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ACS Barker

- 1 Naomi's financial year ends on 30 September. The following information was provided.

	2021 \$	2022 \$	2023 \$
<u>Current Assets</u>			
Inventory	8 000	15 000	35 000
Trade receivables	5 000	7 000	12 000
Cash at bank	4 000	600	
Total current assets	17 000	22 600	47 000
<u>Current Liabilities</u>			
Short-term borrowings			10 000
Trade payables	3 000	7 500	9 000
Total current liabilities	3 000	7 500	19 000

REQUIRED

- (a) Explain what is meant by the liquidity of a business. [2]

- (b) Calculate the following ratios for the year ended 30 September 2023. Your answers should be corrected to **two** decimal places.

- (i) Working capital (current) ratio [2]

- (ii) Quick (acid test) ratio [2]

The following information relates to the three years ended 30 September 2021 and 2022.

		2021	2022
1	Working capital (current) ratio	5.67	3.01
2	Quick (acid test) ratio	3.00	1.01

- (c)** Taking into account the above information and your answers to **(a)(i) and (ii)**,
(i) Comment on the liquidity position of Naomi's business for the year ended
 30 September 2023. [5]

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- (ii) Suggest **two** reasons to explain the liquidity position of Naomi's business for the year ended 30 September 2023. **[2]**

- (d) Advise Naomi on **two** measures she may take to improve her liquidity position. [2]

- (e) Explain why the quick (acid test) ratio is a more accurate measure of the liquidity than the working capital (current) ratio. [2]

The business profit has remained the same over the three years ended 30 September 2021, 2022 and 2023.

REQUIRED

- (f) Advise Naomi why the liquidity of the business has changed even though profit has remained the same over the three years. [2]

Naomi is considering comparing the profitability of her business with that of a competitor.

REQUIRED

(g) Name **one** profitability ratio which Naomi could use.

[1]

.....

[Total: 20]

- 2 Abraham runs a retail business with a financial year end of 31 July. The following ledger account has been prepared at 31 July 2024.

Sale of motor vehicles

Date		Debit	Credit	Balance
2024		\$	\$	\$
July 31	Motor vehicles	24 000		24 000 Dr
	Accumulated depreciation of motor vehicles		11 712	12 288 Dr
	Other receivables: Hybrid		10 800	1 488 Dr
	Income summary		1 488	-

REQUIRED

(a) Interpret **each** of the entries in the sale of motor vehicles account.

(i) Motor vehicles

[1]

.....

(ii) Accumulated depreciation of motor vehicles

[1]

.....

(iii) Other receivables: Hybrid

[1]

.....

(iv) Income summary

[1]

.....

During the year Abrahm had extended his shop premises at a cost of \$17 500, which included \$1500 for repairs to the existing shop premises. He had included the total cost in the business's statement of financial performance.

REQUIRED

(b) State the effect and amount of including the cost of the shop extension in the statement of financial performance on the following:

(i) Profit for the year **[2]**

.....

.....

.....

(ii) Non-current assets **[2]**

.....

.....

.....

[Total: 8]

- 3 Emmie is a sole trader. Her business buys and sells on credit.

The following information relates to Mattie's account in Emmie's ledger for the month of July.

During July, Emmie's business had the following transactions with Mattie.

2024

- July 1 Mattie owed Emmie, \$1567.
- 5 Emmie sold goods to Mattie at a list price of \$6280 less 15% trade discount.
- 14 Mattie returned goods bought on July 5, \$1950, as faulty. This is the value **after** taking into account the trade discount.
- 28 Mattie paid a cheque for \$2425 after deducting 3% cash discount.

REQUIRED

- (a) State one reason why Emmie offered Mattie a trade discount on July 5. [1]

- (b) Calculate the amount of trade discount at July 5. [1]

- (c) Calculate the amount of cash discount at July 28. [1]

- (d) Prepare Mattie's account for the month of July 2024 in Emmie's ledger. [6]

Mattie

- (e) State **three** reasons why a cheque would be returned by the bank as dishonoured.

[3]

1

2

3

[Total: 12]

ANSWERS

- 1 (a)** Liquidity is the ability of the business to repay its current liabilities out of current assets when they fall due. [1]

Liquidity measures how able a business is to convert current assets into cash to pay for current liabilities. [1]

(b) (i) Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$
= $\frac{\$47\,000}{\$19\,000}$
= 2.47

[2]

(b) (ii) Acid-Test ratio = $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$
= $\frac{\$(47\,000 - 35\,000)}{\$19\,000}$
= 0.63

[2]

- (c)(i)** Although the working capital ratio deteriorated from 5.67 in 2021 to 3.01 in 2022 and to 2.47 in 2023 it is still above the benchmark of 2.

Naomi's business is still more than able to meet its current liabilities with its current assets.

Her business is making better use of its resources, it has less idle resources in 2023.

The quick ratio has deteriorated over the three years from 3 in 2021 to 1.01 in 2022 which is the benchmark for quick ratio and then fell below the ideal ratio in 2023 when it decreased to 0.63. This is because the amount of inventory as a proportion of current assets has increased over the years. Inventory holdings have increased from \$8000 in 2021 to \$15 000 in 2022 to \$35 000 in 2023. Increasing inventory may mean funds are tied up in inventory.

The trade receivables position has worsened as trade receivables have increased each year from \$5000 in 2021 to \$7000 in 2022 to \$12 000 in 2023.

Increasing trade receivables runs the risk of a possible loss on impairment of trade receivables.

Increasing trade receivables may mean that funds are less readily available.

The bank balance has deteriorated each year from \$4000 in 2021 to \$600 in 2022 to an overdraft of \$10 000 in 2023.

The trade payables position has worsened as it has increased each year from \$3000 in 2021 to \$7500 in 2022 to \$9000 in 2023.

An increase in trade payable may affect the ability to obtain credit.

An increase in trade payables may affect the relationship with suppliers if unable to pay invoices on time.

Cash may have been used over the three years to purchase or place a deposit on non-current assets.

Naomi would have difficulties servicing her short-term debts when payments are due and payment for daily operating expenses may also be compromised.

Max of 5

- (c)(ii) A substantial amount of Naomi's funds was tied up in inventory (less liquid asset) which amounted to \$35 000, which is 75% of total current asset $[(35\ 000 / 47\ 000) \times 100]$. [1]

Naomi has no cash in the bank account, where cash is the most liquid asset. [1]

An increase in Trade payable of 67% from 2021 [1].

Max of 2

- (d) Contribute more capital to the company.
Sell off surplus non-current assets for cash.
Take additional bank loan

Any 2

- (e) Quick ratio is a better indicator as it does not include inventory and prepayments [1] in the calculation but uses only liquid assets which can be easily converted into cash.[1]

Inventory is not regarded as a liquid asset as a buyer has to be found and time taken for money to be collected. [1]

Quick ratio is a better indicator as it shows whether the business will have any surplus liquid funds if all the current liabilities were paid immediately from the liquid assets. [1]

Max of 2

- (f) Naomi might have increased her cash drawings over the period.
This will reduce cash but not profit.

The business might have spent cash to purchase non-current assets.

This will decrease liquidity but have no impact on profit.

The business might have high sales revenue but make most of its sales on credit.
This may mean a high profit but low levels of cash.

There are non-cash items in the statement of financial performance (eg depreciation, payables and accounting adjustments which can affect profit but have no effect on cash) and income/expenses are accounted for following the matching concept.

This means that income/expenses are not the same as cash paid out.

Interest on the long-term borrowings might have remained the same.

Profit will therefore not be affected, but portions of the loan are becoming payable within 12 months which increases current liabilities and reduces the current ratio.

- (g) Gross profit margin
Mark-up on cost
Profit margin
Return on equity

2 (a) Interpret **each** of the entries in the sale of motor vehicles account.

- (i) Motor vehicles
The cost of buying the motor vehicles sold. [1]
- (ii) Accumulated depreciation of motor vehicles
The total depreciation to date on the motor vehicles sold. [1]
- (iii) Other receivables: Hybrid
Disposal proceeds of the motor vehicles sold on credit to Hybrid. [1]
- (iv) Income summary
Loss made on sale of motor vehicles. [1]

(b) State the effect and amount of including the cost of the shop extension in the statement of financial performance on the following:

- (i) Profit for the year
Profit for the year has been understated by \$16 000. [2]
- (ii) Non-current assets
The value of non-current assets has been understated by \$16 000. [2]

[Total: 8]

3 (a) State one reason why Emmie offered Mattie a trade discount on July 5.

To encourage Mattie to bulk buy.

For Emmie to clear out excess / outdated inventory.

To reward Mattie for continuing to purchase from Emmie [Any 1]

(b) Calculate the amount of trade discount at July 5.

$\$6280 \times 15\% = \942 [1]

(c) Calculate the amount of cash discount at July 28.

$\$(2425/97\% \times 3\%) = \75 [1]

(d) Mattie

		Dr	Cr	Bal
2024		\$	\$	\$
July 1	Balance b/d			1 567 Dr
5	Sales revenue	5 338	[1]	6 905 Dr
14	Sales returns	[1]	1 950	4 955 Dr
28	Cash at bank	[1]	2 425	2 530 Dr
28	Discount allowed	[1]	75	2 455 Dr
Aug 1	Balance b/d	[1]	[1]	2 455 Dr

[6]

(e) State **three** reasons why a cheque would be returned by the bank as dishonoured.

Cheque is over 6 months old / cheque is post-dated / cheque is unsigned /
information on cheque is incomplete / information on cheque is inconsistent /
insufficient funds to pay the cheque. [any 3]

Data for Question 1

The following balances were extracted from the books of Tulip Ltd on 31 July 2024.

	\$
Sales revenue	402 645
Sales returns	30 246
Cost of goods sold	209 856
Rent	37 000
Salaries	80 388
Insurance	17 600
Office furniture	40 300
Inventory	11 920
Motor vehicles	120 800
Accumulated depreciation:	
Office furniture	4 030
Motor vehicles	30 200
Trade receivables	15 320
Allowance for impairment of trade receivables	2 300
Trade payables	2 543
Cash at bank (overdraft)	2 212
2% Bank loan	50 000
Interest on bank loan	500
Share capital, 100 000 ordinary shares	50 000
Retained earnings	20 000

The following information was made available on 31 July 2024.

- 1 Insurance was paid for 15 months ending on 31 October 2024.
- 2 Salaries outstanding was \$700.
- 3 A credit customer who owed \$326 was declared bankrupt and the amount has yet to be written off.
- 4 \$2200 of trade receivables is estimated to be uncollectible.
- 5 Motor vehicles are to be depreciated at 20% on net book value per annum.
- 6 Office furniture is to be depreciated at 10% on cost per annum.
- 7 Interest on bank loan has not been fully paid for the year ended 31 July 2024.
- 8 \$30 000 of long-term borrowing was payable on 31 March 2025.
- 9 The company declared a dividend of \$0.05 per share. The dividend will be paid on 31 August 2024.

Answer **all** questions.

1 Refer to the Insert for data for Question 1.

REQUIRED

(a) Prepare the statement of financial performance for the year ended 31 July 2024.

Tulip Ltd

Statement of Financial Performance for the year ended 31 July 2024

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

Blank lined area for writing.

[10]

- (b)** Prepare the statement of financial position as at 31 July 2024.

Tulip Ltd
Statement of Financial Position as at 31 July 2024

[illegible]

Blank lined area for writing answers.

[10]
[Total: 20]

- 2** Lamech provided the following information for the financial year ended 30 June 2024:

	\$
Gross profit	25 800
Operating expenses	6 450
Average equity	215 000
Mark-up on cost	25%

REQUIRED

- (a)** Calculate the following for the year ended 30 June 2024.

- (i)** Cost of sales **[1]**

.....

.....

- (ii)** Net sales revenue **[1]**

.....

.....

- (iii)** Gross profit margin **[1]**

.....

.....

- (iv)** Profit margin **[1]**

.....

.....

- (v)** Return on equity **[1]**

.....

.....

Japheth is a direct competitor of Lamech in the same industry. Its financial ratios for the year ended 30 June 2024 are as follow:

Gross profit margin	22%
Profit margin	12%
Return on equity	8%

REQUIRED

- (b) Compare and comment on the profitability of both businesses for the year ended 30 June 2024. **[4]**

- (c) State two ways in which a business could increase its gross profit margin. **[2]**

- (d) Suggest two ways in which a business could reduce its expenses. **[2]**

[Total: 13 marks]

- 3 Lumberstone buys and sells furniture. His accounting period ends on 30 April. The following information was extracted from the books of Lumberstone for 2023 and 2024:

	Year ended	
	30 April 2023	30 April 2024
	\$	\$
Inventory	80 000	100 000
Cost of Sales	400 000	350 000
Inventory turnover rate	8.0 times	?

REQUIRED

- (a) State the formula and calculate, to **one** decimal place, the inventory turnover rate for the year ended 30 April 2024. **[2]**

.....

.....

.....

.....

- (b) With your answer to (a), comment on the efficiency of the business in managing its inventory over the two years from 2023 to 2024. **[3]**

.....

.....

.....

.....

On 1 May 2024, Lumberstone had 20 units of wine racks valued at \$1800.

During the month of May, the following purchases (paid by cheque) took place:

5 May	Bought 20 units of wine racks for \$1500.
13 May	Bought 30 units of wine racks for \$1950.
25 May	Bought 10 units of wine racks for \$1400.

REQUIRED

- ## Inventory

[illegible]

-
-
-
-

- (e) At the end of the financial period 30 April 2023, the ending inventory of wine racks was \$2500 while the net realisable value was \$2200.

Complete the following table by stating the effects of the **unadjusted** inventory.

State the amount 'overstated' or 'understated' for gross profit and profit for the year. Write 'No effect' where there is no effect. **[2]**

	Gross Profit	Profit for the year
30 April 2023		
30 April 2024		

- (f) On 31 May 2024, Lumberstone's warehouse caught fire and destroyed some wine racks worth \$5200.

Prepare the journal entries to record the wine racks destroyed on 31 May 2024. **[2]**

[Total: 14]

- 4 Buster Boy Toys is a supplier of soft toys and cushions with local designs.

The following is the allowance for impairment of trade receivables account of Buster Boy Toys for the year ended 31 December 2023.

Allowance for impairment of trade receivables account				
Date	Particulars	Debit	Credit	Balance
2023		\$	\$	\$
Jan 1	Balance b/d			9 400 Cr
Apr 19	Trade receivable: Casper	3 300		6 100 Cr
Dec 31	Impairment loss on trade receivables	4 100		2 000 Cr
2024				
Jan 1	Balance b/d			2 000 Cr

REQUIRED

- (a) Explain the matching theory. **[1]**

- (b) Name the source document that Buster Boy Toys would issue if a credit customer returns goods to Buster Boy Toys. **[1]**

- (c) State the effect of the 19 April 2023 entry on profit. **[1]**

- (d) State **one** reason for the 19 April 2023 entry. **[1]**

- (e) Prepare the expenses section of the statement of financial performance for the year ended 31 December 2023. [2]

Two existing credit customers have approached the business to negotiate for credit extension, from 30 days to 45 days. Help Buster Boy Toys decide who it should offer credit extension to.

	Best Gifts	Novelty Hub
Nature of business	- Sells gifts, cards, decorative items and toys. - Located at a major shopping mall in Orchard.	- Sells books, stationery, gifts and toys. - Located at a major shopping mall in Woodlands.
Annual sales revenue made to customer	\$45 000	\$23 000
Repayment history over the past year	Within 40 days	Within 35 days
Reputation of business	- Popular with working adults. - Has been in business for 15 years.	- Popular with students. - Has been in business for 6 years.
Industry outlook	- Facing stiff competition from online retailers. - No plans to have an online presence.	- Facing stiff competition from online retailers. - Online store will be operational next month.
Rent expenses	\$20 000 per month - The rent rate has been consistent for the past 5 years.	\$14 000 per month - The rent rate has been increasing over the past 5 years.

REQUIRED

- (f) Recommend which business should Buster Boy Toys grant the extension to. Justify your decision with **three** reasons. [7]

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[Total: 13]

Answers

1 (a)

Tulip Ltd

Statement of financial performance for the year ended 31 July 2024

	\$	\$
Sales revenue	[1]	402 645
less Sales returns	[1]	30 246
Net sales returns		372 399
less Cost of sales	[1]	209 856
Gross profit		162 543
less Other Expenses		
Rent	37 000	
Salaries (80 388 + 700)	81 088	[1]
Interest on bank loan (2% x 50 000)	1 000	[1]
Insurance (17 600 /15 x12)	14 080	[1]
Depreciation of office furniture (40 300 x 10%)	4 030	[1]
Depreciation of motor vehicle [(120 800 – 30 200) x 20%]	18 120	[1]
Impairment loss on trade receivables [2200 – (2300 – 326)]	226	[1]
		155 544
Profit for the year	OF [1]	6 999

Tulip Ltd

Statement of financial position as at 31 July 2024

	\$	\$	\$
Assets			
Non-current assets	Cost	Acc Dep	NBV
Motor vehicles (AD + 18 120) [1]	120 800	48 320	72 480
Office furniture (AD + 4030) [1]	40 300	8 060	32 240
Total Non-Current Assets	161 100	56 380	104 720
Current assets			
Inventory		11 920	
Trade receivables (– 326)	14 994	[1]	
less Allowance for impairment of TR	2 200		
Net trade receivables		12 794	[1]
Prepaid insurance		3 520	[1]
Total current assets			28 234
Total assets			132 954
Equity and Liabilities			
Shareholders' equity			
Share capital, 100 000 ordinary shares		50 000	
Retained earnings (20 000 + 6999 – 5000)		21 999	[1]
Total equity			71 999
Non-current liabilities			
Long-term borrowings (– 30 000)		[1]	20 000

Current liabilities			
Trade payable		2 543	
Current portion of long-term borrowings		30 000	
Salaries payable		700	[1]
Dividends payable (100 000 x 0.05)		5 000	[1]
Short-term borrowings		2 212	
Interest payable (1000 – 500)		500	[1]
Total Current liabilities			40 955
Total equity and liabilities			132 954

2(a)(i) Cost of sales = $\$25\,800 / 0.25 = \$103\,200$ [1]

2(a)(ii) Net sales revenue = $\$(103\,200 + 25\,800) = \$129\,000$ [1]

2(a)(iii) Gross profit margin = $\$(25\,800 / 129\,000) \times 100\% = 20\%$ [1]

(a)(iv) Profit margin = $20\% - 5\% = 15\%$ [1]

(a)(v) Return on equity = $\$[(25\,800 - 6450) / 215\,000] \times 100\% = 9\%$ [1]

2(b) Lamech's gross profit margin of 20% is worse than Japheth's gross profit margin of 22%.
This may be due to a more expensive supply of goods for Lamech.

Lamech has a better profit margin of 15% than Japheth's profit margin of 12%.

This suggests that Lamech is more efficient in the management of expenses to generate sales.

Lamech's better return on equity of 9% suggests that Lamech is better at generating profits for his investors.

[2 marks each – Comparison followed by explanation]

2(c) Encourage sales through advertising.

Offer trade discounts to encourage bulk purchases.

Source for a cheaper supply of goods.

Increase the selling price for its products.

[Any two]

2(d) Review its credit policy for customers.

Look for a cheaper source of finance.

Reduce utilities, advertising, rent, or wages expenses to cut costs.

[Any two]

3(a) Inventory turnover rate for the year ended 30 April 2024

= Cost of sales / Average inventory [1]

= \$350 000 / [\$(80 000 + 100 000)/2] [1]

= 3.9 times

3(b) The inventory turnover rate has worsened over the 2 years [1] by 4.1 times from 8 times in 2023 to 3.9 times in 2024. [1]

This means the business is taking a longer time to replenish goods. [1] It could be because the business is holding too much inventory or the business is not selling goods fast enough.

3(c)

Inventory

Date	Particulars	Debit (\$)	Credit (\$)	Balance (\$)	
2024					
May 1	Balance b/d			1 800 Dr	
5	Cash at bank	1 500		3 300 Dr	
13	Cash at bank	1 950		5 250 Dr	
25	Cash at bank	1 400		6 650 Dr	
31	Cost of sales (1800 + 1500 + 1950)		5 250 [1]	1 400 Dr	[1]
June 1	Balance b/d [1]			1 400 Dr	[OF]

[3]

3(d) Inventory is valued at cost or net realisable value, whichever is lower. [1]

Prudence concept states that a business must report and adjust for losses that it is likely to incur even when these losses are not confirmed yet. [1] However, the business does not record profits that are likely to occur. Profits are recorded only when they are actually earned.

3(e)

	Gross Profit	Profit for the year
30 April 2023	No effect	Overstated by \$300
30 April 2024	Understated by \$300	Understated by \$300

3(f)

2024		Debit	Credit
		\$	\$
May 31	Impairment loss on inventory [1]	5 200	
	Inventory [1]		5 200

- 4(a) Expenses incurred must be matched against income earned in the same accounting period to determine the profit for that period. **[1]**
- 4(b) Credit note **[1]**
- 4(c) No effect **[1]**
- 4(d) Casper has gone bankrupt and the amount owed had to be written off. **[1]**
- 4(e)

Buster Boy Toys		
Statement of Financial Performance as at 31 December 2023 (extract)		
	\$	\$
<u>less Other Expenses</u>		
Impairment loss on trade receivables (reversal) [1]	(4 100) [1]	

- 4 (f) Buster Boy Toys should grant the extension to Best Gifts. **(1 decision)**
 Best Gifts is a bigger customer compared to Novelty Hub due to higher sales revenue made to Best Gifts. **(1 basic statement)**
 It would be good for Buster Boy Toys so that Best Gifts will choose to continue buying from Buster Boy Toys instead of turning to other suppliers. **(1 development)**
 Best Gifts is popular with working adults whereas Novelty Hub is popular with students. **(1 basic statement)**
 Working adults have the ability to spend more than students. This could lead to higher revenue for Best Gifts which will help them to pay Buster Boy Toys promptly. **(1 development)**
 Best Gifts has been in business for a longer time compared Novelty Hub. **(1 basic statement)**
 Best Gifts is more stable compared to Novelty Hub and will be less likely to make late payments to Buster Boy Toys in the long run. **(1 development)**
 Best Gifts has a stable rent expense compared to Novelty Hub. **(1 basic statement)**
 Even though Best Gifts' rent is higher than Novelty Hub, it has been stable for the past 5 years unlike Novelty Hub' rent. Best Gifts will be able to manage their liquidity more easily and minimise late payments to Buster Boy Toys. **(1 development)**

OR

Buster Boy Toys should grant the extension to Novelty Hub. **(1 decision)**
 Novelty Hub has a shorter repayment history. **(1 basic statement)**
 As they are relatively prompt with payment compared to Best Books, it would be less risky to grant them the credit extension. **(1 development)**
 Novelty Hub' online store will be ready next month, whereas Best Gifts has no plans to set up one. **(1 basic statement)**
 An online shop will help Novelty Hub to have a wider reach of customers which will help boost their sales. They will therefore be less likely to make late payments to Buster Boy Toys in the long run. **(1 development)**
 Novelty Hub pays lower rent compared to Best Gifts. **(1 basic statement)**
 With lower operational expenses, Novelty Hub is better able to pay Buster Boy Toys promptly. **(1 development)**