

Name	Class				Index Number		
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BROADRICK SECONDARY SCHOOL

SECONDARY 4 EXPRESS

SECONDARY 5 NORMAL ACADEMIC

PRELIMINARY EXAMINATION 2022

PRINCIPLES OF ACCOUNTS

7087/02

Paper 2

September 2022

Additional Materials: answer paper (6 sheets)

2 hours

READ THESE INSTRUCTIONS FIRST

Write your name, index number and class on all the work you hand in.

Write in dark blue or black pen on both sides of the paper.

You may use a HB pencil for rough working.

Do not use staples, paper clips, glue or correction fluid.

The use of an approved calculator is allowed.

Answer **all** questions.

At the end of the examinations, fasten all your work securely together.

The number of marks is given in brackets [] at the end of each question or part question.

The total of marks for this paper is **60**.

Target Grade:
Actual Grade:
For Examiner's Use
60

Parent's Signature: _____

Setter(s) : Mr. Lim Shi Hao

Answer **all** questions.

- 1 The following balances were extracted from Unity Pte Ltd as at 31 May 2022.

	\$
Share capital, 40 000 ordinary shares	40 000
Retained earnings, 1 June 2021	220 100
Consultancy fee income	208 400
Fixtures and fittings	466 000
Accumulated depreciation of fixtures and fittings	128 000
Rent income	29 400
Salary expense	92 400
Trade receivables	64 000
Allowance for impairment of trade receivables	5 000
Cash at bank	162 500
2% Bank loan	100 000
Trade payables	54 000

Additional information

- 1 \$6 000 of rent income was earned but not yet received.
\$4 000 of salary expense was owing.
- 2 The allowance for impairment of trade receivables is to be maintained as 5% of trade receivables.
- 3 Fixtures and fittings are to be depreciated using the straight-line method over a useful life of five years. The estimated scrap value is \$2 400.
- 4 Interest expense has not been paid.
- 5 20% of the bank loan had to be repaid on 31 December 2022.
- 6 The company declared a dividend at \$0.05 per share. The dividend will be paid on 1 July 2022.

REQUIRED

- (a) Prepare the statement of financial performance for the year ended 31 May 2022. [8]
- (b) Prepare the statement of financial position as at 31 May 2022. [12]

[Total : 20]

[Turn over

- 2** Gregory runs a retail business with a financial year end of 31 March. The following ledger account has been prepared at 31 March 2022.

Sale of motor vehicles				
Date 2022	Particulars	Debit (\$)	Credit (\$)	Balance (\$)
Mar 31	Motor vehicles	38 000		38 000 Dr
31	Accumulated depreciation of motor vehicle		13 680	24 320 Dr
31	Trade receivables – Goldie (A)		20 000	4 320 Dr
31	Income Summary		4 320	-

REQUIRED

- (a)** Interpret each of the entries in the sale of motor vehicles account.
- (i)** Motor vehicle
 - (ii)** Accumulated depreciation of motor vehicles
 - (iii)** Trade receivables – Goldie
 - (iv)** Income summary [4]
- (b)** State the source document used to record the transaction **(A)**. [1]
- (c)** Using an appropriate accounting theory, explain why a business should depreciate its non-current assets. [2]
- (d)** State one cause of depreciation. [1]

During the year, Gregory had paid for the installation of his new machinery at a cost of \$18 000, which includes \$2 800 for repairs to his existing machinery. He had included the total cost in the business's statement of financial performance.

REQUIRED

- (e)** State the effect and amount of including the cost of installation of the new machinery in the statement of financial performance on the following:
- (i)** Profit for the year
 - (ii)** Non-current assets [4]
- (f)** Distinguish between capital and revenue expenditure. [1]

[Total : 13]

- 3 The following information relates to Mervyn's business at 31 March 2020, 2021 and 2022.

	2020 \$	2021 \$	2022 \$
Current assets			
Inventory	57 350	72 800	135 500
Prepaid Rental expenses	-	12 000	24 000
Trade receivables	34 400	50 800	55 200
Cash at bank	36 150	18 500	-
	<u>127 900</u>	<u>154 100</u>	<u>214 700</u>
Current liabilities			
Trade payables	32 200	48 500	65 700
Cash at bank	-	-	12 300
Expenses payable	4 550	6 600	8 250
Current portion of long term borrowings	-	-	75 000
	<u>36 750</u>	<u>55 100</u>	<u>161 250</u>
Current ratio	3.48	?	?
Quick ratio	1.92	?	?

REQUIRED

- (a) Explain what is meant by the liquidity of a business. [1]
- (b) Calculate the following ratios of the business for each of the two years ended 31 March 2021 and 2022. Show your answer to **two** decimal places.
- (i) Current ratio
- (ii) Quick ratio [4]
- (c) Using the given information and your answer to (b), evaluate the trend in liquidity of the business over the three years ended 31 March 2020, 2021 and 2022. [6]

Other than liquidity, Mervyn is also concerned about the profitability of the business. The business profit has worsened over the three years ended 31 March 2020, 2021 and 2022.

REQUIRED

- (d) Suggest **two** ways to improve profitability of a business. [2]

[Total : 13]

[Turn over

- 4** Ethel runs a business supplying art supplies. The following information is available for the month of February 2022.

Feb 2 Purchased goods by cheque, \$32 300
 11 Sold goods costing \$22 000 to John on credit for \$88 800
 23 Purchased goods on credit from Roderick, \$30 500
 28 Sold goods for cash, \$50 200. These goods cost \$12 050
 28 The net realisable value of ending inventory was reduced by \$1000 due to flood.

REQUIRED

- (a) Prepare the inventory account for the month of February 2022. [3]
 (b) Prepare the sales revenue account for the month of February 2022. [2]
 (c) Name and explain one accounting theory that is applied to the valuation of inventory. [2]

Ethel's sister, Johanna, is a housewife with 3 young children in the family. She enjoys baking for her family and friends. Her food is always well-received, especially her cupcakes.

Johanna would like to set up a store selling her cupcakes. However, Johanna does not have any experience in setting up and managing a business. Johanna is also unsure of how she could promote her product. Since Ethel is a business woman, she is interested in investing in Johanna's business.

Johanna has sufficient funds from her savings to start the business. She has plans to expand the range of products and would want to be able to make most of the decisions about the business. She hopes to own a chain of stores selling baked goods and wants to leave the business to her children.

REQUIRED

- (d) Recommend whether Johanna should set up a sole proprietor or private limited company. Give **three** reasons for your choice. [7]

[Total : 14]**- End of Paper -**

Suggested solution

Question 1

a)

Unity Pte Ltd		
Statement of financial performance for the year ended 31 May 2022 [1]		
	\$	\$
Consultancy fee income		208400 [1]
Add: Other income		
Rent income (29400+6000)		35400 [1]
Less: Other expenses		
Salary expense (92400+4000)	96400 [1]	
Interest on loan/ Interest expense (2% x 100000)	2000 [1]	
Depreciation of fixtures and fittings [(466000-2400)/5]	92720 [1]	
Reversal [1] of impairment loss on trade receivables (5%x64000) – 5000	(1800) [1]	189320
Profit for the year		54480

b)

Unity Pte Ltd			
Statement of financial position as at 31 May 2022			
Assets	\$	\$	\$
Non-current assets	Cost	Accumulated depreciation	Net book value
Fixtures and fittings (128000+92720)	466 000	220720 [1]	245280
Current assets			
Trade receivables	64000 [1]		
Less: allowance for impairment of trade receivables	3200 [1]	60800	
Cash at bank		162500	
Rent income receivable		6000 [1]	229300
Total assets			474580
Equity and liabilities			
Shareholders' equity [1]			
Issued Share capital, 40 000 ordinary shares		40000 [1]	
Retained earnings (220100+54480-2000)		272580 [OF1]	312580
Non-current liabilities			
Long-term borrowings			80000 [1]
Current liabilities			
Current portion of long-term borrowings		20000 [1]	
Trade payables		54000	
Salary expense payable		4000 [1]	
Interest expense payable (2%x50000)		2000 [1]	
Dividends payable (0.05x40000)		2000 [1]	82000
Total equity and liabilities			474580

- 2ai** The original cost of motor vehicle sold in the period [1]
- aii** The total depreciation to date on the motor vehicle sold in the period [1]
- aiii** Disposal proceed of the motor vehicles sold on credit to Goldie [1]
- aiv** Loss made on sale of motor vehicle in the year[1]
- b** invoice [1]
- c** Matching [1]

According to the matching theory, expenses incurred must be matched against the income earned in the same period to determine the profit for the period. As the non-current assets are being used to generate income, a portion of the cost of using the non-current asset (depreciation expense) should be matched to the income earned in the same financial period to determine the profit for the period. [1]

- d**
- Usage,
 - wear and tear,
 - obsolescence and
 - legal limits.
- Any 1 = 1 mark

- ei** Profit will understated(1) by \$15200 (1)
- eii** Non current assets will be understated (1) by \$15200 (1)
- f** Capital expenditure are the cost to buy and bring the nca to their intended use while revenue expenditure are cots to operate, repair and maintain the nca in working condition (1)

Capital expenditure provides benefits for more than 1 year while revenue expenditure provides benefits which will be used within 1 year (1)

Capital expenditure are presented in statement of financial position while revenue expenditure are presented in statement of financial performance. (1)

Any one set, 1 m

- 3a** Liquidity is the ability of the business to repay its current liabilities when they fall due. [1] OR Liquidity measures how able a business is able to convert current assets into cash to pay for current liabilities [1]

b

		2021	2022
	Current ratio	2.80 [1]	1.33 [1]
	Quick ratio	1.25 [1]	0.34 [1]

c

Current ratio has worsened from 3.48 in 2020 to 2.80 in 2021 and 1.22 in 2022.[1]
Current ratio is below the healthy level of 2 in 2022 [1]

Current assets are greater than current liabilities for each of the three years [1]
Current liabilities have increased to a greater extent than current assets over the period [1]

Inventory holdings have increased from \$57350 in 2020 to \$135500 in 2022 [1]
Increasing inventory may mean funds are tied up [1]

Quick ration has worsened from 1.92 in 2020 to 1.25 in 2021 to 0.34 in 2022 [1]
Quick ratio is below the healthy level of 1 in 2022 [1]

This is because the amount of inventory as a proportion of current assets has increased over the years [1]

Trade receivables position has worsened as trade receivables have increased from \$34400 in 2020 to \$55200 in 2022. [1]
Increasing trade receivables runs the risk of possible loss on impairment of trade receivables [1]
Increasing trade receivables may mean that funds are less readily available [1]

Trade payable position has worsened as it had increased from \$32200 in 2020 to \$65700 in 2022 [1]
An increase in trade payable may affect the ability to obtain credit [1]
An increase in trade payable may affect the relationship with supplier if unable to pay invoice on time [1]

A portion of long term borrowing has now become current as the status has changed from being due in over 1 year to falling due within the next 12 months. [1]
The bank balance has worsened from \$36150 in 2020 to a bank overdraft of \$12300 in 2022 [1]

Over all, liquidity have worsened over the years [1]
Any 6 = 6 marks

- d** find ways to increase its other income to improve its profitability. For example, it can sublet part of the shop space to earn rental income. [1]

could cut down on unnecessary expenses to improve profitability. For example, it can move to a smaller shop with the similar human traffic with cheaper rent [1]

4a

Inventory a/c					
Date	Particulars	Dr (\$)	Cr (\$)	Bal (\$)	
2022					
Feb 2	Cash at Bank	32 300		32 300 Dr	^
11	Cost of sales		22 000	10 300 Dr	}
23	Trade payable Roderick	30 500		40 800 Dr	^1m for Both
28	Cost of sales		12 050	28 750 Dr	}1m for Both
28	Impairment loss on inventory		1 000	17 750 Dr	[1]
Mar 1	Balance b/d			17 750 Dr	

b

Sales revenue a/c					
Date	Particulars	Dr (\$)	Cr (\$)	Bal (\$)	
2022					
Feb 11	Trade receivables John		88 800	88 800 Cr	[1]
28	Cash in hand		50 200	139 000 Cr	[1]
Mar 1	Balance b/d			139 000 Cr	

c

The prudence theory states that assets and profits should not be overstated and expenses and losses should not be understated. (1) Hence, when net realisable value fall below the original cost, inventory should be valued at the net realisable value. (1)

- d** A decision which is supported by reason [1]
Each reason should carry 1 basic statement for [1] which is then developed for an additional [1] – total [6] for discussion 3 reasons.

Johanna should set up a sole proprietor.

- As Johanna is a housewife who does not have any experience in setting up a business, setting up a sole proprietor might be better for her as there are minimal administrative duties to adhere to as compared to a private limited company.
- Johanna has enough capital from her personal savings to contribute to the business and thus can be solely-owned by her. Since she is able to contribute the funds, setting up a sole proprietor is sufficient.
- Setting up a sole proprietorship allows Johanna to have full control over the business decisions which is what she wants. Sandy would then be better able to decide what cakes that she wants to sell and when to introduce new flavours.

Johanna should set up a private limited company.

- Her family has 3 young children, thus setting up a private limited company with her sister has lesser risk for Johanna where in the event that the business fails, Johanna will only forfeit her investment and is not obligated to pay using her personal assets.
- In addition, Johanna's sister can assist in managing the business as she has the expertise and Johanna can focus on preparing the cakes
- Johanna hopes to expand the business in future and she would likely need to borrow money. It is more likely for banks to lend money to a private limited company as compared to a sole proprietor, or the company may issue more shares to raise funds.
- As Johanna wants to leave the business to her children, setting up a private limited company is better as it exists forever until wound up or struck off. If something unfortunate happens to Johanna suddenly, the business will continue to exist.