Deyi Secondary School
Secondary 4E/5NA Prelim
Paper 1
MARK SCHEME

1 Frosty Slushies has a financial year end on 31 March 2024. The following ledger account has been prepared.

Sale of equipment				
Date	Particulars	Debit $	Credit $	Balance $
2024				
Mar 31	Equipment	20 000		20 000 Dr
	Accumulated depreciation of equipment		3 800	16 200 Dr
	Other receivable-Freezie		24 500	8 300 Cr
	Income summary	8 300		-

REQUIRED

(a) Interpret each of the entries in the sale of equipment account.

(i) Equipment

On 31 March 2024, the original cost of the equipment sold is $20 000. [1]/
On 3 March 2024, the business sold an equipment that cost $20 000. [1].

(ii) Accumulated depreciation of equipment

The equipment being sold on 1 January 2024, had a total depreciation of $3 800 to date. [1]

(iii) Other receivables- Freezie

The disposal proceeds of the equipment sold on credit to Freezie was $24 500. [1] OR
The equipment sold to Freezie on credit was for $24 500. [1]

(b) State the effect and amount of the sale of equipment on the following:

(i) The net book value of the non-current assets will decrease by $16 200. [1]

(ii) Profit will increase by $8 300. [1]

(c) Define 'depreciation'.

Depreciation is the allocation of cost of a non-current asset over its estimated useful life. [1]

(d) Name and explain an accounting theory why Frosty Slushies needs to provide for depreciation on its non-current assets.

According to the matching theory [1], expenses incurred must be matched against the income earned in the same period to determine the profit for the period (Definition). 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(Link). [1]

OR

According to prudence theory [1], the business should not overstate the value of its assets and profits (Definition), hence the business should record the loss in value of the assets by providing for depreciation (Link). [1]

(e) State **two** non-accounting information a business should consider when deciding to purchase a non-current asset.

Purpose of non-current assets [1]
Features of non-current assets [1]
Customer reviews of the non-current assets [1]
Warranty of non-current assets [1]

Any 2 of the above.

[Total : 10]

2 Evermore Gym took up a $150 000 loan from Infinity Bank at an interest rate of 2% per annum on 1 May 2022 and the amount was deposited in the business' bank account. The loan is to be repaid equally over 5 years.

The loan and interest expense are repayable every year on 30 April 2023.The financial year of Evermore Gym ends on 31 December.

REQUIRED

(a) Prepare the journal entry to record the borrowing on 1 May 2022.Narration is **not** required.

Journal

Date 2022	Particulars	Debit $	Credit $
May 1	Cash at bank	150 000 [1]	
	Long term borrowing/ Bank loan- Infinity Bank		150 000 [1]

[2]

(b) Calculate the interest expense and the interest expense payable for the **two** years ended 31 December 2022 and 2023. Show all the workings clearly.

31 December	Interest expense	Interest expense payable
2022	1 May 2022 to 31 Dec 2022: 2% X $150 000X 8/12=$2 000 [1]	1 May 2022 to 31 Dec 2022: $2 000 [1]
2023	1 Jan 2023 to 30 Apr 2023: 2% X $150 000X 4/12=$1 000 1 May 2023 to 31 Dec 2023: 2% X $(150 000- 30 000)X 8/12 =$1 600 $1 600 + $1 000= $2 600 [1]	1 May 2023 to 31 Dec 2023: 2% X $(150 000- 30 000)X 8/12 =$1 600 [1]

[4]

(c) State the effect on profit if interest expense was **not** adjusted on 31 December 2023.

Interest expense will be understated by $1 600.
Profit will be overstated by $1 600 [1]

(d) Name **one** stakeholder other than banks and lenders, who would be interested in the financial performance of the business. Give a reason for your answer.

Stakeholder: <u>Investors/Shareholders [1]</u>

Reason:
<u>They would want to know how well the business manages its borrowing practices as it will affect its returns (such as dividends). [1]</u>
Stakeholder: <u>Suppliers [1]</u>

Reason: <u>They need to assess the business' ability to pay the goods purchased on credit and not to have defaults in payment. [1]</u>

Stakeholder: <u>Employees [1]</u>

Reason: <u>They need to know how well the business manages its borrowing practices as excessive borrowing could have an impact such as delayed salaries/ reduced employment benefits.[1]</u>

Stakeholder: <u>Customers [1]</u>

Reason: <u>They need to know how well the business manages its borrowing practices as excessive borrowing affect the quality/ delay of the goods/services from the business.[1]</u>

Any 1 of the above. [2]

[Total: 9]

3 On 1 June 2023, Minion Private Limited provided the following information. The financial year for the business ends on every 31 May.

	$
Share capital,150 000 ordinary shares	300 000
Retained earnings	54 000

On 20 August 2023, the business issued 20 000 ordinary shares at $2 each.

The business declared a dividend of $0.10 per share to be paid on 15 June 2024 and made a profit of $25 300 for the year ended 31 May 2024.

REQUIRED

(a) Define the following terms:

(i) Share Capital

Cash raised by issuing shares to shareholders. [1]

(ii) Retained earnings

It is the accumulation of profits and losses that have not been distributed to shareholders since the business started operation. [1]

(b) Prepare the journal entry to record the transaction on 20 August 2023. A narration is not required.

Journal

Date 2023	Particulars	Debit $	Credit $
Aug 20	Cash at bank	40 000 [1]	
	Share Capital		40 000 [1]

[2]

(c) Prepare the retained earnings account for the year ended 31 May 2024.

Retained earnings account				
Date	Particulars	Dr ($)	Cr ($)	Bal ($)
2023				
Jun 1	Balance b/d			54 000Cr [1]
2024				
May 31	Income summary (Profit)		25 300 [1]	79 300Cr
	Dividends ($0.10 * 170 000)	17 000 [1]		62 300 Cr
Jun 1	Balance b/d			62 300 Cr

[3]

(d) Complete the table by placing a tick (√) to show the effect on retained earnings for the following items. When there is no effect, tick (√) the "No effect" column.

		Increase $	Decrease $	No effect $
(i)	Dividends		√ [1]	
(ii)	Issuance of additional shares			√ [1]
(iii)	Profit for the year	√ [1]		

[Total: 10]

4 Linda runs a business selling healthy smoothies. She has provided the following information at 31 December 2022 and 31 December 2023.

	2022	2023
Non-current assets	$	$
Equipment (net book value)	35 000	10 000
Current assets		
Inventory	12 500	9 200
Trade receivables	14 500	16 300
Cash at bank	5 000	-
Prepaid salaries	3 200	2 100
Current liabilities		
Bank overdraft	-	2 000
Current portion of long-term borrowing		1 000
Trade payable	11 800	12 200
Non-current liabilities		
Long-term borrowing	5 000	4 000
Current ratio	2.98	?
Quick ratio	1.65	?

REQUIRED

(a) Define 'liquidity'.

Liquidity is the ability of the business to repay its current liabilities when they fall due. [1]

OR

Liquidity measures how able the business is to convert current assets into cash to pay for current liabilities. [1]

Any 1 of the above.

(b) Calculate the current ratio as at 31 December 2023. Show your answer to **two** decimal place.

31 December 2023:
Total current assets/Total current liabilities:
$27 600/ $15 200=1.82[1]

(c) Calculate the quick ratio as at 31 December 2023. Show your answers to **two** decimal place.

Total current assets-Inventory-Prepaid salaries /Total current liabilities
= <u>$16 300/$15 200=1.07 [1]</u>

(d) Evaluate the change in the liquidity of Linda's business between 31 December 2022 and 31 December 2023. Use the information provided and your answer to part **(b)** and **(c).**

[Trend] The current ratio of Linda's business has worsened from 2.98 in 2022 to 1.82 in 2023. [1]

[Analyse] In 2022, the current ratio was above the general benchmark of 2. However, in 2023, it fell below the general benchmark of 2 which could mean that the business have lesser current assets to pay for its current liabilities. This could be due to the result of cash at bank balance of $5 000 in 2022 which worsened to $2 000 bank overdraft in 2023 which contributed to an increase of current liabilities. [Reason] [1]

[Analyse and reason] In 2022, the current ratio was above the general benchmark of 2. However, in 2023, it fell below the general benchmark of 2, this may be a result of trade payable balance of $11 800 in 2022 and it increased to $12 200 in 2023. This means that the business may have difficulty in paying off its debts due to insufficient cash as seen from its bank overdraft balance of $2 000 in 2023. [1]

[Analyse and reason] In 2022, the current ratio was above the general benchmark of 2. However, in 2023, it fell below the general benchmark of 2, this may be a result of trade receivables balance of $14 500 in 2022 increased to $16 300 in 2023. Even though this might be a signal of increased in sales, it could also mean the business might have difficulty collecting cash from its credit customers. This resulted in having less liquid resources as seen from the bank overdraft of $2 000 in 2023.[1]

[Trend] The quick ratio of Linda's business has decreased from 1.65 in 2022 to 1.07 in 2023. [1]

[Analyse and reason] In 2022, the quick ratio was above the general benchmark of 1. However, in 2023, it is slightly above benchmark of 1 which could mean that the business may have difficulty to pay its short-term debts using quick assets where they fall due. This could be due to the result of cash at bank balance of $5 000 in 2022 which worsened to $2 000 bank overdraft in 2023. [1]

In conclusion, Linda's business liquidity has worsened over the two years. [1]

Any 5 of the above. [5]

(e) Suggest **two** ways Linda can improve the liquidity of her business.

Increasing sources of cash

- Selling non-current assets by cash /cheque
- Take a long-term loan
- Contribute additional cash
- Bring in more shareholders/owners to contribute cash
- Offer trade discount to reduce selling price of goods so that goods can be sold more easily. In this way, inventory be converted to cash.

Managing Cash Outflow

- Reducing operating expenses e.g cut down on her salaries expense
- Negogiate for a better credit terms from supplier

Any 2 of the above. [2]

(f) Other than liquidity ratios, name one profitability ratio that Linda's business can use to evaluate its performance.

Gross profit margin
Mark-up on cost
Profit margin
Return on equity

Any 1 of the above.

[Total: 11]

END OF PAPER