KUO CHUAN PRESBYTERIAN SECONDARY SCHOOL
2021 Preliminary Examination
Secondary 4 Express
Principles of Accounts
Paper 1
Answer Scheme

Answer **all** questions.

1 The trial balance of Fa Da's business balanced on 31 July 2021. However, the following errors have now been discovered.

1 A cheque received for a cash sale, $1 300, for goods which had a cost price of $350, had been correctly recorded in the inventory and cost of sales accounts. No other entries had been made.

2 Salaries, $1 500, paid by cheque had been debited to the cash at bank account and credited to the salaries expense.

3 Office equipment, $800, bought on credit was posted to the office equipment repairs account in error.

REQUIRED

(a) Prepare the journal entries to correct errors 1, 2 and 3. Narrations are not required.

General Journal

	Dr ($)	Cr ($)
Cash at bank	1 300 [1]	
Sales revenue		1 300 [1]
Salaries expense ($1 500 x 2)	3 000 [1]	
Cash at bank		3 000 [1]
Office equipment	800 [1]	
Office equipment repairs		800 [1]

[6]

(b) Complete the following table to show the effect on profit and assets of correcting errors 2 and 3. Error 1 has been completed as an example.

Error	Effect on profit		Effect on assets	
	Increase	Decrease	Increase	Decrease
1	✓		✓	
2		✓ [1]		✓ [1]
3	✓ [1]		✓ [1]	

[4]

The following transactions took place during July 2021 with a credit customer, Beyonce.

2021	
July 6	Goods, $2 100, were supplied to Beyonce.
15	Beyonce returned faulty goods, costing S280.
18	Beyonce paid Fa Da $600 by cheque.
22	Beyonce paid Fa Da the outstanding balance on his account by cheque.
24	The bank returned Beyonce's cheque due to insufficient funds.

The balance on Beyonce's account was still outstanding at the end of Fa Da's business financial year on 31 July 2021. Fa Da decided to write this balance off in full.

REQUIRED

(c) Prepare the journal entry to write off the outstanding balance at 31 July 2021. A narration is required.

General Journal

Date	Particulars	Dr ($)	Cr ($)
2021 Jul 31 [1]	Impairment loss on trade receivables	1 220 [1]	
	Trade receivable - Beyonce		1 220 [1]
	Narration: To write off the balance owing by Beyonce [1]		

[4]

(d) Explain why a business may decide to make an allowance for impairment of trade receivables.

This is to **anticipate possible losses** due to bad debts [1] occurring in the future so as **not** to overstate profits for the year or assets. [1] This is to match the impairment loss to the sales revenue made in the same period.

[2]

(e) Name **one** accounting theory which is applied when making an allowance for impairment of trade receivables.

Prudence theory [1] or Matching principle [1]

[1]

[Total: 17]

2 The following assets and liabilities were in Jacques's business on 30 June 2021.

	$
Equipment	15 400
Long-term bank loan	9 000
Inventory	8 450
Trade receivables	27 460
Trade payables	21 100
Prepaid expenses	1 420
Bank overdraft	7 600
Cash in hand	670

REQUIRED

(a) Calculate the following:

(i) Current ratio to two decimal places.

Current assets = $8 450 + $27 460 + $1 420 + $670 = $38 000 [½]

Current liabilities = $21 100 + $7 600 = $28 700 [½]

Current ratio = $38 000 / $28 700 = 1.32 : 1 [1]

[2]

(ii) Quick ratio to two decimal places.

Quick assets = $38 000 - $8 450 - $1 420 = $28 130 [1]

Quick ratio = $28 130 / $28 700 = 0.98 : 1 [1]

= $[2]

Jacques's current ratio on 30 June 2020 was 2:1.

REQUIRED

(b) Give three possible reasons for the change in the current ratio between June 2020 and June 2021.

1. Heavy investment in equipment.
2. Purchase excessive inventory on credit (high trade payables)
3. Excessive drawings from cash at bank, resulting in cash at bank.
4. There is more unsold inventory in the business.

Award 1 mark each to relevant answer. Total: 3 points for 3 marks.

[3]

The following information about Jacques's business is available:

1 The business pays its suppliers within 14 days of receiving an invoice.
2 All sales are made on credit.
3 The business purchases its inventory well in advance to meet possible demand.
4 Jacque is considering asking the bank to increase its bank overdraft limit.

REQUIRED

(c) Based on the above information, recommend **two** actions Jacques could take to improve the liquidity of the business. Give reasons to support your answers.

1. Action: Encourage cash sales by giving higher trade discounts.
   Reason: To increase more cash into the business.
2. Action: Monitor the demand for inventory closely and only buy the required amount.
   Reason: Prevent cash being tied onto unsold inventory and to minimize risk of damages and storage expenses.
3. Action: Extend cash discount to trade receivables and to encourage prompt payment .
   Reason: To increase cash into the business and to minimize the risk of impairment loss on trade receivables.
4. Action: Change its sales policy to include cash sales for those who are not regular customers or creditworthiness is in doubt.
   Reason: To minimize the risk of impairment loss on trade receivables and to increase cashflow.

Award 2 marks for each action and each reason. Total 4 marks for 2 actions and 2 reasons.

3 The following information was available for Desla Pte. Ltd. as at 31 July 2021.

	$
Issued share capital 200 000 shares	300 000
Retained earnings at 1 August 2020	80 000
Profit for the year ended 31 July 2021	140 000

Additional information:

1. On 31 July 2021 a final dividend of $0.25 per share was declared and paid in full.
2. On 1 August 2021 there was an issue of 80 000 shares for $2.50 each. All the shares were sold and fully paid.

REQUIRED

(a) Define:

(i) Retained earnings

All the profits or losses made by a private limited company from the beginning of its operation and that **have not been distributed** to the shareholders.

[1]

(ii) Dividends

Portion of the profits **distributed** to the shareholders.

[1]

(b) Prepare the journal entries for items 1 and 2. Narrations are **not** required.

General Journal

Date	Particulars	Dr ($)	Cr ($)
2021			
Jul 31	Dividends (200 000 x $0.25)	50 000	
	Cash at bank		50 000
Aug 1	Cash at bank (80 000 x $2.50)	200 000	
	Issued share capital		200 000

[4]

(c) (i) Calculate the issued share capital on 1 August 2021.

Issued share capital on 1 August 2021
= $300 000 + $200 000 = $500 000.[1]

[1]

(ii) Calculate the retained earnings on 1 August 2021.

Retained earnings on 1 August 2021 = $80 000 + $140 000 [½] - $50 000 [½]
= $170 000.[1 /OF]

[2]

(d) Prepare an extract of the statement of financial position as at 31 July 2021.

Desla Pte. Ltd Statement of financial position as at 31 July 2021 [1]	
	$
Shareholders' Equity	
Issued share capital 280 000 shares	500 000 [1]
Retained earnings	170 000 [1]
Total shareholders' equity	670 000

[3]

[Total: 12]

---------------------------END OF ANSWER SCHEME-----------------------------------

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Answer Scheme
Paper 2

Answer all questions.

1 (a)

Tink Tonk Limited

Statement of financial performance for the year ended 31 March 2021 [1]

	$	$
Sales revenue		405 000
Less Cost of sales		(109 500)
Gross Profit		295 500 [1]
Less: Expenses		
Advertising expense	39 000	
Depreciation of motor vehicles ($165 000 - $42 000) x 20%	24 600 [1]	
Depreciation of property ($300 000 / 30 years)	10 000 [1]	
Utilities expense ($20 900 + $800)	21 700[1]	
Salaries expense	25 000	
Rental expense ($36 000 x 12/15)	28 800 [1]	
Loan interest (5% x $60 000)	3 000 [1]	
Impairment loss on trade receivables [($900 - $300) – 5%x($32 200 - $300)]	995 [2]	
Total expenses		(153 095)
Profit for the year		142 405 [1 /OF]

1(b)

Tik Tok Limited

Statement of financial position as at 31 March 2021

Asset	Cost ($)	Accumulated Depreciation ($)	Net book value ($)
Non-current assets			
Property	300 000	40 000	260 000 [1]
Motor vehicles	165 000	66 600	98 400 [1]
Total non-current assets			358 400
Current assets			
Cash at bank		22 600	
Inventory		20 400	
Prepaid rental expense ($36 000 x 3/15)		7 200 [1]	
Trade receivables ($32 200 - $300)	31 900		
Less allowance for impairment of trade receivables ($31 900 x 5%)	(1 595)		
Net trade receivables		30 305 [1]	80 505
Total assets			438 905
Liabilities and Equity			
Shareholders' Equity			
Issued share capital (200 000 ordinary shares @$1 each)		200 000	
Retained earnings ($25 200 + $142 405 – (200 000 x $0.25)		117 605 [1]	
Total shareholders' equity			317 605
Non-current liabilities			
Long-term borrowing ($60 000 - $8 000)			52 000 [1]
Current liabilities			
Utilities expenses payable		800 [1]	
Current portion of long-term liability		8 000 [1]	
Dividends payable (200 000 x $0.25)		50 000 [1]	
Interest expense payable ($3000 - $1 200)		1 800 [1]	
Trade payables		8 700	69 300
Total shareholders' equity and liabiities			438 905

2 (a)

Cash at bank account				
Date	**Particulars**	**Dr ($)**	**Cr ($)**	**Balance ($)**
2020				
Jan 1	Capital	100 000 [1]		100 000 Dr
	Loan / Long-term borrowing	25 000 [1]		125 000 Dr
	Rental expense		12 000 [1]	113 000 Dr
	Hardly Davidson Motors (12% x $50 000)		6 000 [1]	107 000 Dr
Jan 2	Balance b/d			107 000 Dr [1]

2(b)

(i) Cash transaction – a transaction whereby payment is made **immediately** or **on the spot. [1]**

(ii) Credit transaction – a transaction whereby payment is **delayed** or **made in the future. [1]**

2(c) Recommendation – ATAS CO. [1]

ATAS Co	
Reasons	**Justification**
1. Credit period – company allows customers 30-day credit period so that they can take a longer time to repay amount owing.	A longer credit period allows him more time to get enough cashflow to make payment, especially when he just started business and money is tight.
2. Since it is a local supplier, it is easy to get stocks if there is a surge in demand of certain brands.	The business can stock up immediately if there is a potential demand for certain model, thus avoiding an stock-out situation, which will mean lost of opportunity to sell.
3. Returns policy – customers are allowed to return the defective shoes within 1 week of purchase.	Sandeep will be able to return defective goods and have them replaced immediately since ATAS Co. is a local company. This increases his faith in the company.
4. The business allows Sandeep to preview the shoes before purchasing.	This allows the business to have an actual look at the models and fit before deciding on the purchase. This enables Sandeep to make a better judgement on his purchase instead of just looking at the website.

Any 3 relevant reasons with relevant justifications, award 6 marks. Each relevant reasons with relevant justifications, award 2 marks each.

Recommendation – Classico Ltd. [1]

Classico Ltd.	
Reasons	**Justification**
1. The price range offered by Classico Ltd. is lower than ATAS Co.	This is a cheaper source of supply, as the minimum price and maximum price are lower than that offered by ATAS Co. This allows Sandeep to save some costs, which is very important to a new company which needs cashflow.
2. There are more variety of shoes supplied and they are all popular brands.	He has more models and brands to choose from. This helps in his business as he can stock up with a bigger variety to offer his customers. Moreover, they are popular brands and so the demand for them is already there and they are already tried and tested. This will give him the ready customers needed.
3. The shoes are in stock and are ready to be shipped.	The business can receive the goods within a few days and they can always replenish stocks quite quickly.
4. They are all popular brands.	This will give an idea to Sandeep as to how much and what sizes and specifications to order to meet demand. He does not need to overstock unnecessary if this information is already available.

Any 3 relevant reasons with relevant justifications, award 6 marks. Each relevant reasons with relevant justifications, award 2 marks each.

3(a)

(i) Turnover = Gross Profit / 20% = $39 600 / 20% [1] = $198 000 [1]
(ii) Cost of sales = Turnover – Gross Profit
= $198 000 - $39 600
= $158 400 [1]
(iii) Profit for the year = $39 600 – [($6 500 - $300) [1]+ ($12 400 + $600) [1]]
= $20 400

Total: 5

Summarised information for the year ended 30 September 2018.

		Workings	Business A	Business B
(i)	Gross Profit % mark-up	$39 600 x 100 / $158 400	25% [1/OF]	30.13%
(ii)	Profit % to sales revenue	$20 400 x 100 / $198 000	10.30% [1/OF]	12.15%
(iii)	Rate of inventory turnover	$158 400 / $17 750	8.92 times [1/OF]	11.58 times
(iv)	Rate of return on owner's equity	$20 400 x 100 / [$180 000 + ($ 180 000 + $20 400)] /2 [1]	10.73% [1/OF]	12.50%

[5]

3(c)

a) Gross Profit % mark-up
- Based on this ratio, Business B is more profitable than Business A.
- The ratio for Business B is 30.13% as compared to 25% for Business A, which means that Business B is pricing its products at a higher price than Business A.
- The ratio also shows that for every $100 of cost of the goods, Business B is earning $30.13 in gross profit as compared to Business A.
- The gross profit for Business B is higher than Business A.

Award 3 marks for any 3 points raised.

b) Profit % to sales revenue
- This ratio shows that Business B is more profitable than Business A.
- The ratio for Business B is 12.15% as compared to 10.30% for Business A, which means that Business B is earning higher profit for the year.
- The ratio also shows that for every $100 of sales made, Business B is earning $12.15 in profit as compared to $10.30 for Business A.
- Both businesses are also controlling their expenses well in order to earn profits for the business.

Award 3 marks for any 3 points raised.

c) Rate of inventory turnover
- Business B is more efficient is selling its goods that Business A, as it has a higher rate of inventory turnover of 11.58 times as compared to 8.92 times for Business A.
- This shows that the business is moving its inventory at a faster rate that Business A.
- This suggests that Business B may have a better promotion strategy than Business A, since its goods are priced higher than Business A.

- This may also suggest that the Business B is managing its inventory more efficiently than Business A.

Award 3 marks for any 3 points raised.

d) Rate on return on owner's equity
- Investors are getting a higher return of their investment in Business B than in Business A.
- Business B has a rate of return on owner's equity of 12.50% as compared to Business A's 10.73%.
- This suggests that Business B is earning higher profits than in Business A.
- It also suggests that for every $100 invested in the Business B, the investors are getting a return of $12.50 as compared to $10.73 in Business A, if the risk assessment is the same.

- ***Award 3 marks for any 3 points raised.***

NB: STUDENTS NEED TO CHOOSE ANY TWO TO COMMENT. DO NOT MARK ADDITIONAL RATIO SUGGESTED.

4(a) Effects on profits – profits for the year will be understated by $8 000.[1]

4(b)

Two differences between capital expenditure and revenue expenditure:

Capital Expenditure	Revenue Expenditure
➤ Payment to **buy non-current assets** that can **last for more than one accounting period.**	➤ Payment for **day-to-day running costs or expenses** of the business, usually consumed within one **accounting period.**
➤ Payments that **increase the value of the non-current assets** and increase the productive capacity of the business permanently.	➤ **Appears in the Final accounts (statement of financial performance)** as a reduction of profits.
➤ Payment of **one-off expense** which constitutes the cost of the non-current assets.	➤ Payment of **recurring** expenses.
➤ **Appears in the statement of financial position** as an increase to the value of non-current assets.	➤ Eg. Motor vehicle expenses, wages, rent, stationery, insurance, purchases and etc.
➤ Eg. Motor vehicle, Machinery, Equipment, Furniture and etc.	

Any **two** distinctions made, award 4 marks. A **clear distinction** must be made in order to be awarded full marks.

4(c)

	Transactions	Type of expenditure	Reason
(i)	Cheque payment of import duty for new machinery.	Capital expenditure **[1]**	Import duties are one-off expenditure which forms part of the cost of the new machinery, which has future productive capacity for the business. **[1]**
(ii)	Payment of insurance on delivery vehicle.	Revenue expenditure **[1]**	This is a recurring expense as insurance will be paid on the delivery vehicle on a regular basis, **[1]**

---------------------------------END OF ANSWER SCHEME---------------------------------