Answer **all** questions.

1 The following balances were extracted from the books of KVG Pte Ltd at the end of the financial year on 31 December 2022.

	$
Fixtures and fittings at cost	32 000
Accumulated depreciation of fixtures and fittings	9 600
Motor vehicles at cost	120 000
Accumulated depreciation of motor vehicles	43 200
Sales revenue	792 115
Sales returns	5 935
Cost of sales	576 026
Inventory	60 164
Wages and salaries	110 987
Commission income	13 265
Insurance	5 635
Utilities	3 263
Discount received	3 150
Trade receivables	54 800
Allowance for impairment of trade receivables	3 890
Cash at bank	5 000
Trade payables	12 000
6% Bank loan repayable 2026	35 000
Issued share capital, 100 000 ordinary shares	50 000
Retained earnings, 1 January 2022	11 590

Additional information on 31 May 2023

1 Insurance, $3 000, was prepaid.

2 Commission income, $21 200, had not been received.

3 The allowance for impairment of trade receivables is to be maintained at 6% of trade receivables.

4 Fixtures and fittings are to be depreciated at 10% per annum using the straight-line method.

5 Motor vehicles are to be depreciated at 20% per annum using the reducing-balance method.

6 Loan from the bank was obtained on 1 July 2022 and to be repaid equally over five years.

7 Interest on the bank loan for the year to 31 December 2022 had not yet been paid.

REQUIRED

(a) Prepare the statement of financial performance for the year ended 31 December 2022. [10]

(b) Prepare the statement of financial position as at 31 December 2022. [10]

[Total: 20]

2 Samuel runs an interior design business. The business has a financial year which ends on 31 December each year. He provided the following information about his business for the years 2020 to 2022.

	31 December 2020	31 December 2021	31 December 2022
Assets			
Motor vehicles	50 000	100 000	200 000
Trade receivables	40 000	90 000	100 000
Prepaid expenses	1 500	3 500	18 500
Cash at bank	5 000	7 000	-
Liabilities			
Trade payables	11 000	34 000	50 000
Insurance payable	1 100	4 200	10 020
Bank overdraft	-	-	42 025
Current ratio	3.84	?	?
Quick ratio	3.72	?	?

REQUIRED

(a) Calculate the current ratio and quick ratio of the business for each of two years ended 31 December 2021 and 2022. [4]

(b) Evaluate the trend in liquidity of the business over the three years ended 31 December 2020, 2021 and 2022. Use the given information and your answer to (a). [8]

[Total: 12]

3 Siva is a sole trader. His business buys and sells kitchen appliances. When preparing the business financial statements for the year ended 31 May 2023, he discovered the following errors:

1 Siva took a kitchen appliance worth $1 000 from the business for his personal use but this had been omitted from the books.

2 Insurance, $800, paid in cash had been debited to cash in hand and credited to insurance.

3 A cheque, $8 900, received from a tenant for rental income, had been recorded as $890.

REQUIRED

(a) Name the accounting theory that requires error **1** to be corrected. [1]

(b) Prepare journal entries to correct error **2** and **3**. Narrations are **not** required. [4]

The profit for the year ended 31 May 2023 had been calculated as $15 980 **before** correction of errors.

REQUIRED

(c) Prepare a statement of adjusted profit for the year ended 31 May 2023 after taking into account the effect of errors **1 to 3** on the profit for the year ended 31 May 2023. [4]

(d) Distinguish the**two** differences between a trading business and a service business. [4]

[Total: 13]

4 Fatimah buys and sells bread and cakes on credit. Her business financial year ends on 31 July.

On 1 August 2021, her business had a balance of $2 800 in its allowance for impairment of trade receivables account.

Her business reviews its list of trade receivables at the end of every financial year and estimates that 5% of its trade receivables are likely to be uncollectible.

Fatimah provided the following balances:

	31 July 2022	31 July 2023
	$	$
Trade receivables	50 000	60 000

On 31 December 2021, the business of Perfect Bakes, a credit customer, filed for bankruptcy and Fatimah's business wrote off $2 000 owed by Perfect Bakes.

REQUIRED

(a) State and explain the accounting theory which must be applied when accounting for allowance for impairment of trade receivables. [2]

(b) Prepare journal entries to record the following transactions. Narrations are **not** required.

(i) write-off the debt owed by Perfect Bakes on 31 December 2021 [2]

(ii) adjustment of allowance for impairment of trade receivables as at **31 July 2023** [2]

(c) Prepare an extract of the statement of financial performance for the year ended **31 July 2023** showing the impairment loss on trade receivables. [1]

(d) Prepare an extract of the statement of financial position as at **31 July 2023** showing the trade receivables and allowance for impairment of trade receivables. [1]

Fatimah's business is considering a request from one of its new customers, Efficient Bakes, which traded with Fatimah's business for the past three months. Efficient Bakes has requested for a 30-day credit period.

For the past three months, Efficient Bakes has been buying from Fatimah's business on an ad hoc cash basis. Efficient Bakes is opening a new bakery in a new town with a large population of youth and young adults.

The new town has seen more young families moving into the vicinity. Based on the feasibility studies which Efficient Bakes has shared with Fatimah, the residents moving into the new town generally like to consume bread as their staple meals and cakes as their breakfast and snacks. Currently, the new town has an occupancy rate of 50% and it is set to rise as more families will be moving in upon completion of the renovation of their new homes.

Based on an online search conducted on Efficient Bakes, Fatimah gathered information that Efficient Bakes has been in the bakery business for ten years and has always been able to pay its debts when its credit suppliers delivered their orders in the past ten years. No negative comments or reviews surfaced during the online search except a comment which suggested that the estimated trade receivables collection period of Efficient Bakes is 35 days. This is three days longer than that of Fatimah's business.

Recently, some unfavourable reviews of the services provided by the bakery has started to surface online.

Separately, due to the last two years of Covid-19 pandemic, several home renovations delays have been highlighted by the press.

REQUIRED

(e) Advise Fatimah if her business should sell on credit to Efficient Bakes and grant Efficient Bakes a 30-day credit period. Justify your decision with **three** reasons. [7]

[Total: 15]

End of paper

Marking scheme for 5NA Prelim Paper 2:

1a) KVG Pte Ltd

Statement of financial performance for the year ended 31 December 2022

	$	$	Mark
Sales revenue		792 115	
Less: Sales returns		5 935	
Net sales revenue		786 180	1
Less: Cost of sales		576 026	
Gross profit		210 154	1
Other income			
Discount received	3 150		1
Commission income (+21 200)	34 465	37 615	1
Less: Other expenses			
Wages and salaries	110 987		
Insurance (-3000)	2 635		1
Utilities	3 263		
Reversal of impairment of trade receivables ((6% ×54800) – 3890)	(602)		1
Depreciation of fixtures and fittings (10% X 32000)	3 200		1
Depreciation of motor vehicles (20% × (120 000 –43 200))	15 360		1
Interest on bank loan (6% × 35 000 × 6/12)	1 050		1
		135 893	
Profit for the year		111 876	1

1b) KVG Pte Ltd

Statement of financial position as at 31 December 2022

Assets	$	$	$	
Non-current assets	Cost	Accumulated depreciation	Net book value	Mark
Fixtures and fittings	32 000	12 800	19 200	1
Motor vehicles	120000	58 560	61 440	1
			80 640	
Current assets				
Trade receivables	54 800			
Less: Allowance for impairment of trade receivables (6% × 54800)	3 288	51 512		1
Inventory		60 164		
Cash at bank		5 000		
Prepaid insurance		3 000		1
Commission income receivable		21 200	140 876	1
Total assets			221 516	
Equity and liabilities				
Shareholders' equity				
Share capital, 100 000 ordinary shares		50 000		1
Retained earnings (11590+ 111876)		123 466	173 466	1 OF
Non-current liabilities				
Long-term borrowings (35 000 - 7 000)			28 000	1
Current liabilities				
Current portion of long-term borrowings		7 000		1
Trade payables		12 000		
Interest expense payable		1 050	20 050	1
Total equity and liabilities			221 516	

2a)

	31 December 2020	31 December 2021	31 December 2022
Assets			
Motor vehicles	50 000	100 000	200 000
Trade receivables	40 000	90 000	100 000
Prepaid expenses	1 500	3 500	18 500
Cash at bank	5 000	7 000	-
Liabilities			
Trade payables	11 000	34 000	50 000
Insurance payable	1 100	4 200	10 020
Bank overdraft	-	-	42 025
Current ratio	3.84	100500/38200 = 2.63[1]	118500/102045 = 1.16[1]
Quick ratio	3.72	97000/38200 = 2.54[1]	100000/102045 = 0.98[1]

2b)

Current ratio worsened over the three years from 3.84 in 2020 to 1.16 in 2022. [1] This indicated that business has lesser current assets to pay for its short-term debts in 2022 than 2020.[1]

Trade receivables position has worsened since trade receivables have increased each year from $40000 in 2020 to $90000 in 2021 and to $100000 in 2022.[1] Increasing trade receivables may mean credit customers are not paying.[1]
The trade payables position has worsened since they have increased from $11000 in 2020 to $50000 in 2022.[1] In addition, the business is investing in motor vehicles over the three years from $50000 in 2020 to $200000 in 2022.[1] This is worsened by the insurance payable which increased from $1100 in 2020 to $10020 in 2022 which indicates that the business could be facing issues in meeting its short-term debts as current liabilities increased about 7 times in 2022 as compared to 2020.[1]

Quick ratio worsened over the three years from 3.72 in 2020 to 0.98 in 2022.[1]
Quick assets were lesser than current liabilities in 2022 i.e. the proportion has fallen below the benchmark of 1.[1] As a result, the business may not have sufficient quick assets to pay its immediate debts.[1] This is evident from the business' bank balance has worsened over the three years from $5000 in 2020 and to an overdraft of $42025 in 2022. Or This is evident from the business cash at bank account has worsened by $47025 from 2020 to 2022.[1] Separately, the prepaid expenses have increased significantly over the three years from $1500 in 2020 to $18500 in 2022.[1] Funds are tied up in prepaid expenses which could otherwise be used to pay immediate debts. [1]

The business liquidity position has worsened from 2020 to 2022 and it is unlikely to be able to meet its immediate debts in 2022.[1]

1 mark per suitable comment to a **maximum of 8 marks**.

3a) Accounting entity theory [1]

3b)

Journal

Date	**Particulars**	**Debit**	**Credit**	
2023		$	$	Mark
May 31	Insurance	1 600		1
	Cash in hand		1 600	1
May 31	Cash at bank	8 010		1
	Rental income		8 010	1

3c)

Statement to show adjusted profit for the year ended 31 May 2023

	$	$	Mark
Unadjusted profit for the year		15 980	1
Add:			
Rental income – was understated (error 3)		8 010	1
Less:			
Insurance expense – was understated (error 2)		1 600	1
Adjusted profit for the year		22 390	1

Error 1 has no effect on profit for the year.

3d)

Trading business	**Service business**
Buys and sells goods to its customers	Provides services to its customers
Keeps inventory	Does not keep any inventory
There is trading portion in the statement of financial performance showing sales revenue, cost of sales and gross profit	There is no trading portion in the statement of financial performance of a service business

Any two of the above, **maximum 4 marks**.

4a)

Prudence theory [1] which states that the accounting chosen should be the one that least overstates assets and profits and least understates liabilities and losses. This will ensure that trade receivables balance is not overstated. [1]

4b)

Journal

	Date	**Particulars**	**Debit**	**Credit**	Mark
(i)	2021		$	$	
	Dec 31	Allowance for impairment of trade receivables	2 000		1
		Trade receivable – Perfect Bakes		2 000	1
(ii)	2023				
	Jul 31	Impairment loss on trade receivables	500		1
		Allowance for impairment of trade receivables [(5% × $60000) – (5% ×$50000)]		500	1

4c)

Fatimah
Statement of Financial Performance for the year ended 31 July 2023 (extract)

	$
Less: Other expenses	
Impairment loss on trade receivables	500 1 OFgh

4d)

Fatimah
Statement of Financial Position as at 31 July 2023 (extract)

Assets	**$**	**$**
Current assets		
Trade receivables	60 000	
Less: Allowance for impairment of trade receivables	3 000	57 000 1 OF

4e) (Either answer must be supported by **three** reasons.)

Decision	Fatimah should grant sell and credit Efficient Bakes a 30-day credit period. [1]	Fatimah should not sell and grant credit Efficient Bakes a 30-day credit period. [1]
Reason Development	With Efficient Bakes' expansion of its business to a new town densely populated,1 and Efficient Bakes would be able to increase its business and reap more profits. As a result, it would be able to repay Fatimah without any possibility of default on any of its outstanding debts. 1	With Efficient Bakes' expansion of its business to a new town with only 50% occupancy rate of residents and worsen by the delay in home renovations as a result of backlog from Covid-19 pandemic, 1 there is a risk of the business not doing well in its sales in the new bakery and worsen its debt position. This may mean possible delays in receiving payment from Efficient Bakes. 1
Reason Development	From the online search of the credit rating of Efficient Bakes, there was no negative comments or reviews for the past 10 years. 1 This showed that Efficient Bakes is reliable in its payments of debts and hence, Fatimah can trust that it will settle its debts promptly. 1	The unfavourable reviews of the services of Efficient Bakes 1 may affect the business sales performance and increase the possibility of delays in payment to Fatimah. Hence, granting 30-day credit to Efficient Bakes may not be recommended. 1
Reason Development	From the feasibility studies which Efficient Bakes shared with Fatimah, it showed that the new bakery which Efficient Bakes would bring in good sales since the staple food of the residents in the new town is bread and pastry. 1This will allow Efficient Bakes to increase its sales. This indicates the business may grow and Efficient Bakes will be a good credit customer. 1	Efficient Bakes also takes longer to collect debts from its credit customers than both Fatimah's average trade receivables collection period. 1 This may result in possible cashflow issues for Efficient Bakes as it is required to pay Fatimah with a 30-day but it could only collect from its credit customers within 35 days. This may result in Fatimah not able to collect the debts from Efficient Bakes within the credit period causing her business' liquidity position to be affected. 1