as salaries.		
	(v)	Repair expenses	35 600	
		Motor car		35 600
		Accumulated depreciation – Motor car	7 120	
		($35,600 x 20%)		
		Depreciation – Motor car		7 120
		Correct: repairing expenses wrongly capitalised and depreciated.		

(vi)	Trade receivables – Gin Ltd ($5 860 – $5 680)	180	
	Cash Book – Bank		180
	Cash Book – Cash ($200 – $20)	180	
	Cash advance - Mr Au		180
	Correct: posting errors in the Cash Book and accounts.		
(vii)	Inventory [$12 000 / (1 + 20%)] + $12 000]	22 000	
	Returns inwards	12 000	
	Cost of goods sold [$12 000 / (1 + 20%)]		10 000
	Trade receivables – Peg Ltd ($12 000 x 2)		24 000
	Correct: returns inwards wrongly treated as returns outwards.		

(13)

(b)

Suspense

2008		$	2008		$
31 Dec.	Bal b/f	23 960	31 Dec.	Trade payables – Wayer Ltd	24 660
	Interest income	3 100		Sales	5 500
	Interest expenses	3 100			
		30 160			30 160

(2)

(c)

Statement to show the calculation of revised profit for the year ended 31 December 2008

		$
Profit for the year		500 240
(i)	Discount received omitted	600
(ii)	Sales overstated	(5 500)
(iii)	Interest income understated & interest expenses overstated	6 200
(iv)	Rental expenses understated & salary overstated ($210 000 - $201 250)	8 750
(v)	Repair expenses understated & depreciation overstated ($35 600 - $7 120)	(28 480)
(vii)	Returns inwards understated & costs of sales overstated ($12 000 - $10 000)	(2 000)
Revised profit for the year		479 810

(5)

Total: 20 marks

Question 5
Suggested Solution:

(a)

(i) Capital expenditure is material expenditure in dollar amount and benefits several accounting years. This includes expenditure (1) on acquisition of fixed assets for use in the business and not for resale; (2) on existing assets for increasing their future earning capacity. It is charged to a fixed asset account and depreciation will be provided to write off the fixed assets over its estimated useful life.

Examples of capital expenditure include the purchase of a building; replacement of the component of a machine to extend its useful life, etc.

Revenue expenditure is non-material expenditure in dollar amount and benefits for the current accounting year only. This expenditure is incurred for the purpose of maintaining the earning capacity of fixed assets. It is charged to the profit and loss account when incurred.

Examples of revenue expenditure include the replacement of broken window, purchase of inventories, etc.

(ii)

	$
Purchase price	300 000
Import tax	150 000
Sign writing	1 200
License fee (first registration)	5 000
Total cost of the motor vehicle to be capitalised	456 200

(b)

Journal

30 September 2008	Dr $	Cr $
Depreciation {[$60 000 – ($60 000 x 30/120 months)]/ 5 years}	9 000	
Photocopier - Accumulated depreciation		9 000
To record the depreciation for the photocopier during the year after re-estimation of its useful life.		
Motor vehicle (Mazda) - Accumulated depreciation	67 500	
[($300 000 – $60 000)/96 months x 27 months)]		
Motor vehicle (Lexus) – Cost	450 000	
Loss on disposal [$180 000 – ($300 000 – $67 500)]	52 500	
Motor vehicle (Mazda) – Cost		300 000
Bank ($450 000 – $180 000)		270 000
To record the loss on trade-in of a new motor vehicle.		
Depreciation [($450 000 – $30 000)/5 years x 2/12 months)]	14 000	
Motor vehicle (Mazda) - Accumulated depreciation		14 000
To record the depreciation for the new motor vehicle.		
Leased machinery	150 000	
Bank		37 500
Lease liability		112 500
To record the leased machine and the first lease rental payment.		
Finance charge ($112 500 x 12% x 2/12 months)	2 250	
Accrued finance charge / Lease liability		2 250
To record the accrued interest charge		
Depreciation ($150 000 / 4 years x 2/12 months)	6 250	
Machinery - Accumulated depreciation		6 250
To record the depreciation for the leased machine.		

Total: 20 marks

END OF PAPER