Suggested solutions for Secondary 4E/5N Preliminary Examination 2023

1a.

Law Fairness Statement of financial performance for the year ended 31 December 2022		
	$	$
Legal fees revenue (+4 320)		109 643 ✓
Other income		
Commission income	1 230 ✓	
Discount received	371 ✓	1601
Less: other expenses		
Interest expense (+1200)	5 390 ✓	
Rental expense (+6800)	20240 ✓	
Salaries & wages	28 644	
Discount allowed	6520 ✓	
Depreciation of office equipment (25% x 51000-10200)	10200 ✓	
Depreciation of fixtures and fittings (10% x 37800)	3780 ✓	
Impairment loss on trade receivables ((10% x (4560+4320))-750	138 ✓	(74 912)
Profit for the period		36 332 ✓ OF

1b.

Law Fairness Statement of financial position as at 31 December 2022			
Assets **Non-current assets**	$ Cost	$ Accumulated depreciation	$ Net book value
Office equipment	51000	20400	30600 ✓
Fixtures and fittings	37800	11340	26460 ✓
			57060
Current assets			
Trade receivables (+4 320)	8880 ✓		
Less: allowance for impairment loss of trade receivables	(880)	7 992 ✓	
Cash in hand		11000 ✓	18 992.
			76 052
Equity and liabilities			
Owner's equity			
Capital (+36 332-7860) ✓			57 122 ✓
Non-current liabilities			
Long term borrowing			8000 ✓
Current liabilities			
Interest expense payable		1 200 ✓	
Bank overdraft (+6800)		7300 ✓	
Trade payable		2430	10930
			76 052

2a.

Journal			
Date	**Particulars**	**Debit**	**Credit**
2020		**$**	**$**
Jan 1	Salaries expense payable	5 400 ✓	
	Salaries expense		5 400 ✓
	Reverse salaries expense incurred and will be paid this year ✓		

2b.

Journal			
Date	**Particulars**	**Debit**	**Credit**
2020		**$**	**$**
Dec 31	Rental income receivable	3 890 ✓	
	Rental income		3 890 ✓
	Record rental income earned this year but not yet received ✓		

2c.

Kairos Statement of financial performance for the year ended 31 December 2020 (extract)		
Other income	$	$
Rental income		52 590 ✓
Less: other expense		
Salaries expense		38 100 ✓

Rental income = $(53000-4300+3890) = $52590

Salaries expense = $(45000-5400-1500) = $38100

2d. Profit for the year and equity would be understated by $300.

2e. According to the **revenue recognition theory** ✓, revenue is recognised when **goods are delivered or services are provided.** ✓

OR

Accrual basis of accounting. Business activities that have **occurred**, regardless of whether **cash is paid or received,** should be recorded in the **relevant accounting period.**

3a.

May 31 – business sold fixtures and fittings with an original cost of $13 000 ✓ on credit to Sun for $3 000 ✓. The accumulated depreciation of the disposed fixtures and fittings was $5 000 ✓.

3b.

Journal			
Date	**Particulars**	**Debit**	**Credit**
2021		**$**	**$**
May 31	Income summary	2 000 ✓	
	Sale of non-current assets		2 000 ✓

3c. Depreciation is the allocation of cost of a non-current asset over its estimated useful life. ✓

3d. According to the prudence theory ✓, the accounting treatment should least overstate assets and income and least understate liabilities and expense ✓. Hence, there is a need to present non-current assets with **accumulated depreciation** to show the **net book value** of an asset in the statement of financial position. ✓

3e.

Buy ✓	Rent ✓
There is a 3 year warranty ✓ Should there be any need for repairs or damage to car, business is covered by warranty and can save on expense. ✓	There is no upfront payment. ✓ This will free up the cash in business for other immediate payment like salaries or rental payment. ✓
Business needs to pay monthly instalment of $800. ✓ The low monthly instalment will ensure business still has sufficient cash flow for other immediate operational needs. ✓	Insurance is covered and paid for by rental company. ✓ Business can save on insurance expense and use the cash for other purposes. ✓
Modifications and designs can be done on the car ✓ This allows business to market the business brand and can help increase reputation of business, thus increasing customer ✓	Contract period is 12 months. ✓ Business can change to another car model if there is a need that arise due to the needs of the business. ✓

4a.

Liquidity is the ability of the business to convert current assets into cash to pay its current liabilities.

Profitability is the ability of the business to generate excess income to cover its expenses.

4b.

(i) Gross profit margin
= gross profit / net sales revenue x 100%
= 47 700 / 93 300 x 100%
= 51.13%

(ii) Profit margin
= profit / net sales revenue x 100%
= 24700 x 93300 x 100%
= 26.47%

(iii) Return on Equity
= profit / average capital x 100%
= 24700 / (56 000+77 000)/2 x 100%
= 37.14%

Gross profit = 104 000-45 600-10 700

Net sales revenue = 104 000-10 700

4c. sell goods at a higher selling price / buy goods at lower cost price / increase sources of other income / reducing operating expense (any 2)

4d.

Profit margin of Kate, 26.47% is lower than Spade at 30.11%. ✓

This means that Spade has a greater ability to generate profit per dollar net sales revenue. ✓

However, Kate's return on equity is higher at 37.14% than Spade at 28.91%. ✓

This means that Kate is more efficient in generating profit for its shareholders. ✓

Investor should invest in Kate's business since the return on equity is higher. ✓