

HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY  
HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION

**PRACTICE PAPER**  
**BUSINESS, ACCOUNTING AND FINANCIAL STUDIES PAPER 1**

(1 hour 30 minutes)

This paper must be answered in English

**GENERAL INSTRUCTIONS**

- (1) There are TWO sections, A and B, in this Paper.
- (2) Section A consists of multiple-choice questions in this question paper. Section B contains short questions printed separately in Question-Answer Book B.
- (3) Answers to Section A should be marked on the Multiple-choice Answer Sheet while answers to Section B should be written in the spaces provided in Question-Answer Book B. **The Answer Sheet for Section A and the Question-Answer Book for Section B must be handed in separately at the end of the examination.**

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**INSTRUCTIONS FOR SECTION A (MULTIPLE-CHOICE QUESTIONS)**

- (1) Read carefully the instructions on the Answer Sheet. After the announcement of the start of the examination, you should first stick a barcode label and insert the information required in the spaces provided. No extra time will be given for sticking on the barcode label after the 'Time is up' announcement.
- (2) When told to open this book, you should check that all the questions are there. Look for the words '**END OF SECTION A**' after the last question.
- (3) All questions carry equal marks.
- (4) **ANSWER ALL QUESTIONS.** You are advised to use an HB pencil to mark all the answers on the Answer Sheet, so that wrong marks can be completely erased with a clean rubber. You must mark the answers clearly; otherwise you will lose marks if the answers cannot be captured.
- (5) You should mark only **ONE** answer for each question. If you mark more than one answer, you will receive **NO MARKS** for that question.
- (6) No marks will be deducted for wrong answers.

**SECTION A** (60 marks)

1. Mike wants to set up a yoghurt shop in Mongkok. Which of the following factors is he considering conducts a survey on the tastes and preferences of his target customers?
  - A. technological factors
  - B. physical factors
  - C. economic factors
  - D. social and cultural factors
  
2. Effective management can
  - (1) improve staff morale.
  - (2) guarantee company profits.
  - (3) enhance operational efficiency.
  - A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
  
3. Arrange the following procedures of Management by Objectives.
  - (1) formulate the action plan
  - (2) evaluate the result of the action plan
  - (3) set objectives for the action plan
  - (4) implement the action plan
  - A. (1) 、 (2) 、 (3) 、 (4)
  - B. (1) 、 (4) 、 (3) 、 (2)
  - C. (3) 、 (1) 、 (4) 、 (2)
  - D. (3) 、 (2) 、 (1) 、 (4)
  
4. For products traded on the Hong Kong Exchanges and Clearing Limited, if an investor suffers financial losses on investment due to default of an authorised intermediary, from which of the following institutions should a remedy be sought?
  - A. Investor Compensation Company Limited
  - B. Hong Kong Deposit Protection Board
  - C. Hong Kong Exchanges and Clearing Limited
  - D. Securities and Futures Commission
  
5. Rank the following competences that a top manager should possess in descending order according to importance.
  - (1) job-relevant knowledge
  - (2) ability to create a vision and solve problems
  - (3) ability to communicate with others
  - A. (1) 、 (2) 、 (3)
  - B. (2) 、 (3) 、 (1)
  - C. (1) 、 (3) 、 (2)
  - D. (3) 、 (2) 、 (1)

6. Which of the following double entries are correct?

	<u>Transaction</u>	<u>Account to be debited</u>	<u>Account to be credited</u>
(1)	goods purchased in cash	<i>Purchases</i>	<i>Cash</i>
(2)	goods returned by a customer	<i>Returns inwards</i>	<i>Trade payables</i>
(3)	cash deposited into the bank account	<i>Bank</i>	<i>Cash</i>
(4)	inventories withdrawn for owner's private use	<i>Drawings</i>	<i>Capital</i>

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

7. Which of the following is least useful for promoting corporate governance?

- A. develop a code of ethics for managers and employees
- B. appoint professionals with high academic qualification as directors
- C. set up an internal audit committee
- D. ensure an appropriate mix of executive directors and non-executive directors

8. A well-planned personal budget can help to avoid

- (1) overspending.
- (2) misuse of consumer credit.
- (3) losses in stock investments.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

9. Which of the following transactions would have the same effect on the balances of asset and liability of a firm?

- A. receiving a cheque of \$1200 from a customer
- B. receiving a loan of \$2500 in cash, of which \$500 is used to pay rent on the proprietor's residence
- C. paying office expenses of \$2000 in cash
- D. buying office equipment for \$1000 and paying the vendor 3 months later

10. Which of the following accounting concepts cannot be applied in the situation listed to its right?

	<u>Accounting concept</u>	<u>Situation</u>
A.	<i>Historical cost</i>	The market price of an asset is not shown on the statement of financial position.
B.	<i>Business entity</i>	The vehicle used by the owner and his family is not recorded as an asset of his firm.
C.	<i>Consistency</i>	The same method is used to record the same type of transaction in different companies.
D.	<i>Accrual</i>	The expenses prepaid in the previous year have been recorded in the financial statements of the current year.

11. \_\_\_\_\_ is / are a set of principles, values and beliefs, which govern business decisions or actions that conforms to generally accepted norms.
- A. Business ethics
  - B. Social responsibility
  - C. Company law
  - D. Accounting principles
12. Workers in which of the following industries are required to join the Mandatory Provident Fund scheme even when their working period is less than 60 days?
- (1) retailing
  - (2) catering
  - (3) construction
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)

**Based on the following information, answer Questions 13 to 14:**

Ms Cheung is working in a long-established grocery store. She plans to resign to establish her own grocery store. Mr Sze, aged 62, is the employer of Ms Cheung. He wants to retire and invites Ms Cheung to take over his store.

13. In the life-cycle context, which of the following is the major financial need of retired people, such as Mr Sze?
- A. create and accumulate wealth
  - B. insure on earning ability
  - C. arrange for children's educational fees
  - D. plan for medical expenses
14. Compared with establishing a new store, which of the following is the benefit to Ms Cheung of taking over Mr Sze's store?
- A. enjoy economies of scale
  - B. acquire existing customer source
  - C. lower operational costs
  - D. lower initial investment
15. The planning process includes
- (1) deciding the objectives of the enterprise.
  - (2) maximising the profitability of the enterprise.
  - (3) completing different tasks in order to achieve the objectives of the enterprise.
- A. (1) only
  - B. (1) and (2) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)

16. Which of the following are the roles of small and medium enterprises in Hong Kong's economy?
- (1) create employment
  - (2) widen the variety of products offered
  - (3) promote competition
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
17. Which of the following is / are the benefit(s) of buying a company's ordinary shares over buying its debentures?
- (1) avoid total loss of investment
  - (2) have voting rights in the annual general meeting
  - (3) guarantee higher returns
- A. (1) only
  - B. (2) only
  - C. (1) and (3) only
  - D. (2) and (3) only
18. Which of the following are performance indicators for property agents?
- (1) number of customer complaints
  - (2) volume of transactions
  - (3) appreciation of property values
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
19. Rank the following investment instruments in descending order according to the level of risk to investors who would like to have a stable return.
- (1) government bonds
  - (2) warrants of a public utility
  - (3) shares of a listed company
- A. (1) 、 (3) 、 (2)
  - B. (2) 、 (3) 、 (1)
  - C. (3) 、 (1) 、 (2)
  - D. (3) 、 (2) 、 (1)
20. Which of the following descriptions of business ownership is correct?
- A. A limited company distributes dividends to ordinary shareholders before preference shareholders.
  - B. A franchise is formed by two or more business entities to develop, produce or sell products.
  - C. A sole proprietorship does not have a separate legal entity status.
  - D. Public enterprises are wholly owned by large multinational corporations to provide essential goods and services to the public.

21. Which of the following are functions of insurance in businesses?
- (1) reduce operational risks of businesses
  - (2) help businesses to transfer risks
  - (3) provide source of capital for businesses
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
22. Which of the following statements is correct?
- A. Trade discounts are recorded as discounts allowed in the books.
  - B. Cash discounts are enjoyed when a large quantity of goods is purchased.
  - C. Cash discounts are given to encourage customers to settle debt within the credit period.
  - D. Trade discounts are not entered in the sales journal.
23. The main function of the \_\_\_\_\_ is to provide financial and technical assistance to developing countries.
- A. World Trade Organisation
  - B. International Monetary Fund
  - C. World Bank
  - D. Asia-Pacific Economic Cooperation
24. A bookshop plans to hire sales assistants. Which of the following management functions contribute to deciding their salary?
- (1) human resources management
  - (2) financial management
  - (3) information management
- A. (1) and (2) only
  - B. (1) and (3) only
  - C. (2) and (3) only
  - D. (1), (2) and (3)
25. The Board of Directors announces a new company policy to its employees by email. This is an example of
- A. formal and one-way communication.
  - B. formal and two-way communication.
  - C. informal and one-way communication.
  - D. informal and two-way communication.
26. Which of the following is the difference between small and medium enterprises (SMEs) and multinational corporations (MNCs) in Hong Kong?
- A. SMEs have limited sources of financing while MNCs have more sources of financing.
  - B. SMEs operate locally while MNCs operate beyond their national boundaries.
  - C. SMEs are reluctant to respond to market change while MNCs are responsive to market change.
  - D. SMEs are capital intensive and use relatively simple technology while MNCs are labour intensive and use relatively high technology.

27. Which of the following is not a necessary characteristic of entrepreneurs?
- A. ready to receive innovative ideas
  - B. possess good academic qualifications
  - C. persist in order to actualise goals
  - D. ambitious to initiate change

**Based on the following information, answer Questions 28 and 29:**

The following are the account balances of Lily Ltd as at 31 December 2011:

	\$
Sales	20 000
Purchases	8 000
Discounts allowed	400
Discounts received	1 200
Rental income	1 600
Electricity expenses	3 700
Cash and bank	3 000
Accounts receivables	2 900
Accounts payables	4 000
Office equipment	15 000
Inventory (1 January 2011)	3 500
Capital (1 January 2011)	?

Inventory as at 31 December 2011 amounted to \$4200.

28. The amount of capital of Lily Ltd as at 1 January 2011 is:
- A. \$8 300
  - B. \$9 700
  - C. \$19 800
  - D. \$33 700
29. The gross profit ratio of Lily Ltd for 2011 is:
- A. 42.5%
  - B. 56.5%
  - C. 60%
  - D. 63.5%
30. The current assets shown in the statement of financial position are arranged in order of
- A. significance, with the most important assets coming first and the least important assets coming last.
  - B. value, with the most valuable assets coming first and the least valuable assets coming last.
  - C. liquidity, with the least liquid assets coming first and the most liquid assets coming last.
  - D. acquisition time, with the earliest acquired assets coming first and the latest acquired assets coming last.

**END OF SECTION A**

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**PRACTICE PAPER**  
**BUSINESS, ACCOUNTING AND FINANCIAL STUDIES**  
**PAPER 1**  
**SECTION B : Question-Answer Book B**

This paper must be answered in English.

**INSTRUCTIONS**

- (1) After the announcement of the start of the examination, you should first write your Candidate Number in the space provided on Page 1.
- (2) Stick barcode labels in the spaces provided on Pages 1 and 3.
- (3) Refer to the general instructions on the cover of the Question Paper for Section A.
- (4) Answer **ALL** questions.
- (5) Write your answers to Section B in the spaces provided in this Question-Answer Book. Do not write in the margins. Answers written in the margins will not be marked.
- (6) Supplementary answer sheets will be supplied on request. Write your candidate number, mark the question number box and stick a barcode label on each sheet, and fasten them with string **INSIDE** this book.
- (7) No extra time will be given to candidates for sticking on the barcode labels or filling in the question number boxes after the 'Time is up' announcement.

Please stick the barcode label here.

Candidate Number











5. (b) Mr Cheung has a retailing firm. He knows little about book-keeping and has trouble preparing financial statements for the firm. Based on the following information, prepare for his business an income statement for the year ended 31 December 2011. (6 marks)

	\$
Rent and rates	22 000
Salaries	31 000
Inventory (1 January 2011)	45 000
Inventory (31 December 2011)	38 000
Sales	188 000
Purchases	92 100
Returns inwards	5 500
Returns outwards	4 400
Carriage outwards	1 900
Discounts allowed	2 700

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.

Answers written in the margins will not be marked.



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PAPER 2A

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HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY  
HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION

**PRACTICE PAPER**  
**BUSINESS, ACCOUNTING AND FINANCIAL STUDIES PAPER 2A**  
**Accounting Module**

(2 hours 30 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.



**SECTION A**

Answer **ALL** questions in this section.

1. The bank account of VM Ltd as at 31 December 2011 had a debit balance of \$4000, which was different from the ending balance shown on the bank statement for the month of December 2011. Subsequent comparison of the cash book with the bank statement revealed the following:

- (i) Bank charges of \$496 shown on the bank statement had not been recorded in the cash book.
- (ii) Cash of \$7933 deposited by a customer on 20 December 2011 had been credited by the bank but no record had been made in the cash book.
- (iii) The following cheques issued to suppliers were not shown on the bank statement:

<u>Cheque Number</u>	<u>Date of issue</u>	<u>Amount</u>
30801	17 December 2011	\$2453
30834	30 December 2011	\$3758

- (iv) A cheque with an amount of \$5100 deposited into the bank on 31 December 2011 was shown on the bank statement for the month of January 2012.

**REQUIRED:**

- (a) Update the bank account in the books of VM Ltd. (3 marks)
- (b) Prepare for VM Ltd a bank reconciliation statement as at 31 December 2011, commencing with the updated bank account balance in (a). (2 marks)
- (c) List two uses of a bank reconciliation statement for a company. (2 marks)
- (Total: 7 marks)

2. Perry Ltd started producing Product A on 1 January 2012. The unit selling price and cost of Product A for the month of January 2012 were as follows:

	(\$/unit)
Selling price	5.90
Direct material	1.20
Direct labour	1.40
Variable production overheads	0.70
Variable selling and administrative expenses	0.15

- (i) Fixed production overheads were budgeted at \$308 000 per month and were absorbed based on the number of units produced. Actual fixed production overheads of Product A were the same as the absorbed fixed production overheads for the month.
- (ii) Budgeted production and budgeted sales were the same at 280 000 units per month.
- (iii) Actual production and actual sales of Product A for the month were 250 000 units and 220 000 units respectively.
- (iv) Actual fixed selling and administrative expenses were \$110 000.
- (v) There were no closing direct materials and work-in-progress inventories of Product A as at 31 January 2012.

**REQUIRED:**

- (a) Prepare the income statement for the month ended 31 January 2012 using absorption costing. (7 marks)
- (b) As compared with the absorption costing system, advise Perry Ltd two advantages of using the marginal costing system. (2 marks)
- (Total: 9 marks)

3. Easy Company makes all purchases and sales on credit. The following balances of the company as at 31 December 2011 were extracted:

	\$
Sales	10 186 000
Purchases	7 294 500
Inventory – as at 1 January 2011	878 000
– as at 31 December 2011	990 000
Trade receivables – as at 1 January 2011	856 000
– as at 31 December 2011	996 000

**REQUIRED:**

- (a) Calculate (to one decimal place) the following accounting ratios for 2011:
- (1) trade receivables collection periods (in months) (1 mark)
- (2) inventory turnover (2 marks)

Subsequent checking of the records by the accountant of Easy Company revealed that no entries had been made for the following items:

- (i) Loan interest of \$5050 incurred in 2011 remains unpaid as at 31 December 2011.
- (ii) A motor vehicle costing \$80 000 with an accumulated depreciation of \$40 000 as at 31 December 2011 was sold for \$48 000 in cash on the same date.

**REQUIRED:**

- (b) Prepare the journal entries to record the above transactions for the year ended 31 December 2011. (Narrations are not required.) (3 marks)
- (c) Explain the accounting treatment of item (i) using a relevant accounting concept. (2 marks)
- (Total: 8 marks)

4. Over the past few decades, computers have been extensively used to perform routine bookkeeping and accountancy work. Justify with three reasons the use of the computerised accounting system as compared with the manual accounting system in a large corporation. (Total: 6 marks)

**SECTION B**

Answer **ALL** questions in this section.

5. The following balances as at 31 December 2011 relate to Hing Fat Company:

	\$
Suspense account	?
Sales ledger control account (debit balance)	59 090

Control accounts were kept on a memorandum basis and they did not form part of the double entry system. Subsequent investigation revealed the following:

- (i) All goods were sold at a gross profit margin of 20% in 2011.
- (ii) Total cash sales for 2011 were \$87 520. This was properly recorded in the cash book but was credited to the sales account as \$85 720.
- (iii) The sales returns day book had been undercast by \$2160.
- (iv) A sales invoice for \$68 900 had been entered in the purchases day book as \$69 800.
- (v) Discounts allowed for 2011 were \$12 400 and had been correctly recorded, but only \$12 000 was posted to the sales ledger control account.
- (vi) A debt of \$2500 owed by a customer had been written off. Proper entry had been made in the trade receivables account but the bad debts account had been credited with the amount of \$250. No records had been made in the sales ledger control account.
- (vii) In 2011, goods costing \$48 600 were despatched to a customer on a sale or return basis. Hing Fat Company was advised by the customer on 31 December 2011 that 40% of the goods would be retained and the rest would be returned to the company in January 2012. No records had been made in the books.

**REQUIRED:**

- (a) Prepare a sales ledger control account, showing all the necessary adjustments. (7 marks)
- (b) Write up a suspense account. (5 marks)

In a seminar, the bookkeeper of Hing Fat Company learned that certain qualitative characteristics have to be fulfilled in the preparation of financial statements under the regulatory framework of accounting in Hong Kong.

**REQUIRED:**

- (c) Explain two principal qualitative characteristics of financial statements. (4 marks)

(Total: 16 marks)

6. Alice, Brian and Clara had been in partnership for 10 years, sharing profits and losses in the ratio of 1:1:1 respectively. The balance sheet as at 31 December 2011 of the partnership was as follows:

	\$		\$
Premises, net	850 000	Capital accounts	
Plant and equipment, net	64 000	– Alice	276 000
Motor vehicles, net	82 100	– Brian	468 000
Inventory	33 600	– Clara	395 000
Trade receivables, net	23 800	Accrued expenses	21 400
Bank	135 500	Trade payables	28 600
	<u>1 189 000</u>		<u>1 189 000</u>

Alice retired from the partnership on 31 December 2011. Brian and Clara were to share profits and losses equally after Alice's retirement. Additional information was provided as follows:

- (i) In recognition of Alice's long service to the partnership, a motor vehicle with a net book value of \$22 000 was to be given to her free of charge and the amount was to be borne equally by Brian and Clara.
- (ii) The premises and the plant and equipment were to be revalued to \$1 400 000 and \$107 000 respectively.
- (iii) The allowance for doubtful debts was to be increased by \$2600 and inventory costing \$2400 was to be written off due to obsolescence.
- (iv) Goodwill was to be valued at \$420 000. No goodwill account was to be maintained in the books.
- (v) It was agreed that \$100 000 of the amount due to Alice upon her retirement was to be paid by cheque immediately while the remaining balance was to be left as a three-year loan to the new partnership.

**REQUIRED:**

- (a) Prepare
  - (1) the revaluation account; (3 marks)
  - (2) the partners' capital accounts, in columnar form, as at 31 December 2011, showing all the adjustments regarding the retirement of Alice; and (5 marks)
  - (3) the balance sheet of Brian and Clara as at 1 January 2012. (5 marks)

After her retirement from the partnership, Alice joined Dali Ltd as the sales director. She believed that her professional knowledge in the industry would bring benefits to the company. Therefore, she suggested valuing her expertise at \$6 000 000 and recognising it in the financial statements as an intangible asset.

**REQUIRED:**

- (b) With reference to one relevant accounting principles / concepts, briefly explain to Alice whether the amount of \$6 000 000 should be recognised in the financial statements as an intangible asset.

(3 marks)

(Total: 16 marks)

7. Joy Ltd manufactures a range of products. The company has two production departments (A and B) and two service departments (X and Y), and each department operates 50 weeks per year. Department A has 12 direct employees, each of whom works for 45 hours per week. Department B has 6 machines, each of which operates for 30 hours per week. Manufacturing overheads are allocated to Department A and Department B based on the total direct labour hours and the total machine hours respectively. In 2012, the total budgeted manufacturing overheads of the company are \$999 000, of which \$599 000 is allocated to respective departments as follows:

<i>Department</i>	\$
A	272 500
B	211 500
X	65 000
Y	50 000
	<u>599 000</u>

The remaining balance of the budgeted manufacturing overheads is to be apportioned as follows:

<i>Department</i>	%
A	35
B	30
X	15
Y	20

Services provided by the service departments for the production departments are to be apportioned as follows:

<i>Service Department</i>	<i>Production department</i>	
	A	B
X	60%	40%
Y	30%	70%

**REQUIRED:**

- (a) Prepare an overhead analysis sheet to calculate the predetermined overhead absorption rate for each of the production departments. (7 marks)

Joy Ltd has just been asked to quote for a one-off job to produce 600 units of Product H in December 2012.

Additional information:

- (i) Department A requires 10 cm of direct materials to produce one unit of Product H. The purchase cost of the direct materials is \$3 per cm.
- (ii) Department B requires 2 kg of direct materials to produce one unit of Product H. The purchase cost of the direct materials is \$8 per kg.
- (iii) The direct labour hours required for department A and department B to produce each unit of Product H is 0.5 and 0.25 respectively.
- (iv) The basic wage rate of direct labour for both production departments is \$50 per hour. The remaining total capacity in December 2012 will be 400 direct labour hours. The wage rate for overtime work is 130% of the basic wage rate and will be counted as the direct labour cost.
- (v) The total machine hours required for department A and department B to produce 600 units of Product H are 30 and 100 respectively.

**REQUIRED:**

- (b) Calculate the production cost per unit of Product H. (5 marks)
- (c) If the actual manufacturing overheads and the actual direct labour hours of department A in 2012 are \$560 800 and 28 300 hours respectively,
- (1) calculate the amount of manufacturing overheads over / under absorbed by department A in 2012; and (2 marks)
  - (2) give two reasons to explain why the use of the predetermined manufacturing overheads absorption rate is preferred to the use of the absorption rate based on actual data when calculating product cost. (4 marks)
- (Total: 18 marks)

**SECTION C**

Answer **ONE** question in this section.

8. Hilary Ltd manufactures and sells one single product, FS2. The budgeted production level and sales level for December 2012 are the same at 80 000 units. The budgeted income statement of Hilary Ltd for the month ended 31 December 2012 is as follows:

	\$	\$
Sales		2 400 000
Direct material	784 000	
Direct labour	280 000	
Designer fees	120 000	
Fixed production overheads	280 000	(1 464 000)
Gross profit		<u>936 000</u>
Fixed administrative expense	158 840	
Sales commission	112 000	(270 840)
Net profit		<u><u>665 160</u></u>

The following information was supplied by the accountant of the company:

- (i) Designer fees and sales commission are based on the budgeted number of units produced and the budgeted number of units sold respectively.
- (ii) Fixed costs remain the same regardless of any changes in the production or sales levels.

**REQUIRED:**

- (a) Calculate the following items for the month of December 2012:
  - (1) the breakeven volume (in units) (3 marks)
  - (2) the margin of safety (in sales dollars) (2 marks)

On 1 May 2012, the management of the company spent \$120 000 to hire a consultancy firm to investigate the possibility of extending the business to produce and sell a new product, FS4, starting from 1 January 2013.

Additional information relating to FS4 from 2013 to 2016:

- (iii) The consultancy firm estimates that the monthly demand for FS4 will be 15 000 units if its selling price is \$60 per unit.
- (iv) Part of the existing office area of Hilary Ltd will be put aside for a new sales team of FS4. If the office area is not used by the team, it will be sublet to outsiders at \$20 000 per month.
- (v) The variable production cost of FS4 will be \$15 per unit while the sales commission will be \$5 per unit.
- (vi) To produce FS4, a new factory with a monthly rental of \$100 000 will be rented and a new machine costing \$893 960 with a useful life of four years will be acquired. It is expected that the scrap value of the new machine at the end of its useful life is \$5000. The company adopts the straight line method of depreciation.
- (vii) There will be no change in the cost structure of the company from 2012 to 2016.

**REQUIRED:**

- (b) What are 'opportunity cost' and 'sunk cost' respectively? Illustrate the meaning of each cost with an example from the information provided above. (4 marks)
- (c) If Hilary Ltd spends an additional \$12 000 per annum on advertising and at the same time reduces the selling price of FS2 and FS4 by 10%, the expected monthly sales volume for FS2 will be increased from 80 000 to 100 000 units, while FS4 will be increased from 15 000 to 18 750 units. Assuming the company does not keep any opening and closing inventories for budgeted purposes, explain to the management whether the additional spending on advertising, together with the selling price reduction, should be introduced starting from 1 January 2013. (Ignore the time value of money.) (6 marks)
- (d) If Hilary Ltd decides to spare more resources to explore new market potential and therefore will sell only 10 000 units of FS2 per month after the introduction of FS4, calculate the monthly sales revenue of FS4 which Hilary Ltd needs to break even. (5 marks)
- (Total: 20 marks)



9. BC Ltd was incorporated and commenced its business selling imported tiles on 1 January 2010. On the date of incorporation, the company issued 1 000 000 ordinary shares of \$2 each at par. A four-year, \$1 000 000 bank loan with an interest rate of 6% per annum was obtained on the same date. The following information was available:
- (i) The ratio of total non-current liability to total equity (based on the year-end balances) as at 31 December 2010 was 1:4. No dividends had been proposed or paid in 2010 and 2011.
  - (ii) Total sales for 2011 were \$3 600 000. All goods were sold at a gross profit margin of 50%.
  - (iii) All sales and purchases were made on credit and were evenly spread throughout the year. In 2010 and 2011, the collection period of trade receivables was maintained at 1 month, while the settlement period of trade payables was maintained at 3 months.
  - (iv) Closing inventory as at 31 December 2010 and 2011 was valued at \$500 000 and \$1 100 000 respectively.
  - (v) Selling and distribution expenses of \$645 000 incurred in 2011 were fully paid.
  - (vi) Administrative expenses of \$270 000 were incurred in 2011, of which one-third remained unpaid as at 31 December 2011.
  - (vii) In order to finance the expansion of the business, the company further issued 1 000 000 ordinary shares at \$5 per share on 1 January 2011 and obtained a five-year bank loan with an interest rate of 4% per annum on the same date. The ratio of total non-current liability to total equity decreased to 1:5 immediately after the issuance of shares and the acquisition of the bank loan. The interests on all the bank loans incurred in 2011 were duly paid and properly recorded.
  - (viii) On 1 January 2011, the company purchased a piece of equipment for \$420 000. It is the company's policy to provide depreciation at an annual rate of 20% using the reducing balance method. The net book value of equipment as at 31 December 2010 was \$480 000.
  - (ix) All transactions were made through the bank account of the business. On 31 December 2011, there was no cash in hand while the bank account showed a debit balance.

**REQUIRED:**

- (a) Prepare for BC Ltd
    - (1) the income statement for the year ended 31 December 2011; and (6 marks)
    - (2) the statement of financial position as at 31 December 2011. (10 marks)
  - (b) As compared with 2010, many of the financial ratios of BC Ltd in 2011 had improved. Therefore, the Chief Executive Officer (CEO) of the company concluded that the performance of BC Ltd in 2011 was better. Give two reasons why the CEO's conclusion might be incorrect. Explain your answers. (4 marks)
- (Total: 20 marks)

**END OF PAPER**

HONG KONG EXAMINATIONS AND ASSESSMENT AUTHORITY  
HONG KONG DIPLOMA OF SECONDARY EDUCATION EXAMINATION

**PRACTICE PAPER**  
**BUSINESS, ACCOUNTING AND FINANCIAL STUDIES PAPER 2B**  
**Business Management Module**

(2 hours 30 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.

**SECTION A**

Answer **ALL** questions in this section.

1. Explain two advantages of using debt financing. (4 marks)
2. List two activity ratios and state what aspects of management efficiency each of them measures. (4 marks)
3. List four commonly used channels for external recruitment. (4 marks)
4. Outline three types of consumer protection measures in Hong Kong. (6 marks)
5. Describe three differences between a consumer market and a business market. (6 marks)
6. Conciliation and arbitration are commonly used in resolving labour disputes. Outline three differences between them. (6 marks)

**SECTION B**

Answer **ALL** questions in this section.

7. Moon Flower is a small travel agency established eight years ago specialising in selling travel related products and making travel arrangements for business and individual travellers. Daisy, the sole owner of Moon Flower, makes all the major decisions and relies only on ad hoc meetings to communicate with her employees. As a result, staff in the firm get used to waiting for Daisy's instructions and follow closely her work orders.

Moon Flower has been growing steadily with the recent increase in people travelling abroad. However, as the level of manpower is more or less the same as eight years ago, the workload of staff has become very heavy and most staff need to come to the office early in the morning and leave late at night. Although overtime payments are paid to the front-line employees in addition to their basic salary, they are dissatisfied and complain about overwork and underpayment compared to the industry average. Some of them have even started looking for new jobs and plan to leave the firm.

In addition, there seems to be a lack of coordination among employees, which leads to frequent delays of work and some key corporate accounts left unattended. Complaints over the poor service of the firm are increasing and employees are busy handling angry customers.

Daisy is very worried about the situation. She tries to establish a manpower plan and revise the existing compensation system to cope with the problems. In view of the potential growth in the business, Daisy also considers expanding her business by establishing a website and setting up new branches in other districts. Apart from the Small and Medium Enterprises (SME) Development Fund, Daisy wants to explore other sources of funds for the operations and expansion of the business. Therefore, she starts to analyse the firm's financial position and prepare a cash budget.

- (a) Describe two advantages of Daisy's practice of making all the major decisions of Moon Flower by herself. (4 marks)
- (b) Explain why the front-line employees of Moon Flower feel dissatisfied with reference to:
- (1) Maslow's Hierarchy of Needs Theory (4 marks)
- (2) McGregor's Theory X and Theory Y (4 marks)
- (c) Suggest two measures by which the situation of lack of coordination among Moon Flower's employees can be improved. (4 marks)
- (d) Describe the steps in manpower planning that Daisy should follow. (8 marks)
- (e) Apart from the SME Development Fund, list two other sources of funds for Moon Flower's operations and expansion. (2 marks)

(Total: 26 marks)

8. Century Group is a large local manufacturer of consumer electronics with a mission to provide entertainment to as many people as possible. With the growing popularity of interactive electronics, the Group has developed a four-dimensional (4D) portable electronic game device. In a management meeting, Mr Lam, the Chief Executive Officer, said, "After spending several years on research and development (R&D), it's time for us to reap our rewards and be the leader in the market."

Ms Ho, the Marketing Manager, responded, "To launch the new product, we need to develop effective marketing strategies. As the 4D portable electronic game device is in the introductory stage of the product life cycle, we have to select our target market carefully and formulate appropriate marketing mix strategies. According to my preliminary analysis, the new product can be marketed as a high-priced version which targets high income professionals, or it can be marketed as a low-priced version which targets the general public." The estimated net cash flows of the two versions are presented in the following table:

	<u>High-priced version</u> \$ (in millions)	<u>Low-priced version</u> \$ (in millions)
Year 0	-100	-70
Year 1	40	30
Year 2	60	50
Year 3	80	80
Year 4	50	60
Payback Period	2 years	?
Net Present Value (cost of capital is 10%)	\$80 206 270	?

Mr Lam said, "Your analysis reminds us that we have to be aware of the financial implications of launching the new product. Since we have already spent a vast amount of capital on the R&D of the new product in the past few years, if we further spend a considerable amount of money in marketing the new product, the pressure on capital would put our Group into a tight financial situation. As our Group is not able to undertake both versions, we have to choose one of them. I would choose the low-priced version."

Mr Fok, the Financial Manager, remarked, "I think financial control is important. Say for example, although the purchase price of raw materials and the wage rate of our employees were the same as budgeted, the actual spending on these two areas substantially exceeded the budgeted spending in the last financial year."

- With reference to the concept of the product life cycle, state four characteristics of the market of the 4D portable electronic game device. (4 marks)
- Ignoring any tax implications, calculate (1) the payback period and (2) the net present value of the low-priced version of the 4D portable electronic game device. Show your workings. (4 marks)
- Give three reasons to explain why Century Group should launch the low-priced version of the 4D portable electronic game device. (6 marks)
- Suggest the appropriate marketing mix strategies for the low-priced version of the 4D portable electronic game device. (8 marks)
- For (1) raw materials and (2) wages, suggest a reason for each to explain why there was a variance between the actual spending and the budgeted spending of Century Group in the last financial year. (2 marks)

(Total: 24 marks)

**SECTION C**

Answer **ONE** question in this section.

9. A company is considering applying for the rights to distribute a branded electric car in Asia. As a risk reduction measure, the company plans to conduct market research to assess the market potential of the electric car.
- (a) Describe the steps involved in conducting market research to assess the market potential of the electric car. (8 marks)
- (b) Suppose the company finally got the distribution rights. Apart from the risk reduction strategy, discuss the other risk management strategies that the company can adopt for distributing the electric car. (12 marks)
- (Total: 20 marks)
10. A large company has recently employed a group of young university graduates who have a great need for achievement. The company wants to develop them to take up senior management positions in the future. Discuss how the company could tailor its human resources management functions to support the development of the new recruits. (20 marks)
- (Total: 20 marks)

**END OF PAPER**