2020 Preliminary Examination

Paper 1

Question 1

(a) Non-current assets are valued at cost
less depreciation to date **/ Accumulated depreciation**
Net book value

(b) Non-current assets will be shown in the balance sheet at the revised / revaluation value**.**
Any increase in value due to revaluation represents a capital reserve **/Asset Revaluation Reserve .**
Future net book value / carrying value will be recalculated / adjusted on revised depreciation

(c) **Perfect 10 Pte Ltd**

Draft **balance sheet as at 31 December 2019**

Non-current assets	$ **Cost/ Valuation**	$ **Accumulated depreciation**	$ **Net book value**	$
Property at valuation	510 000		510 000	
Office equipment	106 000	54 000	52 000	
Total non-current assets	616 000	54 000		562 000
Current assets				
Inventories			116 590	
Trade receivables		13 750		
Less: Allowance for impairment of trade receivables		(2 250)		
			11 500	
Cash in hand			24 771	
				152 861
				714 861
Equity and liabilities				
Shareholders capital and reserves			150 441*	
Asset revaluation reserve (510-140)			370 000	
Total equity				520 441
Non-current liabilities				
Long-term loan			75 000	
Total non-current liabilities				75 000
Current liabilities				
Trade payables			87 100	
Short term borrowings/ bank overdraft			32 320	
Total current liabilities				119 420
Total equity and liabilities				714 861

(d) (i) Capital reserves are available for distribution as bonus issue only
Company cannot issue cash dividends from capital reserves

(ii) Solvency: Quick assets (11 500 + 24 771) $36 271 are less than current liabilities $119 420
Quick ratio is 0.3:1/ below 1:1/ is unable to meet current liabilities
Decision is NOT to pay dividends
Decision rationale: either insufficient cash /or bank overdraft / or incorrect usage of capital reserves

Allow answers based upon own figures.

Question 2

(a) General Journal

Date	**Account name**	**Debit** $	**Credit** $
2	Cash at bank	67 068	
	Trade receivables		67 068
3	Wages	60 750	
	Cash at bank		60 750
4	Inventory *(97.5% X 38 600)	37 635	
	Cash at bank*		37 635
5	Cash in hand	5 000	
	Cash at bank		5 000

Marks are one for both correct narratives and figures except where indicated*

(b) Computation of updated cash at bank balance as at 30 June 2020.

	$
Opening cash at bank balance(1)	(23 475)
Receipts from Trade receivables (2)	67 068
Wages paid (3)	(60 750)
Inventory purchased with cash (4)	(37 635)
Transfer to cash in hand (5)	(5 000)
	(59 792)

Accept alternative presentation of the answer.

(c) (i)

1. No adjustment.
2. No adjustment.
3. No adjustment.
4. Invalid cheque $40 070 needs deducting from bank as debtor has technically not paid
5. Overdraft interest has been charged by bank therefore needs deducting from the account
6. Deduction of $5 000 to bank account to correct company accounting error.

Computation of the updated cash at bank account and the balance being held by the bank.

	$
Opening cash at bank balance	(59 792)
Dishonoured cheque (4)	(40 070)
Bank interest	(2 167)
Overstated receipt correction	(5 000)
Closing cash at bank balance	(107 029)*

(ii) Reconciliation of updated cash at bank with bank statement balance

	$
Balance as per updated cash at bank (Part c)	(107 029)
Add:	
Cheques not yet presented	17 435
Correction of error made by bank	9 525
	(80 069)
Less:	
Receipts value not yet received	(65 010)
Estimated balance on the bank statement	(145 079)
Accept alternative formats	

(d) Reasons reconciliation are produced:

Provide a separate / independent check on entries in the cash at bank account

Identifies and errors or omissions between bank and company account.

Reduces the risk of fraud being carried out

To ensure the correct amount of cash at bank is included in the financial statements.

To ensure that discrepancies are due to timing.

(e) Decision to amend overdraft limit:

The existing overdraft limit will exceed by $25 079

The company need to ask for an increased overdraft of $120 000 + 25 079 = $145 079

Question 3

(a) Annual interest = 350 000 X (6/100) = $21 000
(if capital repayments are made at end of year one)

Note: Average annual interest on 6% loan = (350 000 + 315 000) / 2 X 6/100 = $19 950
(if capital repayments made monthly over the year)

(b) **Statement of changes in equity for the year ended 31 December 2021**

	Share capital	Retained earnings	Asset revaluation	Total
	$	$	$	$
Beginning balance	3 000 000	1 700 000	1 000 000	5 700 000
Changes in equity for the year				
Issue of share capital	400 000			400 000
Profit for the year (800 000 – 21 000)		779 000		779 000
Dividends		(510 000)		(510 000)
Ending balance	3 400 000	1 969 000	1 000 000**(1)**	6 369 000

(c) Debt to equity ratio given is : Total liabilities / Equity
Total liabilities = (Long term loan + Mortgage + Short term borrowings + Trade payables)
$350 000 + $750 000 (1m for LTL)+ $2 400 000 + ($1 200 + $150)(1m for CL)
= $4 850 000

Equity (own figure from (b) above) - $6 369 000
Debt to equity = $4 850 000 / $6 369 000 = 0.7615 or 0.76

(d) Interest $21 000 has to be paid / interest to be paid annually. Profits will be reduced
Reduced profits will mean less profit available for distribution for use of dividends or retained earnings for shareholders.
Higher risk of not being able to settle interest & debt (Gearing ratio)

(e) Alternative funding option:
Ordinary shares held 3 400 000 / 8 = 425 000 rights shares issued

New dividend is 3 825 000 shares X $0.14 = $535 500
Original dividend cost: $510 000 (see answer in **(b))**
Additional cost + $25 500

If additional cost more than interest; $21 000 (see answer in **(a)) REJECT**
Or less than interest charge (see answer in **(a))** ACCEPT

Mark awarded only if clear decision made and linked to calculation.

4(a) **[Total: 10m]**

Solid Pte Ltd
Statement of cash flows for the year ended 30 August 2020

	$'000	$'000
Cash flows from operating activities		
Net profit for the year before interest (2644 + 547)	3 191	
Adjustments for:		
Depreciation	2 638*	
Gain on sale of property, plant and equipment	(273)*	
Operating cash flows before movements in working capital		5 556
Increase in inventories	(988)**	
Decrease in trade receivables	146**	
Increase in trade payables	161**	(681)
Net cash provided by operating activities		4 875
Cash flows from investing activities		
Purchase of non-current assets (13350+142-335-2638-19193)	(8 674)	
Proceeds from sale of non-current assets (335+273-142)	466	
Net cash used in investing activities		(8 208)
Cash flows from financing Activities		
Proceeds from issuance of shares	2 000*	
Proceeds from borrowings	3 400*	
Interest paid	(547)	
Net cash provided by financing activities		4 853
Net increase in cash and cash equivalents		1 520
Cash and bank balance at start of the year (113 -1 294)		(1 181)
Net increase in cash and cash equivalents		1 520
Cash and bank balance at end of year		339

4(b) The statement shows a POSITIVE CASH flow generated from operations /
Positive cash flow indicates a successful trading company

The company is making major investment in non-current assets/
Significant as investment has increased by $8 208 000 ($8 674 000-466 000)

The company's long-term investment has been funded by:
Increased share capital $2 000 000
Increased long-term borrowings $3 400 000

The surplus of approximately $1.5m is available to improve liquidity
From a bank overdraft of $1.294m to a positive bank balance of $272 000
The surplus may be available for extra non-current assets/current assets/inventory
Accept reasonable answers based on own figure calculations. **[Total:6m]**

4(c)

Ratios	Formula	Calculation
(i) Rate of inventory turnover	$\frac{\text{Cost of sales}}{\text{Average inventory}}$	$\frac{17100}{(3938+2950)/2}$ $= \frac{17100}{3\,444}$ Ans = 4.97 times
(ii) Quick ratio	$\frac{\text{Total quick assets}}{\text{Total Current Liabilities}}$	$\frac{2639+272+67}{2408}$ $=\frac{2978}{2408}$ Ans=1.24 : 1
(iii) Accounts receivable collection period	$\frac{\text{Average net accounts receivable}}{\text{Net credit sales revenue}} \times 365$	$\frac{(2639 + 2785)}{2}$ = 2 712 $\frac{2712}{28500} \times 365$ days = 34.73 days Ans = 35 days
(iv) Return on equity	$\frac{\text{Net Profit after interest}}{\text{Average Equity}} \times 100$	$\frac{2\,644}{(17701 + 13057)/2} \times 100$ $= \frac{2\,644}{15\,379}$ Ans = 17.19%

4(d)

Question	Solid	Industry ratios	Evaluation
(i)Rate of inventory turnover	4.97 times	3.9times	Rate of inventory turnover is higher/better, inventory is moving/ being purchased and sold more quickly than industry standard. This maybe due to lower prices(1OF)/ better credit terms for their customers. Good selling strategies/ effective advertising or good sales staff
(ii)Quick Ratio	1.24 :1	1.15 : 1	Quick ratio is higher/ better than industry and the theoretical minimum of 1:1 Extra cash is being held after the increase in long-term financing activities (1OF), it may be used for buying long-term assets/ and reduce quick ratio in the future. (1OF) /effectively cover ST debts/day-to-day expenses
Accounts receivable collection period	35 days	30 days	Accounts receivable collection period is longer/ worse for the company (35 versus 30 days) This is not a good indicator/ this is adverse/ worse indicator. This may be caused by inefficient credit collection/ possible increased credit period being offered to customers. (1OF) (worse credit policy)
Return on equity	17.19%	20%	Return on equity is less/ worse for the company (17.19% versus 20.0%) and is not a good indicator for shareholders. It could be due to increased investments by shareholders that has caused this ratio to be below industry standard/ non-current assets may take longer to improve or restore returns to shareholders. Less profitable; poorer management of expenses **Accept reasonable answers based on own figure calculations**

4(e)(i)

The product is not safe/ faulty goods and will be returned to Solid Pte Ltd (1m)
Company has a responsibility (integrity) to act ethically to its customers and shareholders. (1m)
Ethically the company should not record this contract as sales income as the materials will be returned/ no guarantee the contract will continue. (1m)

Alternative answer to 4(e) (i):
1. Sales will be overstated (consequently; gross/net profits, retained earnings etc)
2. Unethical practice as the company should not record this contract as sales income as the materials will be returned/ no guarantee the contract will continue.
3. Not a fair representation of financial state; hence lack integrity/ ethical accountability to shareholders and customers. (Reputation maybe affected if found out)
4. Impact on decision-making -may mislead managers in their decision making/comparison due to the overstated sales amount.

4(e)(ii) Accounting adjustments: **[[Max 3 marks]**
Reduce sales /increase returns inwards/ increase inventory
Make provision for writing off damaged inventory
Increase impairment loss on inventory
Decrease trade receivables
Making provision for possible carriage/ transport costs for faulty goods