POA S4 Prelim 2022 Paper 1
Mark Scheme

1(a)
Accounting entity theory states that the activities of a business are separate from the actions of the owner and all transactions are recorded from the point of view of the business. ✓ Therefore, the amount withdrawn by the owner from the business for personal use should be recorded as drawings. ✓

[2m]

1(b)

Drawings

Date	Particulars	Debit	Credit	Balance
2021		$	$	$
Nov 28	Inventory ✓	200		200 Dr
2022				
Mar 11	Cash in hand ✓	520		720 Dr
Jun 30	Capital ✓		720	-

[3m]

1(c)

Capital

Date	Particulars	Debit	Credit	Balance
2021		$	$	$
Jul 1	Balance b/d			42 500 Cr
Aug 15	Office equipment ✓		1 380	43 880 Cr
2022				
Jun 30	Income summary ✓		9 300	53 180 Cr
	Drawings ✓ **OF**	720		52 460 Cr
Jul 1	Balance b/d ✓			52 460 Cr

[4m]

1(d)
- Easier to raise funds from issuance of shares. ✓
- Easier to raise funds by obtaining loans as there are more assets to serve as collaterals. ✓
- Lower risk for Julian as the shareholders are not obliged to pay for the company's debts and losses using their personal assets. ✓

[Any 2 of the above x 1m - 2m]

1(e)
It is the accumulation of profits and losses ✓ that has not been distributed to shareholders since it started operation. ✓

[2m]

[Total: 13m]

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2(a)
According to the prudence theory✓, inventory is valued at the lower of cost or net realisable value ✓ to ensure that inventory is not overstated. ✓

[3m]

2(b)
Cost of sales
= 3800 + 6400 + 1300 + 900 ✓ (at least 3 items)
= $12400 ✓

[2m]

2(c)
Gross profit
= 12000 + 2700 – 12400
= $2300 ✓ **OF**

[1m]

2(d)
$4200 ✓

[1m]

2(e)
Cost of inventory
= 5300 + 150 + 280 + 90 + 120 ✓ (at least 3 items)
= $5940 ✓

[2m]

2(f)

Journal

Date	Particulars	Debit	Credit
2022		$	$
Jun 30	Impairment loss on inventory (12700 – 4600) ✓	8 100	
	Inventory ✓		8 100

[2m]

2(g)

	Effect on	Overstated	Understated	No effect
(i)	Gross profit			✓
(ii)	Profit for the month	✓		
(iii)	Current assets	✓		

[3m]

[Total: 14m]

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3(a)
- Cash is needed to pay operating expenses on time. If expenses are not paid on time, business operations would be affected. ✓
- Cash is needed to pay creditors on time so that they will continue to supply inventory to the business. ✓
- Early cash payment to creditors enables the business to receive cash discounts from suppliers. ✓
- Cash is needed to pay loans and interest on loans. ✓
- Cash is needed to meet unforeseen emergencies. ✓

[Any 2 of the above x 1m - 2m]

3(b)(i)
Current ratio
= Current Assets / Current Liabilities
= 11200 / 8100
= 1.38 ✓

[1m]

3(b)(ii)
Quick ratio
= (Current Assets – Inventory – Prepayments) / Current Liabilities
= (11200 – 7900 – 1200) / 8100 ✓
= 0.26 ✓

[2m]

3(c)
- The current ratio has worsened from 4.57 in 2019 to 3.18 in 2020 to 1.38 in 2021. Similarly, the quick ratio also worsened from 3.18 in 2019 to 1.47 in 2020 and 0.26 in 2021. This means that the business liquidity has worsened over the 3 years.

- In 2019, the current ratio of 4.57 was much higher than the general benchmark of 2, and the quick ratio of 2.68 was also much higher than the general benchmark of 1. This means that the business is not optimising its current assets to earn profits.

- Both the current and quick ratio dropped to below the general benchmark in 2021. Based on the quick ratio of 0.26 which is less than 1, this means that business has insufficient quick assets to meet immediate debts, and is facing a cashflow problem.

[Accept any other reasonable explanation – Max 3m]

- Reasons
    - Increase in inventory from $4 500 to $5 400 to $7 900
    - Increase in trade payables from $2 100 to $2 900 to $4 300
    - Decrease in bank balance from $5 200 in 2019 to $3 900 in 2020 and eventually to a bank overdraft position of $2 200 in 2021
    - Increase in prepaid expense from $800 to $1 100 to $1 200

[any 2 points above x 1m = 2m]
[Accept any other reasonable explanation]

3(d)
To increase liquidity:

- Increase cash by obtaining additional cash contribution from owner ✓
- Increase cash by obtaining a long-term loan ✓
- Sell excess non-current assets for cash ✓
- Manage cash outflow by reducing operating expenses ✓
- Manage cash outflow by negotiating for better credit terms from supplier ✓

[any 3 points above x 1m = 3m]
[Accept any other reasonable suggestion]

[Total: 13m]

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