# CF04

# Basic Accounting

## 9 OCTOBER 2003

| | | | |
|---|---|---|---|
| 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.** Ominashi Sdn Bhd ("Ominashi") began trading on 1 July 1996 with an issued and paid-up share capital of RM2,000,000. The trial balance of Ominashi as at 30 June 2003 is as follows:

**TRIAL BALANCE AS AT 30 JUNE 2003**

| | **DR** | **CR** |
|---|---|---|
| | RM'000 | RM'000 |
| Furniture and fittings, at cost | 725 | |
| Motor vehicles, at cost | 850 | |
| Freehold land, at cost | 2,880 | |
| Factory building | 1,785 | |
| Accumulated depreciation as at 30 June 2002: | | |
| - Furniture and fittings | | 375 |
| - Motor vehicles | | 510 |
| - Factory building | | 285 |
| Share capital: | | 2,000 |
| - Authorised (5,000,000 ordinary shares of RM1.00 each) | | |
| - Issued and paid-up (2,000,000 ordinary shares of RM1.00 each) | | |
| Motor expenses | 86 | |
| Trade debtors/Trade creditors | 1,637 | 1,146 |
| Other debtors and deposits | 423 | |
| Other creditors and accruals | | 213 |
| Provision for taxation | 60 | 75 |
| Cash at bank/Bank overdraft | 18 | 187 |
| Term loan | | 500 |
| Purchases/Sales | 9,211 | 13,095 |
| Stock as at 30 June 2002 | 1,208 | |
| Discount allowed/discount received | 46 | 105 |
| Insurance | 286 | |
| Interest expenses | 55 | |
| Electricity and water | 604 | |
| Retained profits as at 30 June 2002 | | 1,383 |
| | 19,874 | 19,874 |

The following information is also available:

- Ominashi's yearly depreciation rates for its fixed assets using the reducing balance method are as follows:

| | |
|---|---|
| Furniture and fittings | 10% |
| Motor vehicles | 20% |
| Factory building | 2% |

- Insurance includes RM23,000 relating to financial year ending 30 June 2004.
- Closing stock as at 30 June 2003 is RM1,368,000.
- Electricity and water bills for June 2003 amounting to RM56,000 have not been accrued for in the accounts.
- With the prevailing weak market conditions, Ominashi's Board of Directors is of the view that a 2% doubtful debt provision is necessary on the year-end trade debtors' balance.
- The freehold land was acquired in the year 1998. Based on the advice of professional valuers, the current market value of the freehold land is RM3,890,000. Ominashi's Board of Directors have agreed to incorporate the new market value in the book of Ominashi.
- Ominashi's Board of Directors have also proposed a first and final tax-free dividend of 8% for this financial year.

**Required:**

(a) Prepare the following for Ominashi:

(i) Trading, Profit and Loss Account for the financial year ended 30 June 2003. [11]

(ii) Balance Sheet as at 30 June 2003. [14]

(Note: Show calculations to the nearest RM'000.)

(b) Name **two** types of share capital for a limited company. [2]

(Total:27 marks)

**2.** (a) Skumi Sdn Bhd ("Skumi") manufactures and assembles electronic equipment. Skumi's stock consists of a wide variety of raw materials and components as well as manufactured finished goods.

It was not possible for Skumi to undertake a physical stock count at its year-end on 30 June 2003 and the stock count had to be delayed until 8 July 2003.

| | **RM** |
|---|---|
| Raw materials and components | 72,270 |
| Finished goods | 260,200 |

Additional information regarding the stock count is as follows:

- Included in the raw materials stock are some components bought in August 2002. These cost RM13,750 but can only be used in a product that Skumi no longer manufactures. The scrap value is RM3,500 or the stock could be sold to another manufacturer for RM4,500 less transportation cost of RM500.
- Included in the finished goods are some pagers made in October 2002. These cost RM65,700 but they are now out of fashion and could only be sold for RM38,500. An alternative is to modify them at a cost of RM22,100 and sell them for RM54,900.

**Required:**

Based on the principle of lower of cost and net realisable value, calculate the following items, which will be disclosed in Skumi's Balance Sheet as at 30 June 2003:

(i) Raw materials and components [5]

(ii) Finished goods [5]

(b) La Faber Bhd is nearing to the end of its financial year. The Chairman is concerned about La Faber Bhd's profit performance and he suggests the following to the Finance Director to improve the year's profit:

***Suggestion 1:***

"We have fixed assets which cost RM2,850,000. We usually depreciate by 10% on cost. If we do not depreciate the fixed assets this year, our expenses will be reduced."

***Suggestion 2:***

"We could buy more stock for RM825,000. This will increase our closing stock. It improves our profits and makes our balance sheet stronger."

***Suggestion 3:***

"The property valuers advise that La Faber Bhd's freehold factory land and building at Puchong Industrial Park are now worth RM555,000 more than what we previously paid for them. If taken into account, this would improve our profits."

**Required:**

Comment on each of the **three** above suggestions by the Chairman. Indicate whether each of the Chairman's suggestions is advisable or not. You are required to take into account good accounting practice and conventions in your commentary. [6]

(Total:16 marks)

**3.** For each of the following questions, there are **four** possible answers (A, B, C and D). Select the **best** answer.

(a) What will cause a company's gearing to increase?

A. Bonus issue of ordinary shares.
B. Conversion of debenture into ordinary shares.
C. Issue of debentures.
D. Rights issue of ordinary shares. [2]

(b) Which of the following items could be included in a balance sheet at more than its historical cost?

A. Goodwill.
B. Land and building.
C. Research expenditure.
D. Stock (Inventory). [2]

(c) AAA Sdn Bhd bought a Proton Perdana V6 for RM120,000. The car was later sold for RM98,000 and a profit of RM6,000 was made on disposal.

What is the accumulated depreciation of the Proton Perdana V6 in the book of AAA Sdn Bhd?

A. RM28,000.
B. RM16,000.
C. RM26,000.
D. RM6,000. [2]

(d) What is ignored in the calculation of depreciation of a fixed asset?

A. The cost of purchase of the fixed asset.
B. The cost of repairs.
C. Its estimated residual value at the end of its useful life.
D. The length of expected useful economic life to the business. [2]

(e) For which of the following purposes can a share premium account legally be used?

A. To repay debentures.
B. To pay ordinary dividends.
C. To make a rights issue.
D. To make a bonus issue. [2]

(f) What will always be classified in a balance sheet as a current liability?

A. Debentures.
B. Preference shares.
C. Prepaid expenses.
D. Proposed dividends. [2]

(g) Revenue _____ a company's shareholders' fund.

A. increases
B. decreases
C. does not affect
D. both increases and decreases [2]

(h) Which of the following reserves could be used to distribute cash dividends?

A. Assets revaluation reserves.
B. General reserves.
C. Share premium.
D. Retained earnings. [2]

(i) Under the accrual basis of accounting, expenses are recognised when:

A. goods or services are consumed by the firm in generating revenue.
B. the cash outflow takes place.
C. the cash inflow takes place.
D. goods are purchased to help generate revenues. [2]

(j) Revenues _____ and expenses _____ retained earnings respectively.

A. decrease …… decrease
B. increase …… decrease
C. increase …… increase
D. decrease …… increase [2]

(Total:20 marks)

**4.** (a) Gizmos Sdn Bhd embarks on a new project, Project A. The cash flow for Project A is shown in the table below:

| Year | Cash Inflow/(Outflow) RM | Discount factor at 15% |
|---|---|---|
| 0 | (86,000) | 1.000 |
| 1 | 40,000 | 0.870 |
| 2 | 50,000 | 0.756 |
| 3 | 30,000 | 0.658 |

**Required**:

What is the net present value, using a 15% discount factor, for Project A? [5]

(b) Kizmos Sdn Bhd ("Kizmos") is considering a proposal to buy a new equipment for a new product line. The equipment costs RM400,000, has an estimated 10-year service life, and an estimated salvage value of RM50,000. Kizmos estimates that production and sale of the new product will increase its annual net cash flow by RM100,000 per annum for the next 10 years.

**Required**:

What is the net present value if Kizmos requires a 15% annual rate of return on the investment? [5]

(c) Sismo Sdn Bhd ("Sismo") has a plot of freehold land in Puchong at cost of RM150,000. It was appraised by an independent professional valuer with a market value of RM180,000. A real estate agent proposes for Sismo to put up a multi-purpose office building. The construction cost would be RM900,000. The real estate agent foresees a shortage of office space and estimates that a year from now, the new building would fetch RM1.28million if Sismo sold it. The expected rate of return of Sismo is 8%.

**Required:**

If you are the Finance Director of Sismo, which of the following alternatives would you advise the Board of Directors of Sismo to carry out?

***Alternative 1:***

Dispose the land outright, assuming Sismo can identify a ready buyer.

***Alternative 2:***

Accept the proposal by the real estate agent, assuming there will be ready buyers for the office building.

Substantiate your proposal to Sismo with the necessary workings/explanation.

[5]
(Total:15 marks)

**5.** The summarised final accounts of Tarsha Sdn Bhd ("Tarsha") and Marsha Sdn Bhd ("Marsha") are given below. Both Tarsha and Marsha are competitors. They are selling similar products to the same target market.

**SUMMARISED TRADING, PROFIT AND LOSS ACCOUNTS FOR FINANCIAL YEAR ENDED 30 JUNE 2003**

| | Tarsha | | Marsha | |
|---|---|---|---|---|
| | **RM'000** | **RM'000** | **RM'000** | **RM'000** |
| Sales* | | 1,540 | | 2,310 |
| *Less*: Cost of goods sold | | | | |
| - Opening stock | 528 | | 660 | |
| - Purchases | 1,232 | | 1,716 | |
| | 1,760 | | 2,376 | |
| - Closing stock | 660 | (1,100) | 726 | (1,650) |
| Gross profit | | 440 | | 660 |
| *Less*: | | | | |
| - Interest expense | - | | 33 | |
| - Administrative and selling expenses | 187 | (187) | 209 | (242) |
| Net profit | | 253 | | 418 |

** Assuming all sales are credit sales.*

**BALANCE SHEET AS AT 30 JUNE 2003**

| | Tarsha | | Marsha | |
|---|---|---|---|---|
| | **RM'000** | **RM'000** | **RM'000** | **RM'000** |
| Fixed assets | | 462 | | 748 |
| Current assets: | | | | |
| Stock | 660 | | 726 | |
| Trade debtors | 308 | | 396 | |
| Bank | 110 | | - | |
| | 1,078 | | 1,122 | |
| Current liabilities: | | | | |
| Trade creditors | 308 | | 264 | |
| Bank overdraft | - | | 176 | |
| | 308 | | 440 | |
| Net current assets | | 770 | | 682 |
| | | 1,232 | | 1,430 |
| Financed by: | | | | |
| Ordinary shares of RM1.00 each | | 660 | | 660 |
| Profit & loss | | 132 | | 110 |
| General reserves | | 440 | | 330 |
| | | 1,232 | | 1,100 |
| Term loan (repayable in year 2008) | | - | | 330 |
| | | 1,232 | | 1,430 |

**Required:**

(a) Calculate the following ratios for both Tarsha and Marsha:

(i) Net profit to sales or net profit margin [2]

(ii) Stock turnover (times) [3]

(iii) Fixed assets turnover (times) [3]

(iv) Average collection period (ACP) (in days) [3]

(v) Return on shareholders' equity [3]

(vi) Current ratio [2]

(Present your answer to the nearest **two** decimal points.)

(b) Compare the performance of Marsha and Tarsha using the following criteria:

(i) Profitability [3]

(ii) Utilisation of resources [3]

(Total:22 marks)

**- END OF QUESTION PAPER -**

# OUTLINE ANSWERS

**Question 1**

A good number of candidates scored well in this question. The remaining candidates were not able to differentiate the items that were supposed to be in the Profit and Loss Account and the Balance Sheet. Some candidates were unable to identify the different types of share capital.

**1.** (a) (i)

**Ominashi Sdn Bhd**
**Trading, Profit and Loss Account**
**for the year ended 30 June 2003**

| | RM'000 | RM'000 |
|---|---|---|
| Sales | | 13,095 |
| *Less: Cost of sales* | | |
| Opening stock | 1,208 | |
| Purchases | 9,211 | |
| | 10,419 | |
| Closing stock | (1,368) | 9,051 |
| Gross profit | | 4,044 |
| Discount received | | 105 |
| | | 4,149 |
| *Less: Expenses* | | |
| Motor expenses | 86 | |
| Discount allowed | 46 | |
| Interest expenses | 55 | |
| Provision for depreciation | | |
| - Furniture and fittings | 35 | |
| - Motor vehicles | 68 | |
| - Factory building | 30 | |
| Provision for doubtful debts (1,637 x 2%) | 33 | |
| Insurance (286 – 23) | 263 | |
| Electricity and water (604 + 56) | 660 | 1,276 |
| Net profit before taxation | | 2,873 |
| Less: Provision for taxation | | 60 |
| Net profit after taxation | | 2,813 |
| Less: Proposed dividend – first and final (RM2,000,000 x 8%) | | 160 |
| | | 2,653 |
| Retained earnings brought forward | | 1,383 |
| Retained earnings carried forward | | 4,036 |

(a) (ii)

**Ominashi Sdn Bhd**
**Balance Sheet as at 30 June 2003**

| | Cost/ Revaluation | Accumulated Depreciation | Net Book Value |
|---|---|---|---|
| | **RM'000** | **RM'000** | **RM'000** |
| Freehold land | 3,890 | - | 3,890 |
| Furniture and fittings | 725 | 410 | 315 |
| Motor vehicles | 850 | 578 | 272 |
| Factory building | 1,785 | 315 | 1,470 |
| | 7,250 | 1,303 | 5,947 |
| | | | |
| *Current assets* | | | |
| Stock | | 1,368 | |
| Trade debtors (1,637 – 33) | | 1,604 | |
| Other debtors, prepayment and deposits (423 + 23) | | 446 | |
| Cash at bank | | 18 | |
| | | 3,436 | |
| | | | |
| *Current liabilities* | | | |
| Trade creditors | | 1,146 | |
| Other creditors and accruals (213 + 56) | | 269 | |
| Provision for taxation | | 75 | |
| Provision for dividend | | 160 | |
| Bank overdraft | | 187 | |
| | | 1,837 | |
| Net current assets | | | 1,599 |
| | | | 7,546 |
| *Financed by:* | | | |
| Authorised share capital (5,000,000 ordinary shares of RM1.00 each) | | | 5,000 |
| Issued and paid-up share capital (2,000,000 ordinary shares of RM1.00 each) | | | 2,000 |
| Retained earnings carried forward | | | 4,036 |
| Revaluation reserves (3,890 - 2,880) | | | 1,010 |
| | | | 7,046 |
| Term loan | | | 500 |
| | | | 7,546 |

(b) **Two** types of share capital for a limited company are ordinary shares and preference shares.

**Question 2**

Generally candidates were not able to give satisfactory answers to all the topics examined in this question. Their performance indicated they did not understand the treatment and principle of financial accounting and depreciation.

**2.** (a) (i) Raw materials and components to be disclosed in Skumi's Balance Sheet as at 30 June 2003 are as follows:

| | RM | RM | RM |
|---|---|---|---|
| As given (before adjustment) | | | 72,270 |
| *Adjustments on product no longer being manufactured* | | | |
| Less: Cost of raw materials stock | | | (13,750) |
| *Alternatives (Note 1)* | | | |
| (1) Scrap value | | 3,500 | |
| (2) To be sold to another manufacturer | 4,500 | | |
| Less: Transportation cost | (500) | 4,000 | 4,000 |
| | | | (9,750) |
| Adjusted value of raw materials and components as at 30 June 2003 | | | 62,520 |

***Note (1)***

Valuation of stock is based on the principle of **lower of cost and net realisable value (LCM)**. In this instance, because Skumi Sdn Bhd is no longer manufacturing the product, the raw materials stock and components being used solely for that particular product line will have to be written down to the lower of cost and its net realisable value.

Skumi Sdn Bhd has a choice, either to take up:

- Alternative (1) – to sell the raw materials stock as scrap for RM3,500; or
- Alternative (2) – to sell to another manufacturer for RM4,000 (net of transportation cost).

In order to realise as much value for that particular raw materials stock, Skumi Sdn Bhd should opt for Alternative (2). This is because Alternative (2) will give a net realisable value of RM4,000 as opposed to RM3,500 under Alternative (1).

Based on the LCM principle (as opposed to the original cost of that particular raw material stock of RM13,750) the value of the raw materials stock will be RM4,000. Accordingly, the loss in value of the raw materials stock to Skumi Sdn Bhd will be RM9,750.

(ii) Finished Goods to be disclosed in Skumi Sdn Bhd's Balance Sheet as at 30 June 2003 is as follows:

| | RM | RM | RM |
|---|---|---|---|
| As given (before adjustment) | | | 260,200 |
| *Adjustments for out-of fashion product* | | | |
| Less: Cost of finished goods | | | (65,700) |
| *Alternatives (Note 2)* | | | |
| (1) To sell at a discounted price | | 38,500 | 38,500 |
| (2) To be sold after modification | 54,900 | | |
| Less: Modification cost | (22,100) | 32,800 | |
| | | | (27,200) |
| Adjusted value of finished goods as at 30 June 2003 | | | 233,000 |

***Note (2)***
Valuation of stock is based on the principle of **lower of cost and net realisable value ("LCM")**. In this instance, the finished goods (i.e. pagers) are out of fashion. Accordingly, a LCM test is necessary.

Skumi Sdn Bhd has a choice either to take up:

- Alternative (1) – to sell the finished goods at a discounted price for RM38,500; or
- Alternative (2) – to modify and re-sell them in the market at RM32,800 (after deducting modification cost of RM22,100).

Based on the above, Alternative (1) will give a higher net realisable value of RM38,500 as opposed to RM32,800 under Alternative (2). Accordingly, Skumi Sdn Bhd should just sell the pagers at a discounted price to the market rather than undertake the modification process.

Based on the LCM principle, the value of the finished goods to be disclosed in Skumi Sdn Bhd's balance sheet will be RM38,500 (as opposed to the original cost of the finished goods of RM65,700). Accordingly, the loss in value of finished goods to Skumi Sdn Bhd will be RM27,200.

(b) ***Suggestion 1***

The Chairman's suggestion is incorrect. Fixed assets are bought to be used in the ordinary course of business over a period of time, which is normally longer than one (1) accounting period. Based on the matching concept, one matches the cost of the fixed asset with the benefit to be received from its use. By not doing so, the financial statement will not reflect the company's actual performance and also the value of the fixed asset will not reflect its actual depleted value.

***Suggestion 2***

The Chairman's suggestion is incorrect and against the Convention of Conservatism. This suggestion not only inflates profits without any real trading activities but also puts La Faber Bhd's liquid resources in stock, which may take a long time to be utilised in the future.

***Suggestion 3***

The Chairman's suggestion is incorrect. If a landed property is revalued to its prevailing market value, the arising gain is deemed a capital gain. Thus, it should be credited to the revaluation reserves account rather than be taken up as the current year's profit.

**Question 3**

This question, comprising multiple-choice questions on accounting theories and concepts, was well answered.

3. Answers to multiple-choice questions:
   (a) C
   (b) B
   (c) A
   (d) B
   (e) D
   (f) D
   (g) A
   (h) D
   (i) A
   (j) B

**Question 4**

The majority of the candidates had difficulty answering this question. As they were not able to calculate the Net Present Value, they were unable to make a good decision between the 2 alternative investments given.

**4.** (a) Gizmos Sdn Bhd embarks on a new project, Project A. The Net present value for Project A is as follows:

| Year | Cash Inflow/(Outflow) RM | Discount factor at 15% | Present Value RM |
|---|---|---|---|
| 0 | (86,000) | 1.000 | (86,000) |
| 1 | 40,000 | 0.870 | 34,800 |
| 2 | 50,000 | 0.756 | 37,800 |
| 3 | 30,000 | 0.658 | 19,740 |
| | | **Net Present Value is:** | **6,340** |

(b)

| | RM |
|---|---|
| Present value of expected annual cash inflow of RM100,000 Per annum for 10 years (RM100,000 x 5.019) *(Refer Table 2)* | 501,900 |
| Present value of estimated salvage value to be received at the end of the 10th year (RM50,000 x 0.247) *(Refer Table 1)* | 12,350 |
| Present value of estimated future cash inflows | 514,250 |
| LESS: Cost of Initial Investment (already in present value) | (400,000) |
| Net Present Value on proposal | 114,250 |

(c) ***Alternative 1:*** Outright sales of land, assuming there is a ready buyer.

Gain on disposal = RM180,000 – RM150,000
= RM30,000

***Alternative 2:*** To construct a multi-purpose office building, assuming there will be ready buyers for the office building.

The present value (PV) of the multi-purpose office building would be:

PV = RM1,280,000 / (1+8%)
= RM1,280,000 / 1.08
= RM1,185,185

Net present value (NPV) = PV – Required Investment
= RM1,185,185 – (RM900,000 + RM150,000)
= RM135,185

Based on the above, assuming a ready buyer could be identified for the stated price at RM1.28 million, I would advise the Board of Directors to accept ***Alternative 2*** (i.e.: to accept the proposal of the real estate agent.)

**Question 5**

Some candidates were not able to give the correct formula to compute the ratios. Thus, they could not analyse and interpret the performance of both companies based on the ratios.

5. (a)

| | | Tarsha Sdn Bhd | Marsha Sdn Bhd |
|---|---|---|---|
| (i) | Net profit to sales<br>= (Net Profit/Sales) x 100% | (RM253,000/RM1,540,000) x 100%<br>= 16.43% | (RM418,000/ RM2,310,000) x 100%<br>= 18.09% |
| (ii) | Stock turnover (times)<br>= Cost of goods sold / Average Stock | RM1,100,000 / (RM528,000 + RM660,000)/2<br>= 1.85 times | RM1,650,000 / (RM660,000 + RM726,000)/2<br>= 2.38 times |
| (iii) | Fixed assets turnover (times)<br>= Sales / Fixed Assets | RM1,540,000 / RM462,000<br>= 3.33 times | RM2,310,000 / RM748,000<br>= 3.09 times |
| (iv) | Average collection period (ACP) (in days)<br>= (Trade Debtors/Credit Sales) x 365 days | RM308,000 x 365 days<br>RM1,540,000<br>= 73 days | RM396,000 x 365 days<br>RM2,310,000<br>= 63 days |
| (v) | Return on shareholders' equity<br>= Net profit x 100% / Shareholders' fund | RM253,000 x 100% / RM1,232,000<br>= 20.54% | RM418,000 x 100% / RM1,100,000<br>= 38.00% |
| (vi) | Current ratio<br>= Current Assets / Current Liabilities | RM1,078,000 / RM308,000<br>= 3.5 times | RM1,122,000 / RM440,000<br>= 2.55 times |

(b) (i) Profitability

Marsha's profitability is higher as compared to Tarsha's. Marsha's net profit margin is 18.09% as compared to Tarsha's 16.43%. In terms of return on equity, Marsha also reported a higher return on equity of 38% as compared to 20.54% for Tarsha.

(ii) Utilisation of resources

The ratios indicating how well the business makes use of its resources are Fixed Assets Turnover, Stock (inventory) turnover and Trade Debtors' Collection Period. Tarsha is less efficient in its utilisation of resources. Tarsha's Stock Turnover and Trade Debtors' Collection Period is longer than Marsha's is. However, Tarsha is able to generate more sales value (in RM) for every RM of investment in fixed assets as compared to Marsha.