Candidate Name: ______________________________ Class: ____________

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millennia institute

2021 Preliminary Examination
Pre-university 3

PRINCIPLES OF ACCOUNTING 9593/1

15 September 2021

3 hours

Additional Materials: Answer Booklet

READ THESE INSTRUCTIONS FIRST

An answer booklet will be provided with this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Section A
Answer **all** questions.

Section B
Answer **all** questions.

Start each answer to a new question on a new page
All calculations must be shown adjacent to the answer

The number of marks is given in brackets [ ] at the end question or part question.

SECTION A

Answer **all** questions in this section.

1.

The accountant of Street Wear Pte Ltd, a local company selling fashion apparel, has produced the following set of balances, after preparing the income statement for year ended 31 July 2020.

	$000
Net Loss for the year	32
Retained earnings at 31 July 2019	680
Property and plant at cost	5 000
Accumulated depreciation for property and plant	1 700
Specialised equipment at cost	700
Accumulated depreciation for specialised equipment	200
Inventory	1 476
Trade receivables	710
Trade payables	2 600
Bank overdraft	88
Ordinary share capital at $1.00 each	2 000
Asset revaluation reserve	650

The directors met to finalise the accounts and agreed to make the following adjustments.

1. Upon consulting an appraisal company, it was determined that the specialised equipment had an estimated fair value of $350 000 and value-in-use of $290 000.

2. Included at cost in inventory are two batches of old clothing items. Their net realisable values are given below.

Item	Cost $	Net Realisable Value $
1	30 000	23 000
2	40 500	50 000

3. A review of the bank statement for the month of July revealed $20 000 of cheques which were unpresented by suppliers and several cheques from major credit customers which were directly credited amounting to $128 000.

4. A major credit customer who owed $10 000 has gone bankrupt. Allowance for impairment of trade receivables is estimated to be 5% of trade receivables at year end.

5. An invoice dated 1 March 2020 for $45 000 for a newly built extension for the plant had been posted to repairs and maintenance account. This amount included repair costs of $2 500 and insurance of $2 100 for the 12 months to 28 February 2021.

6. The company depreciates property and plant at 25% on net book value. A full year's depreciation is charged in the year of acquisition and none in the year of disposal.

REQUIRED

(a) Prepare a statement to show the corrected net profit or loss for the year ended 31 July 2020. [7]

(b) Prepare an extract of the balance sheet as at 31 July 2020, showing **only assets** of the company. [6]

(c) Explain your treatment of adjustment **(1)** above, citing relevant accounting principles adopted. [4]

Additional information

During a recent board meeting, Mr Lim, a newly appointed director proposed changing depreciation method on property and plant from reducing balance method to the straight line method.

REQUIRED

(d) Advise Mr Lim about his proposal. Justify your answer with relevant accounting concepts.

[3]

[Total : 20]

2.
Strategic Marine Ltd, an importer of nautical equipment, supplies maritime companies with such equipment. An inexperienced accountant who was recently hired produced the following.

Balances at 1 January 2020	$$000
Non-current assets at cost	400
Accumulated depreciation	84
Prepaid general expenses	10
Inventory	45
Trade receivables	66
Trade payables	120

A summary of its bank account for the last 4 months ended 30 April 2020 is provided.

	Jan	Feb	Mar	Apr
<u>Receipts</u>	$000	$000	$000	$000
Cash Sales	76	84	78	38
Credit Sales	66	228	252	234
Disposal of non-current assets	-	-	-	15
Long term loan	-	110	-	-
	142	422	330	287
<u>Payments</u>				
Payment for credit purchases	120	350	210	85
General expenses	29	45	30	-
Dividends	20	30	-	27
	169	425	240	112
Net cash flow	(27)	(3)	90	175
Opening balance	85	58	55	145
Closing balance	58	55	145	320

Additional information

1. 25% of monthly sales are cash sales and credit sales are on one month's credit terms.
2. Purchases are on one month's credit terms. Inventory of $130 000 was bought on credit on 18 April 2020.
3. The long term loan which was taken on 1 February 2020, bears an interest rate of 8% per annum.
4. Depreciation is provided for on the cost of all non-current assets at 2% per month.
5. Non-current assets costing $75 000 with an accumulated depreciation of $65 000 was sold in April. No depreciation is provided in the month of sale.
6. An inventory count on 30 April revealed inventory costing $90 000.

REQUIRED

(a) Prepare an income statement for Strategic Marine Ltd for the four months ended 30 April 2020. [6]

(b) Prepare an extract of the Balance sheet as at 30 April 2020, showing only the sections relevant for working capital for Strategic Marine Ltd. [6]

Additional information

A director made this comment - “The management of the company’s working capital is quite good. This is evident from our current ratio, which is higher than industry standards of 2.80 : 1”.

Our working capital should also not only surpass industry standards, but it should always be kept as high as possible.

REQUIRED

(c) Compute the current ratio to two decimal places for Strategic Marine Ltd and explain its meaning to the company. [2]

(d) Advise the director regarding his comments on the company’s working capital. [4]

(e) State 2 reasons why the current ratio of Strategic Marine Ltd could differ from industry standards? [2]

[Total : 20]

3.

AB Ltd makes its accounts to 31 March yearly and had been experiencing several years of difficult trading conditions. At 1 April 2020 it had the following issued share capital and reserves.

	$'000
200 000 8% Preference shares $1 each	200
800 000 Ordinary shares $0.50 each	400
Retained losses	(165)

At that date AB Ltd also had $600 000 of 10% debentures.

The following information was provided by the directors for the next year:

1. On 1 June 2020, the directors agreed to revalue its property by $900 000 to reflect its increased value in the books.

2. On 1 September 2020 AB Ltd completed a 2-for-1 bonus issue of ordinary shares, keeping reserves in their most flexible form.

3. On 1 October 2020 AB Ltd successfully completed a 3-for-2 rights issue of ordinary shares at $0.40 per share on all ordinary shares in issue at that date

4. On 1 January 2021 AB Ltd redeemed $400 000 of the debentures as they were due.

5. Trading conditions improved and for the year ended 31 March 2021, AB Ltd made a net profit before interest of $318 000. In addition to paying its preference dividend, it declared an ordinary dividend of 2 cents per share on all outstanding shares at year end.

REQUIRED

(a) State two differences between a bonus issue and rights issue of shares. [2]

(b) Prepare a statement of changes in equity for the year ended 31 March 2021. [8]

Additional information

The company is facing pressure from ordinary shareholders to increase their dividends and two directors, C and D have made proposals to increase the dividends.

Director C proposes to distribute all remaining profits for the year as ordinary dividends.

Director D proposes to transfer all gains from revaluation of its assets to net profit so as to report higher profits and pay higher dividends.

REQUIRED

(c) Calculate the dividends per ordinary share if Director C's proposal is accepted. [2]

(d) Advise the company if it should accept Director C's proposal. [4]

(e) Advise the company if it should accept Director D's proposal. [4]

[Total: 20]

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SECTION B

Case study: Answer **all** questions.

4.

Verizon Medical Pte Ltd is a well-established company, providing medical health equipment and supplies to major hospitals and health care providers. The company started with selling diagnostic health care devices and has expanded over the last five years.

Given the pandemic, the company has seen an increase in demand for its products. You have been asked to examine the company's financial statements and undertake a series of tasks as part of your training as an accounts executive.

Verizon Medical Pte Ltd
Income Statement for year ended 31 December 2020

	$	
Sales revenue		356 000
Less : Cost of sales		(280 400)
Gross Profit		75 600
Add : Gain on sale of motor vehicle		4 000
Less : Other expenses		(35 000)
Net Profit		44 600

Balance sheets as at 31 December	2019	2020
Non-current assets	-	-
Freehold buildings, at cost	23 000	-
at valuation	-	90 000
Motor vehicles	213 000	272 000
Accumulated depreciation – motor vehicles	(92 800)	(108 000)
Total non-current assets	143 200	254 000
Current assets		
Cash at bank	11 000	-
Cash in hand	10 000	-
Trade receivables	52 200	48 000
Inventory	47 000	41 000
Total current assets	120 200	89 000
Total assets	263 400	343 000
Shareholder's Equity		
Issued share capital $1 ordinary share	80 000	100 000
Retained earnings	104 000	130 400
Asset Revaluation reserve	-	7 000
	184 000	237 400
Non-current liabilities		
6% long term loan	-	50 000
Current liabilities		
Bank overdraft	-	9 000
Trade payables and other payables	31 400	34 000
Proposed dividend	8 000	12 600
8% mortgage loan	40 000	-
	79 400	55 600

Total equity and liabilities	263 400	343 000

Additional information

The following took place during the year ended 31 December 2020.

1. Apart from revaluation, an extension to freehold building was built. No sale or purchase of freehold building took place. The company does not depreciate freehold buildings.

2. On 1 July 2020, motor vehicle costing $49 000 were sold for $39 200 and new motor vehicles were acquired as well.

3. Interim dividends of $5 600 was paid.

4. The company repaid its 8% mortgage loan on 30 June 2020 and took on a new 6% long term loan on 1 September 2020.

REQUIRED

(a) Prepare a statement of cash flow for Verizon Medical Pte Ltd for the year ended 31 December 2020. [9]

(b) Analyse the significant areas of cash flowing in and out of the company from your answer in part **(a)** and explain these movements of cash. [6]

Additional information

In a recent meeting to review the company's progress and future direction, a director asked the executive in the finance department. He asked - "Why did the bank balance dip from a positive balance to an overdraft, despite a profit in the in the year?"

REQUIRED

(c) Provide an explanation to the director as to why net profit does not necessarily result in a positive change in cash resources. [4]

Additional information

The directors of Verizon Medical Pte Ltd regularly evaluate its financial ratios against industry standards. The following is extracted from annual publication for the industry.

	Name of financial ratio	Industry standards
(i)	Accounts receivable collection period	38 days
(ii)	Inventory turnover	65 days
(iii)	Accounts payable payment period	35 days
(iv)	Debt-equity ratio	39%
(v)	Net Profit Margin	10%

REQUIRED

(d) State the formula and calculate the above ratios for Verizon Medical Pte Ltd for year ended 31 December 2020. [5]

(e) Evaluate the company's performance against industry standards. [12]

Additional information

An inspection of the Verizon Medical Pte Ltd's cash in hand system shows amounts of cash being borrowed by staff, when they find that they are running out of their own personal funds. In some cases, the money is not repaid for several months.

REQUIRED

(f) Recommend whether the company should lend money to its staff. Justify your answer by referring to appropriate ethical accounting principles. [4]

[Total : 40]