

**Hillgrove Secondary School**  
**4E/5NA Preliminary Examination 2022**  
**Principles of Accounts Paper 2 (7087/02)**  
**Suggested answers and marking scheme**

Q1

(a)

Sedap Pte Ltd		
Statement of Financial Performance for the year ended 30 June 2022		
	\$	\$
Sales revenue	900000	
		(1)
Less: Sales returns	(7000)	
Net sales revenue		893000
Less: Cost of sales		(795000)
Gross profit		98000
Add: Other income		
Service fee income	12000 (1)	
Discount received	100 (1)	12100
Less: Other expenses		
Discount allowed	200 (1)	
Rent expense (- 2/3 x \$9000)	29000 (1)	
Utilities expense	4900	
Wages and salaries expense	38500	
Depreciation expense:		
office equipment (10% x \$30000)	3000 (1)	
motor vehicles [25% x (\$90000 - \$22500)]	16875 (1)	
Reversal of impairment loss on trade receivables (1)	(160) (1)	
[(3% x \$8000) - \$400]		
Interest expense (3/12 x 2% x \$24000)	120	(92435)
Profit for the year		17665
		<b>[9m]</b>

(b)

Sedap Pte Ltd

Statement of Financial Position as at 30 June 2022

	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net book value</u>
<u>Assets</u>			
<u>Non-current assets</u>			
Office equipment	30000	9000	21000
Motor vehicles	90000	39375	50625
Total Non-current assets			71625 (1)
<u>Current assets</u>			
Cash at bank		10800	
Trade receivables	8000		
Less: Allowance for impairment of trade receivables	(240)		(1)
(3% x \$8000)			
Net trade receivables		7760	
Inventory		14800	
Service fee income receivable (\$12000 - \$10800)		1200 (1)	
Prepaid rent expense (2/3 x \$9000)		6000 (1)	
Total current assets			40560
Total assets			112185
<u>Equity and Liabilities</u>			
<u>Shareholders' equity</u>			
Share capital, 10 000 ordinary shares		20000 (1)	
Retained earnings (\$50450 + \$17665(1)* - \$1000(1)**)		67115	
Total equity			87115
<u>Non-current liabilities</u>			
Long-term borrowings (-\$4000)			20000 (1)
<u>Current liabilities</u>			
Current portion of long-term borrowings (1)		4000 (1)	
Interest expense payable		70	
Dividends payable		1000 (1)	
Total current liabilities			5070
Total equity and liabilities			112185

\*OF based on profit for the year in (a)

\*\*OF based on dividends payable amount

[11m]

[Q1 Total: 20m]

**Q2**

(a) Cost of purchases = \$7 000 + \$100 + \$490 + \$200 + \$900 = \$8 690 **[1m]**

(b)

In the books of Durian Queen

Inventory				
		Dr (\$)	Cr (\$)	Bal (\$)
2022				
Jan 1	Bal b/d			480 Dr
Jan 5	Trade payable: Fruits King	500 (1)		980
Jan 10	Cost of sales (1)		480 (1)	500 Dr
Feb 1	Bal b/d			500 Dr (1)*

**\*OF  
[4m]**

(c)

In the books of Durian Queen

Journal			
Date	Particulars	Dr (\$)	Cr (\$)
2022			
Mar 31	Impairment loss on inventory	750 (1)	
	Insurance claim receivable	250 (1)	
	Inventory		1000 (1)

**[3m]**

(d) The prudence theory **[1m]** states that the accounting treatment chosen should be the one that least overstates assets and profits and least understates liabilities and losses **[1m]**. Thus, inventory should be valued at the lower of cost or net realisable value on statement of financial position to ensure that inventory (which is a current asset) is not overstated **[1m]**.

(e) Sales revenue and cost of sales **[1m]**

*Note: Both accounts must be correct to be awarded 1m.*

**[Q2 Total: 12m]**

**Q3**

(a) Claim by the owner(s) on the net assets of a business. **[1m]**

(b) On 12 December 2020, owner (or Mugum) contributed \$7 000 to the business bank account. **[1m]**

(c) Mugum's business made a loss of \$3 000 for the year ended 31 October 2021 and this amount was transferred to the capital account on 31 October 2021. **[1m]**

(d)

In the books of Mugum's business

Journal			
Date	Particulars	Dr (\$)	Cr (\$)
2021			
Oct 31	Capital (1)	240	(1)
	Drawings		240

**[2m]**

(e) Liquidity is the ability of a business to convert its current assets into cash to pay its current liabilities.  
 OR Liquidity measures the ability of a business to meet its short-term financial obligations.  
**[1m]**

Workings

(f) (i) Working capital  
 = Current assets – Current liabilities = \$138 720 - \$41 300 = \$97 420 **[1m]**

(f) (ii) Current ratio  
 = Current assets / Current liabilities = \$138 720 / \$41 300 = 3.36 **[1m]**

(f) (iii) Quick ratio  
 = Quick assets / Current liabilities = \$40 000 / \$41 300 = 0.97 **[1m]**

(g) 1m for each point. Award up to 8 marks.

Point	
1	Working capital <b><u>improved</u></b> from \$38900 in 2019 to \$47800 in 2020, and to \$97420 in 2021.
2	This <b><u>seemingly implied</u></b> that liquidity <b><u>improved</u></b> over the three years.
3	Current ratio <b><u>improved</u></b> from 3.15 in 2019 to 3.25 in 2020, and to 3.36 in 2021. However, quick ratio <b><u>worsened</u></b> from 2.60 in 2019 to 2.22 in 2020, and to 0.97 in 2021.
4	Since quick ratio is a <b><u>stricter indicator of liquidity as compared to current ratio</u></b> , liquidity <b><u>worsened</u></b> over the three years.
5	Moreover, quick ratio was <b><u>less than 1</u></b> in 2021. This indicated that the business had <b><u>insufficient quick assets to pay off its current liabilities</u></b> and was probably <b><u>experiencing cash flow problem</u></b> in 2021.
	Reasons for worsening liquidity:
6	<b><u>Inventory holdings worsened</u></b> from \$10000 in 2019 to \$22000 in 2020, and to \$98720 in 2021.
7	This may mean that <b><u>increasing amount of funds are tied up in unsold inventory</u></b> .
8	<b><u>Trade receivables position worsened</u></b> from \$27000 in 2019 to \$30000 in 2020, and to \$40000 in 2021.
9	This may mean that <b><u>funds are less readily available</u></b> .
10	Cash at bank balance <b><u>worsened</u></b> from \$20000 in 2019 to \$17000 in 2020, and to <b><u>bank overdraft</u></b> of \$9000 in 2021.
11	Cash may have been used over the three years to purchase non-current assets as shown from the increase in non-current assets net book value from \$50000 in 2019 to \$70000 in 2020, and to \$180000 in 2021.
12	<b><u>Trade payables position worsened</u></b> from \$18000 in 2019 to \$21000 in 2020, and to \$27000 in 2021.
13	It might become <b><u>increasingly difficult</u></b> for the business to <b><u>obtain credit for future purchases</u></b> .
14	\$5000 of long-term borrowings has now <b><u>become current</u></b> as the status changed from being due in over 1 year to <b><u>falling due within the next 12 months</u></b> .

**[8m]**

**[Q3 Total: 17m]**

Q4

(a) A business is assumed to have an indefinite economic life unless there is credible evidence that it may close down. **[1m]**

(b) Revenue is earned when goods have been delivered or services have been provided. **[1m]**

(c) A transaction is considered material if it makes a difference to the decision-making process. **[1m]**

(d) In a sole proprietorship, the sole owner can easily transfer ownership by updating the corporate regulatory authority with the particulars of the new owner.

However, in a limited liability partnership, all partners need to agree to the addition or withdrawal of partner(s) before the corporate regulatory authority will acknowledge the transfer of ownership. **[1m]**

(e)

1m each for each point.

Decision	Isaac should set up a limited liability partnership (LLP) with his relatives.
Reason 1	Isaac's only expertise is in the teaching of Art and he hopes to make all the decisions regarding the content and delivery of the Art lessons. Moreover, he has relatives who are professionals in other areas of business.
Elaboration 1	Thus, by setting up a LLP with his relatives, Isaac can be in charge of the curriculum while his relatives manage the other aspects of the business since control will be shared between Isaac and his relatives.
Reason 2	\$20 000 is insufficient to start an Art enrichment centre.
Elaboration 2	Thus, by setting up a LLP with his relatives, Isaac can overcome shortage of capital by getting interested relatives to join as partners and contribute capital. If the capital is still not enough, it should not be difficult for the business to get a bank loan.
Reason 3	Isaac would like his children to run the business together with him in future.
Elaboration 3	Thus, by setting up a LLP with his relatives, Isaac's children can run the business together with him by being added as partners, as long as all the relatives involved agree to the addition.

or

Decision	Isaac should set up a private limited company (PLC).
Reason 1	Isaac's only expertise is in the teaching of Art and he hopes to make all the decisions regarding the content and delivery of the Art lessons
Elaboration 1	Thus, Isaac can set up a PLC and appoint himself to be part of the management team to be in charge of the curriculum. The PLC can hire professionals to manage other aspects of the business that Isaac has no experience in.
Reason 2	Isaac hopes to set up many Art enrichment centres which will require a lot of funds.
Elaboration 2	Thus, by setting up a PLC, Isaac's expansion plan can be funded by issuing additional shares or getting a bank loan.
Reason 3	Due to family financial commitments, Isaac is not able to take on any business debts or losses.
Elaboration 3	Thus, by setting up a PLC, Isaac will not need to sell off his private investments should the business incur debts or losses as he will not be personally liable and only stand to lose his initial investment of \$20 000.

[7m]

[Q4 Total: 11m]