

Answer to 4E5N Prelim 2022 P1

Question 1

Geremi has just started a business and has some questions on accounting matters that he would like to clarify.

REQUIRED

- (a) When a trial balance is balanced, it does not mean that there are no errors in the accounts. Explain the reason for this. [1]

This is because ledger accounts may contain errors which do not affect the balancing of the trial balance. [1]

- (b) Explain why it is important to have internal controls in a business. [2]

Any two of the following points [1 mark for each point]

- To safeguard the assets of the business
- To ensure that business transactions are recorded accurately
- To ensure that business comply with laws and regulations

- (c) State two examples of internal control procedure over cash. [2]

Any two of the following points [1 mark for each point]

- Separate cash handling and cash recording duties among different employees so that no single person has control over the entire cash process
- Secure cash and cheques in a locked storage and limit access to authorised personnel
- Deposit cash and cheques daily into the bank to minimise the amount of cash or cheques kept overnight at the business location
- Obtain proper approvals for all payments from authorised personnel
- Require valid source documents for all payments
- Prepare bank reconciliation to check internal records against external documents.

- (d) Explain one advantage of operating a business as a sole proprietorship instead of a private limited company. [1]

Any one of the following points [1]

- A sole proprietor has full control over the business
- A sole proprietorship business has minimum administrative duties to adhere to

- (e) Explain one disadvantage of operating a business as a sole proprietorship instead of a private limited company. [1]

Any one of the following points [1]

- A sole proprietor has unlimited liability and has to use his personal assets to pay business debts if the business is unable to do so
- A sole proprietorship business has limited resources as there is only one owner who can contribute capital
- A sole proprietorship may find it difficult to borrow loans as there is limited resources to use as collaterals

- (f) Explain why a business needs to prepare financial statements at regular time intervals with the support of an accounting theory [2]

According to the going concern theory which states that the business is assumed to have an indefinite economic life unless there is credible evidence that it may close down [1], a business needs to prepare financial statements at regular time intervals in order to provide timely financial information to stakeholders to help them make decisions.[1]

Or

According to the accounting period theory, the life of a business is divided into regular time intervals [1] and financial statements are prepared at regular time intervals to provide timely financial information to stakeholders to help them make decisions.[1]

[Total: 9]

Question 2

The following service fee revenue account was extracted from the books of Get Together Pte Ltd, which is an event organiser.

Service fee revenue Account

| Date | Particulars | Dr | Cr | Balance |
|--------|---|-------|-------|----------|
| 2022 | | \$ | \$ | \$ |
| Mar 1 | Service fee revenue received in advance (1) | | 4,900 | 4,900 Cr |
| Mar 6 | Cash in hand | | 2,300 | |
| Mar 15 | Cash at bank (3) | | 3,600 | |
| Mar 22 | Trade receivables (4) | | 7,300 | |
| Mar 31 | Service fee revenue received in advance (2) | 1,500 | | |

REQUIRED

- (a) Explain the difference between entries (1) and (2). [2]

Entry (1) is the reversing entry for \$4,900 which was received during the previous accounting period but was not earned during the previous accounting period and will be earned this accounting period when services are provided. [1]

Entry (2) is the adjusting entry for \$1,500 which was received during this accounting period but is not earned for this period and will be earned during the next period when services are provided. [1]

- (b) State the amount of service fee revenue to be presented in the statement of financial performance for the month ended 31 March 2022. [1]

The amount of service fee revenue = \$4,900 + 2,300 + 3,600 + 7,300 – 1,500
= \$16,600 [1]

- (c) Explain the difference between transactions (3) and (4). [2]

Transaction (3) is a cash transaction where cheques are received for services provided [1] whereas Transaction (4) is a credit transaction where services were provided on credit to customers. [1]

- (d) State the effect on the following if no adjustment was made to service fee revenue on 31 March 2022.

(i) Statement of financial performance [2]
Service fee revenue would be overstated by \$1,500 [1] causing profit to be overstated by \$1,500. [1]

(ii) Statement of financial position [1]
Service fee revenue received in advance is missing causing current liabilities to be understated by \$1,500. [1] Equity would be overstated by \$1,500 because profit was overstated.

- (e) Get Together Pte Ltd is a service business. Explain the difference between a service business and a trading business. [2]

A service business earns its main income by providing services [1] while a trading business earns its main income by selling goods.[1]

[Total: 10]

Question 3

The following information is extracted from the books of Resilience Trading for the years ended 30 June.

| | 2021 | 2022 |
|-------------------------|----------|----------|
| | \$ | \$ |
| Sales revenue | 165,000 | 188,600 |
| Less Sales returns | (4,200) | (7,500) |
| Net Sales revenue | 160,800 | 181,100 |
| Less Cost of sales | (64,270) | (71,200) |
| Gross profit | 96,530 | 109,900 |
| Ending inventory | 18,200 | 25,700 |
| Days sales in inventory | 96.5 | |

REQUIRED

- (a) Calculate, to one decimal place, the days sales in inventory for the year ended 30 June 2022. [2]

Days sales in inventory = $365 / \text{Rate of Inventory Turnover}$

Rate of Inventory Turnover = $\text{Cost of sales} / \text{Average inventory}$
 $= 71,200 / (18,200 + 25,700) \div 2$
 $= 71,200 / 21,950 = 3.243735763$ [1]

Days sales in inventory = $365 / 3.2437357 = 112.5$ days [1]

Note: If the answer is incorrect, give 1 mark for the correct formula.

- (b) Comment on the change in days sales in inventory over the two years. [3]

Any three of the following points [1 mark per point, max 3]

- The days sales in inventory has worsened from 96.5 days in 2021 to 112.5 days in 2022.
- This shows that the business has taken more days to sell its average inventory in 2022 compared to 2021.
- The business has become less efficient in inventory management in 2022.
- This may be due to the business buying more inventory in 2022 but was unable to sell them fast enough.
- This may also be due to the inventory of the business appearing unattractive to customers and therefore could not be sold as fast.

- (c) Explain why efficiency in inventory management is important to a business. [2]

Efficiency in inventory management can help the business earn more profit by reducing unnecessary expenses to store excessive inventory or incurring impairment loss on inventory.[1]

Being efficient in inventory management will also help the business improve its liquidity as less funds are tied up in inventory and more funds can be used for payments.[1]

- (d) Suggest two ways in which the days sales in inventory can be improved. [2]

Any two of the following ways **[1 mark for each point]**

- Reduce selling price for slow-moving goods to attract customers to buy
- Provide trade discounts to encourage customers to buy in bulk or regularly
- Attract more customers through advertising and marketing
- Track the levels of inventory and order sufficient inventory for sale and a little more to cater for unexpected demands and not to buy excessive inventory

Harhash, a potential investor who is interested in investing in Resilience Trading has computed the return on equity.

REQUIRED

- (e) Explain the meaning of return on equity. [1]

Return on equity measures the amount of profit a business earns for every dollar of equity invested by the owner or shareholders of the business.[1]

- (f) Explain how Harhash can use the return on equity that he has computed to make his decision on whether to invest in Resilience Trading. [2]

Any one of the following

Harhash can compare the return on equity of Resilience Trading with that of other businesses **[1]** and decide to invest in Resilience Trading if its return on equity is better than the other businesses.[1]

Harhash can compare the return on equity of Resilience Trading with his expected rate of return from his investment **[1]** and decide to invest in Resilience Trading if its return on equity matches or is better than his expected rate of return. **[1]**

Harhash can compare the return on equity of Resilience Trading over time to evaluate if the business is becoming more profitable. **[1]** If the business is becoming more profitable, Harhash may decide to invest in Resilience Trading.[1]

[Total: 12]

Question 4

Gonzales started a business to provide delivery services on 1 May 2020 by purchasing two delivery vans costing \$12,000 each, paying by cheque.

Another van costing \$15,000 was purchased on 1 August 2021 on credit from Toyoda Ltd.

It was the business' policy to depreciate motor vehicles at 20% using the reducing balance method.

REQUIRED

- (a) Explain why motor vehicles need to be depreciated using a relevant accounting theory. [2]

Motor vehicles provide benefits over several accounting periods and therefore their costs need to be allocated as expenses over their useful lives to calculate profit fairly for each accounting period. [1] This is to comply with the matching theory which states that expenses incurred must be matched against income earned in the same period to determine the profit for that period. [1]

Or

As motor vehicles provide benefits over several accounting periods, they lose their usefulness gradually over their useful lives. They are depreciated to reduce their net book value to reflect that they are losing their usefulness. [1] This is to comply with the prudence theory which states that the accounting treatment chosen should be the one that least overstate assets and profits and least understates liabilities and losses. [1]

- (b) Name two causes of depreciation. [2]
Any two of the following [1 mark each]

- Usage
- Wear and tear
- Obsolescence
- Legal limits

- (c) Calculate the depreciation of motor vehicles for the year ended 30 April 2022. [3]

Depreciation for the year ended 30 April 2021 = $20\% \times (12,000 \times 2) = 4,800$

Depreciation for the year ended 30 April 2022

= $20\% \times (24,000 - 4,800)$ [1] + $[20\% \times 15,000 \times 9/12]$ [1] = $3,840 + 2,250$

= \$6,090 [1]

Besides the reducing balance method, another method to depreciate non-current assets is the straight-line method.

REQUIRED

- (d) Explain the difference between using the two depreciation methods on profits for the period [2]

The straight-line method results in the same annual depreciation for the non-current asset over its useful life and so will cause profits for the periods to decrease by the same amount. [1] For reducing balance method, the annual depreciation decreases in each successive year over the non-current asset's useful life and so will cause profits for the period to decrease by a smaller amount of expense each year. [1]

[Total: 9]

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