

CF04

Basic Accounting

11 OCTOBER 2001

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions
3. Number of questions to be answered : All five (5) questions
4. Show details of workings where appropriate. Silent, non-programmable calculators may be used.
5. Mathematical tables are provided in this question paper.
6. Begin each answer to a new question on a fresh page.
7. Answer **all** questions in **English**.

ANSWER ALL FIVE (5) QUESTIONS

1. The following trial balance was extracted from the books of TinkleBell Enterprise Bhd for the year ended 31 December 2000:

TRIAL BALANCE AS AT 31 DECEMBER 2000

	RM	RM
Trade debtors and trade creditors	2,560,000	1,742,000
Prepayments and accruals	29,350	50,000
Premises, at cost	1,363,000	
Fixtures and fittings, at cost	972,000	
Motor vehicles, at cost	354,000	
Trading profit		1,421,960
8% Irredeemable Convertible Unsecured Loan Stock (ICULS) 99/04		240,000
Interest paid on ICULS	9,600	
Ordinary share capital		1,500,000
Ordinary dividend – paid (interim)	72,000	
6% preference share capital		480,000
Preference dividend – paid (interim)	14,400	
Long-term investment, at cost	175,000	
Stock	979,200	
Bank	26,400	
Auditors' fees	15,000	
Accumulated depreciation as at 31 December 2000:		
• Fixtures and fittings		348,000
• Motor vehicles		150,000
Depreciation charge for the year ended 31 December 2000	206,400	
Retained profit as at 31 December 1999		830,800
Directors' remuneration	57,600	
Directors' fees	6,000	
Share premium		492,000
Administration, selling and distribution expenses	394,650	
Taxation	20,160	
	7,254,760	7,254,760

Additional information:

- (i) TinkleBell Enterprise Bhd has the following authorised share capital:
- 2,000,000 ordinary shares of RM1.00 each.
 - 500,000 of 6% preference shares of RM1.00 each.
- (ii) It is the company's policy to make a general provision of 5% of the outstanding trade debtors' balance as at 31 December 2000.
- (iii) The long-term investment consists of:

<i>Investment type</i>	Cost RM'000
Quoted, at cost	86,000
Unquoted, at cost	89,000
<i>Total</i>	<i>175,000</i>

As at 31 December 2000, the market price of the quoted investment is RM53,000.

- (iv) Administrative, selling and distribution expenses include a premium of RM5,400 for an insurance policy from 1 April 2000 to 31 March 2001.
- (v) The directors proposed payment of the preference dividend for the 2nd half of the year and a final dividend of RM0.02 per ordinary share.

Required:

Prepare the following for TinkleBell Enterprise Bhd:

- (a) Profit and Loss Account (in vertical format) for the financial year ended 31 December 2000. [10]
- (b) Balance Sheet as at 31 December 2000. [13]
- (c) Is share premium, a distributable or non-distributable reserve? List any **two** non-distributable reserves. [1]
- (Total:24 marks)

2. (a) As at 31 December 2000, Mestic Chemical Products Sdn Bhd undertook a stock count and arrived at a total stock of RM230,548, at cost. The stock count includes:
- (aa) 600 units of stock item 1122A of RM18 each which is stock under consignment from its supplier A.
 - (bb) RM6,355 of stock sold on credit as at 15 December 2000 pending collection by its customer.
 - (cc) 280 units of stock item 2233B, which cost RM35 each but the current market price is RM22 each.
 - (dd) Damaged goods which originally cost RM3,388. They were repaired at a cost of RM924 and this amount was added to the stock valuation. This stock has an estimated sales value of RM4,050. The customer has not sold the stock.

Required:

Prepare the following for Mestic Chemical Products Sdn Bhd:

- (i) A table showing the net effect of correcting items (aa) to (dd) on the original stock valuation, including the totals. Use the following headings in your answer:

Item reference [(aa) to (dd)]	Increase/(Decrease) in valuation RM	Reason(s)

[12]

- (ii) A calculation of the revised stock valuation as at 31 December 2000. [5]

- (b) Dewani Sdn Bhd is a trading company that sells goods on credit. Dewani Sdn Bhd has prepared the following information for the financial year ended 31 December:

	Year	
	1999 RM'000	2000 RM'000
Customers' balances as at 31 December	1,960	1,640
Bad debts written off as at 31 December	64	52
Provision for doubtful debts: % of total debtors amount to be adjusted to net income	2%	2%

On 15 February 1998, Dewani Sdn Bhd sold goods to Cempaka Sdn Bhd for RM64,000. Later in that year, Cempaka Sdn Bhd went into liquidation before the debt owed to Dewani Sdn Bhd was repaid.

At the end of financial year ended 31 December 1999, Dewani Sdn Bhd decided to write off the amount to bad debts. This was the only bad debt incurred in that financial year.

On 8 December 2000, Dewani Sdn Bhd received a cheque for RM12,800 from the liquidator of Cempaka Sdn Bhd as partial and final settlement of this debt.

Required:

Prepare the following accounts in Dewani Sdn Bhd's book for the financial years ended 31 December 1999 and 2000 in respect of the above transactions:

- (i) Profit and loss account (an extract) [3]
- (ii) Provision for bad debts account [4]
- (iii) Bad debts recovered account [2]

(Total:26 marks)

3. (a) The following issues arose from an examination of the draft final accounts of Company A, a public company, for the year ended 31 December 2000. Provide a brief explanation/comment for each of the issues raised below:
- (i) Company A has not provided depreciation on its newly constructed factory building as one of its directors alleged that depreciation is not necessary, as under normal circumstances, a completed factory building will fetch a higher market value than its original cost. [3]
 - (ii) Company A is proposing to include a quantity of stock in the financial year end valuation at its net realisable value of RM82,000 rather than its cost of RM60,000. The reason is that one of its longstanding customers has given its firm indication to purchase the goods from Company A in January 2001. [3]
 - (iii) During the year, Company A had undertaken a revaluation of all its landed properties. Some of its directors are contemplating the distribution of cash dividend to its shareholders using the surplus arising from the revaluation exercise. [3]
- (b) Select the **best** answer for each of the following:
- (i) Guotech Berhad acquired a machine at a special price of RM238,000. Its market value at the time of acquisition was RM250,000. The difference of RM12,000 should be:
 - A. credited to a non-operating gain income.
 - B. recorded in a deferred credit account and amortised over the useful life of the machine.
 - C. ignored.
 - D. credited to the profit and loss appropriation account. [2]
 - (ii) In a period of falling prices, the use of the first-in, first-out (FIFO) as against the last-in, first-out (LIFO) periodic inventory procedures will produce:
 - A. a higher gross profit.
 - B. the same gross profit.
 - C. a lower gross profit. [2]
 - (iii) A transaction caused a RM75,000 decrease in both the total assets and total liabilities. This transaction could have been the following:
 - A. The purchase of a delivery truck for RM75,000.
 - B. An asset that costs RM75,000 has been destroyed by fire.
 - C. Repayment of a bank loan of RM75,000.
 - D. Collection of a RM75,000 account receivable. [2]
- (Total:15 marks)

4. T-Recycle Sdn Bhd is a newly incorporated company, principally involved in tyres recycling. It was incorporated on 20 June 2000.

T-Recycle Sdn Bhd's director, Mr Yomiko, requested you to prepare a set of cashflow budget for his company.

Below are the information furnished to you by Mr Yomiko:

- T-Recycle started off with subscribers' cash capital of RM120,000.
- Sales are as follows:

Sales	2000					
	July RM	Aug RM	Sept RM	Oct RM	Nov RM	Dec RM
Cash	500	1,350	4,275	7,880	14,440	20,560
Credit	2,380	3,094	6,414	10,262	20,535	35,155

On average, 80% of the debtors pay their accounts **two** months after sales are made while the remaining 20% pay their accounts **three** months after sales are made.

- Purchases of raw material are all on cash terms and are as follows:

	2000					
	July RM	Aug RM	Sept RM	Oct RM	Nov RM	Dec RM
Cash	2,269	3,631	4,892	6,337	10,423	13,766

- Machinery costing RM135,600 is to be paid on 1 July 2000.
- Monthly rental for factory premises is RM2,000, to be paid in advance.
- T-Recycle Sdn Bhd has **three** principal shareholders who have agreed to provide shareholders' advances in order to meet its cashflow for each month.

Required:

Prepare a cash budget for T-Recycle Sdn Bhd for 6 months from July 2000 to December 2000 and indicate how much of shareholders' advances are required for each of the months. Show the necessary workings. (Total:15 marks)

5. As part of its business expansion plan, Kiasu Corporation Berhad (Kiasu) has decided to integrate backward to invest RM8,000,000 on its suppliers. Kiasu is contemplating to purchase shares in either Aiki Bhd or Zai Bhd, its two suppliers of raw material.

The following information are provided for Aiki Bhd and Zai Bhd:

	Aiki Bhd	Zai Bhd
	RM'000	RM'000
<u>As at 31 December 2000</u>		
Issued and fully paid-up ordinary share capital of RM1.00 each	4,750	5,750
9% debenture	2,750	2,125
Retained earnings as at 31 December 2000	3,500	2,750
Current assets	7,000	4,500
Current liabilities	1,750	2,250
Total spending on research and development	5,000	225
Kiasu's yearly raw material purchases from Aiki Bhd and Zai Bhd over its total purchases	45%	10%
Net profit for financial year ended 31 December:		
• 1998	1,500	1,750
• 1999	1,875	250
• 2000	2,125	1,250
Current market value per ordinary share	RM5.50	RM4.25

Required:

- (a) Based on the information above, compute each of the following ratios for Aiki Bhd and Zai Bhd:
- (i) Current ratio [2]
 - (ii) Gearing ratio [2]
 - (iii) Return on capital employed for financial year 2000 [3]
 - (iv) Earnings per share for financial years 1998 to 2000 [3]
- (b) Give **five** reasons why Kiasu might choose to purchase shares in either Aiki Bhd or Zai Bhd. For each of these reasons, indicate which of the company's shares (Aiki Bhd or Zai Bhd) should be purchased. [10]
- (Total:20 marks)

- END OF QUESTION PAPER -

OUTLINE ANSWERS

Question 1

A high proportion of the candidates were unable to prepare a full set of financial statements (Balance Sheet, Profit & Loss Account).

Candidates were also unable to differentiate between “distributable” and “non-distributable” reserves.

1. (a)

TinkleBell Enterprise Bhd
Profit and Loss Account for the year ended 31 December 2000

	<u>RM</u>	<u>RM</u>
Trading profit		1,421,960
<i>Less:</i> Expenses		
Directors' remuneration	57,600	
Directors' fee	6,000	
Auditors' fee	15,000	
Interest on ICULS (W1)	19,200	
Provision for doubtful debts (W2)	128,000	
Depreciation charges	206,400	
Administrative, selling & distribution expenses (W3)	393,300	
		825,500
Net profit before taxation		596,460
<i>Less:</i> Taxation		(20,160)
Net profit after taxation available for appropriation		576,300
Ordinary dividend - paid	(72,000)	
- proposed	(30,000)	(102,000)
Preference dividend - paid	(14,400)	
- proposed	(14,400)	(28,800)
		445,500
Net profit for the year after appropriation		445,500
Retained earnings brought forward		830,800
Retained earnings carried forward		1,276,300

(b)

TinkleBell Enterprise Bhd
Balance Sheet as at 31 December 2000

	<u>RM</u> <u>Cost</u>	<u>RM</u> <u>Accumulated</u> <u>Depreciation</u>	<u>RM</u> <u>Net Book</u> <u>Value</u>
<u>Fixed Assets</u>			
Premises	1,363,000	-	1,363,000
Motor vehicles	354,000	150,000	204,000
Fixtures & fittings	972,000	348,000	624,000
	<u>2,689,000</u>	<u>498,000</u>	<u>2,191,000</u>
Investment, at cost (W4)			175,000
<u>Current Assets</u>			
Stock			979,200
Trade Debtors (RM2,560,000 – RM128,000)			2,432,000
Prepayment (W3)			30,700
Bank			26,400
			<u>3,468,300</u>
<u>Current Liabilities</u>			
Trade Creditors			1,742,000
Accruals (W5)			59,600
Proposed dividend			44,400
			<u>1,846,000</u>
Net Current Assets			<u>1,622,300</u>
			<u>3,988,300</u>
Financed by:			
Share capital			
<u>Authorised</u>			
2,000,000 ordinary shares of RM1.00 each			2,000,000
500,000 6% preference shares of RM1.00 each			500,000
			<u>2,500,000</u>
<u>Issued and fully paid-up</u>			
1,500,000 ordinary shares of RM1.00 each			1,500,000
480,000 6% preference shares of RM1.00 each			480,000
Share Premium			492,000
Retained earnings			1,276,300
<u>Shareholders' fund</u>			<u>3,748,300</u>
8% Irredeemable Unsecured Loan Stock 99/04			240,000
			<u>3,988,300</u>

(c) Share premium is a non-distributable reserve.

Two non-distributable reserves are revaluation reserves and capital reserves.

(W1) Interest on 8% ICULS

	RM
Paid during the year	9,600
Interest accrued	9,600
Total interest	<u>19,200*</u>

(RM240,000 x 8% = RM19,200*)

(W2) Provision for doubtful debts

RM2,560,000 x 5% = RM128,000

(W3) Administrative, selling & distribution expenses

	RM
Per Trial Balance	394,650
Less: Insurance prepaid (5400 x ¼)	(1,350)
	<u>393,300</u>

Prepayment

	RM
Per Trial Balance	29,350
Add: Insurance prepaid	1,350
	<u>30,700</u>

(W4) Investment

Long-term investment should be stated at cost. Any fluctuation in market prices will not affect the valuation of the long-term investment. Provision in diminution in value of investment is only required when there is a permanent diminution in value of the said investment.

(W5) Accruals

	RM
As per the book	50,000
Add: Interest accrued for 8% ICULS	9,600
	<u>59,600</u>

Question 2

Most candidates did poorly in this question, in particular, the part requiring the computation and disclosure of provision for doubtful debts & bad debts recovered.

2. (a) (i)

Item reference	Increase/(decrease) in valuation RM	Reasons
(aa)	(RM10,800) ¹	Consignment stock is not asset of Mestic Chemical Products Sdn Bhd. As such, consignment stock should be excluded from stock valuation.
(bb)	(RM6,355)	Stock sold before financial year end pending collection by customers would have been recognised as sales for the financial year ended 31 December 2000. The double entry would be DEBIT trade debtors and CREDIT sales. As such, it should not be counted as stock of Mestic Chemical Products Sdn Bhd as at 31 December 2000 to avoid double counting of assets.
(cc)	(RM3,640) ²	The stock should be written down to its current market value based on the LOWER of COST and NET REALISABLE VALUE principle.
(dd)	(RM262) ³	The cost of stock (after taking into account the cost of repair) is RM4,312. However, based on the LOWER OF COST and NET REALISABLE VALUE principle, the maximum value to be recognised as stock should be capped at the net realisable value of RM4,050.

Workings

1. $RM18 \times 600 \text{ units} = \underline{RM10,800}$
2. $(RM35 - RM22) \times 280 = \underline{RM3,640}$
3. $(\text{Original cost} + \text{cost of repair}) - \text{Net realisable value}$
 $\Rightarrow (RM3,388 + RM924) - RM4,050 = \underline{RM262}$

(ii)

	RM
Cost as at 31 December 2000	230,548
Less : Item (aa)	(10,800)
Less : Item (bb)	(6,355)
Less : Item (cc)	(3,640)
Add : Item (dd)	(262)
	209,491

(b) (i)

Dewani Sdn Bhd
Profit and Loss Account
for financial year ended 31 December (extract)

	1999	2000
	RM	RM
Trading profit	xxx	xxx
<i>Less:</i> Provision for doubtful debts	(37,920)	-
<i>Add:</i> Write-back of provision for doubtful debts	-	6,160
<i>Less:</i> Bad debts write off	(64,000)	-
<i>Add:</i> Bad debts recovered	-	12,800

(ii)

Provision for Doubtful Debts Account					
1999		RM	1999		RM
31/12	Balance c/f	37,920	31/12	Profit and loss account (W1)	37,920*
2000			2000		
31/12	Profit and loss account	6,160	1/1	Balance b/f	37,920
31/12	Balance c/f	31,760			
		<u>37,920</u>			<u>37,920</u>

(W1) $(1,960,000 - 64,000) \times 2\% = \underline{37,920}$

* Assuming no provision for doubtful debts brought forward from previous financial year.

(iii)

Bad debts recovered account					
2000		RM	2000		RM
31/12	Profit and loss account	12,800	18/12	Trade debtors	12,800
		<u>12,800</u>			<u>12,800</u>

Question 4

Candidates were generally able to answer the question. However, some showed a lack of understanding of “shareholders’ advances” which was required in this question.

4.

T-Recycle Sdn Bhd
Cash Budget for 6 months from July 2000 to December 2000

	July	Aug	Sept	Oct	Nov	Dec
	RM	RM	RM	RM	RM	RM
Cash receipt						
Subscription capital	120,000	-	-	-	-	-
Cash sales	500	1,350	4,275	7,880	14,440	20,560
Trade debtors –80%	-	-	1,904	2,475	5,131	8,210
Trade debtors – 20%	-	-	-	476	619	1,283
	<u>120,500</u>	<u>1,350</u>	<u>6,179</u>	<u>10,831</u>	<u>20,190</u>	<u>30,053</u>
Cash Payment						
Purchases	2,269	3,631	4,892	6,337	10,423	13,766
Machinery	135,600	-	-	-	-	-
Rental	2,000	2,000	2,000	2,000	2,000	2,000
	<u>139,869</u>	<u>5,631</u>	<u>6,892</u>	<u>8,337</u>	<u>12,423</u>	<u>15,766</u>
Cash surplus/deficit	(19,369)	(4,281)	(713)	2,494	7,767	14,287
Balance b/f	-	(19,639)	(23,920)	(24,633)	(22,139)	(14,372)
Shareholders’ (advances)/return	(19,639)	(23,920)	(24,633)	(22,139)	(14,372)	85

Question 5

Most of the candidates were unable to compute the “gearing” & “return on capital employed” ratios.

5. (a)

	Aiki Bhd	Zai Bhd
(i) Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{\text{RM7,000,000}}{\text{RM1,750,000}}$ = 4 times	$\frac{\text{RM4,500,000}}{\text{RM2,250,000}}$ = 2 times
(ii) Gearing ratio = $\frac{\text{Debt}}{(\text{Debt} + \text{shareholders' funds})}$	$\frac{\text{RM2,750,000}}{(\text{RM2,750,000} + \text{RM4,750,000} + \text{RM3,500,000})}$ = $\frac{\text{RM2,750,000}}{\text{RM11,000,000}}$ = 25%	$\frac{\text{RM2,125,000}}{(\text{RM2,125,000} + \text{RM5,750,000} + \text{RM2,750,000})}$ = $\frac{\text{RM2,125,000}}{\text{RM10,625,000}}$ = 20%
(iii) Return on capital employed = $\frac{\text{Net profit}}{\text{shareholders' funds}}$	$\frac{\text{RM2,125,000}}{(\text{RM4,750,000} + \text{RM3,500,000})}$ = $\frac{\text{RM2,125,000}}{\text{RM8,250,000}}$ = 25.8%	$\frac{\text{RM1,250,000}}{(\text{RM5,750,000} + \text{RM2,750,000})}$ = $\frac{\text{RM1,250,000}}{\text{RM8,500,000}}$ = 14.7%
(iv) Earnings per shares (EPS) = $\frac{\text{Net profit}}{\text{No. of ordinary shares issue}}$	1998: $\frac{\text{RM1,500,000}}{4,750,000}$ = 31.6 sen 1999: $\frac{\text{RM1,875,000}}{4,750,000}$ = 39.5 sen 2000: $\frac{\text{RM2,125,000}}{4,750,000}$ = 44.7 sen	1998: $\frac{\text{RM1,750,000}}{5,750,000}$ = 30.4 sen 1999: $\frac{\text{RM250,000}}{5,750,000}$ = 4.3 sen 2000: $\frac{\text{RM1,250,000}}{5,750,000}$ = 21.7 sen

(b) Kiasu Corporation Berhad may choose to purchase shares in Aiki Bhd for the following reasons:

Liquidity:

Aiki Bhd's financial position is more liquid than Zai Bhd as every RM1 of current liabilities is backed by RM4 of current assets.

Profitability:

Aiki Bhd is more profitable than Zai Bhd. Aiki Bhd is able to generate 25.8 sen for every RM1 of capital invested by its shareholders in the company. Conversely, Zai Bhd is able to generate only 14.7 sen for every RM1 of capital invested by its shareholders.

Stable upward profit trend: This is evidenced in Aiki Bhd's relatively higher and stable upward trend of earnings per shares ("EPS") as compared to Zai Bhd's EPS over the past 3 financial years.

Pricing: Aiki Bhd's Price Earnings ("PE") multiples based on its current market price of RM5.50 and net profit for year 2000 of 44.7 sen gives rise to a PE Multiples of 12.3 times (i.e. RM5.50/RM0.447) as compared to Zai Bhd's PE multiples of 19.6 times (i.e. RM4.25/RM0.217).

In layman's terms, assuming the **two** companies are able to maintain their respective earnings level at RM0.447 (Aiki Bhd) and RM0.217 (Zai Bhd), it will take the investors 12.3 years and 19.6 years to recover their investment today in Aiki Bhd and Zai Bhd respectively. As such, it will be cheaper to invest in Aiki Bhd than Zai Bhd.

Dependency on raw material sourcing: Based on the information given, Kiasu sources approximately 45% of its total raw material requirement from Aiki Bhd and only 10% from Zai Bhd. As such, it will be very crucial for Kiasu to have a good business relationship with Aiki Bhd in order to ensure constant and non-interrupted supply of raw materials. It will be a good decision to buy into Aiki Bhd and own approximately 30.6% of equity interest in the company, i.e.:

$$\frac{\text{Investment fund}}{\text{current market price per ordinary share of Aiki Berhad}} = \frac{\text{RM8,000,000}}{\text{RM5.50}} = 1,454,545.45 \text{ shares}$$

$$\% \text{ of ownership} = \frac{1,454,545.54 \text{ shares}}{4,750,000 \text{ shares}} \times 100 = \mathbf{30.6\%}$$

Research and development: Aiki Bhd has spent RM5,000,000 on research and development as compared to RM225,000 by Zai Bhd.