2022 H2PAA Pu3 Prelim Paper 1 Answer guide

Question 1

(a)

	Categories							
Transaction	Total assets		Profit		Working capital		Equity	
	Increase	Decrease	Increase	Decrease	Increase	Decrease	Increase	Decrease
(i)		3 340		3 340		3 340		3 340
(ii)		1 000		1 000		1 000		1 000
(iii)		480	20		20		20	
(iv)	50 000				50 000		50 000	

(b)

Computation of profit available for distribution to ordinary shareholders.

	$
Net profit before interest	100 000
Less: Interest expense (6% X 400 000)	24 000
Net profit	76 000
Less: Preference dividend (8% X 400 000)	32 000
Profit for distribution as ordinary dividends	44 000

(c)

	Gotham	**Hot Wheels**	**Gears**
Debt – Equity Ratio	66.67%	42.86%	0
Total liabilities/ Total Equity	400 000/ 600 000	300 000/700 000	0/1 000 000

Gotham is the most highly geared as it has the highest debt – equity ratio of 66.67%.

(d)

- Risk of not being able to generate enough profits to cover interest costs which is a mandatory expense and hence make a loss.
- Risk of not being able to repay its interest and debt when they fall due which may result in a company being forced into liquidation
- Risk of fluctuation in EPS
- Risk of not being able to obtain more loan capital

(e)

In years of high profits, it will be better to be an ordinary shareholder are entitled to share larger profits as there will be more profits available for distribution as ordinary dividends after paying fixed interest expense and preference dividends.

For bondholders, the interest received is fixed regardless of the profits earned.

(f) Trade unions/Management/Lenders/Suppliers/Government/General Public

Question 2

(a) Swee Silk Limited

Statement of Cash Flows for the year ended 31 March 2022

	$'000	$'000
Cash flows from operating activities		
Net profit for the year before interest [240 +60]	300	
Adjustments for :		
Depreciation (12.5% X 280 000)	35	
Loss on disposal (15 - 20)	5	
Operating cash flows before movements in working capital		340
Increase in inventory	(170)	
Increase in trade receivables	(110)	
Increase in trade payables	79	
		(201)
Net cash provided by operating activities		139
Cash flows from investing activities		
Deposit for PPE	(30)	
Purchase of non-current assets	(280)	
Proceeds from sale of non -current assets	15	
Net cash used in investing activities		(295)
Cash flows from financing activities		
Proceeds from loan	400	
Issue of share	70	
Repayment of old loan	(10)	
Repayment of new loan	(60)	
Interest paid	(60)	
Dividends paid (20+20)	(40)	
Net cash provided by financing activities		300
Net decrease in cash and cash equivalents		144
Cash and cash equivalents at beginning of the year		(54)
Net decrease in cash and cash equivalents		144
Cash and cash equivalents at end of the year		90

(b)

Overall, there was a improvement in the company's cash resources from an overdraft of $54 000 to a positive balance of $90 000.

Cash from operations tied up in inventory & receivables. Business made a profit of $300 000 before interest but was only able to generate cash of $139 000 from its operations

Business made major investment in PPE totalling $310 000 which resulted in net investment outflow of $295 000.

The purchase of PPE was financed by new loans of $400 000 and issue of shares of $70 000. This inflow of cash was used in the repayment of loans ($70 000), interest ($60 000) and dividends ($40 000).

(c)

- Holding excessive inventory leading to cash from operations being tied up in inventory.
- Inefficient management of trade receivables resulting to cash from operations being tied up in trade receivables
- Inadequate funding for PPE investment of $580 000 (280 000 + 300 000) funded by loans and share issue of $470 000, leaving $110 000 to be funded by its operations.
- If profits fall in the future, the business may have problems repaying its loans of about $100 000 per annum. Currently cash from operations come up to $139 000.

Question 3

a.	$
Beginning equity on 1 July 2021	5 000 000
New OS	2 000 000
Net Profit [320 000 – (5%x 1 000 000)]	270 000
Less Dividends	(180 000)
Ending equity on 30 June 2022	7 090 000

b.					
ROE =	Net Profit	=	270 000	=	4.47%
	Average Equity		(5 000 000 + 7 090 000) / 2		

c.
Return excess funds to shareholders through higher dividends.
Return excess funds to shareholders through share buybacks.
// Any 1 relevant point

d

Earnings per share	=	Net profit	=	270 000	=	$0.06
		Average no of OS		(3 400 000 + 5 400 000)/2		
Dividend yield	=	Dividend per OS	=	180000/(3400 000 + 2000000)	=	1.67%
		Market price per OS		$2		
Price earnings ratio	=	Market price per OS	=	$2	=	33.33 times
		Earnings per OS		$0.06		

e
Lilly Limited is a better investment - Lilly has higher, hence better EPS. Each share earns more profit in Lilly than Kenny so there is a chance of higher dividends in Lilly than Johnny. - Lilly has higher, hence better dividend yield. Each share invested now in Lilly earns higher returns than in Johnny. *(Kenny should also compare against yield from other investments e.g. savings interest)* - Lilly has a higher Price Earnings ratio. Investors are more confident in Lilly than in Johnny and are hence willing to pay a higher price relative to earnings. 6 marks - 2marks per point

Question 4

a. Income statement for the year ended 30 June 2022

<u>Revenue</u>	$	$
Sales		104 600
Less: <u>Expenses</u>		
Assistant's wages	16 000	
Make up supplies	21 200	
Motor vehicle expenses [(6400 + 2000) x ¾]	6 300	
Advertisement (1200+400+600)	2 200	
Depn – MV [(100 000 + 16 000) X 20% X ¾]	17 400	
Depn – equipment (50000 X 20%)	10 000	
Interest (60 000 X 5% X 6/12)	1 500	
		(74 600)
Net profit		30 000

Working:

To find as sales:

Analysing trade receivables

Beginning balance + Sales – Receipts = Ending balance

3500+ Credit Sales – 87 000 = 2 600

Credit sales = 86 100

Total sales = 86 100 + 18 000 + 500 = $104 600

To find make up supplies used:

Analysing payables

Beginning balance + Credit purchases – Payments = Ending balance

950 + Credit purchases – 21 000 = 1 350

Make up supplies purchased = 21 000 – 950 + 1350 = 21 400

Make up supplies purchased & used = 21 400 – 200 = 21 200

(c)Advantages of keeping a full set of accounts

- Detection of errors is easier as a trial balance can be prepared.
- Fraudulent entries are difficult to make.
- Ensures that important items or transactions are not omitted as there are no or inadequate records of capital, accounts payable, expenses, revenue, etc.

- Assurance of accuracy and reliability of information produced for better decision making.
- Meets legal requirements.

Marie Antoinette
Balance sheet as at 30 June 2022

$	Cost	Acc Depn	Net Book Value	
Non-current Assets	$	$	$	$
Motor vehicles	116 000/	23 200	92 800	
Equipment	50 000	30 000	20 000	
Total non-current assets				112 800
Current Assets				
Loan to employee			5 000	
Trade receivables			2 600	
Income receivable			500	
Bank			115 800	
Cash (18 000 – 16 000 – 1 200)			800	
Total current assets				124 700
				237 500
Equity				
Capital, at start			57 950	
Add:				
Additional capital (100 000 + 2 000)			102 000	
Net profit			30 000	
			189 950	
Less: Drawings (9 800 + 200 + 5 800 + 2 100)			(17 900)	
				172 050
Non-current liabilities				
Loan (100 000-40 000)/5 X 4				48 000
Current liabilities				
Current portion of long-term borrowing			12 000	
Trade payables			1 350	
Deposit from customer			2 000	
Advertising payable			600	
Interest payable			1 500	
				17 450
				237 500

Capital at start = 30 000 + 25 000 + 3 500 – 950 + 400 = 57 900

(d)

Transaction	Impact on Bank Balance in business records	
	Increase	Decrease
(i)	Nil	Nil
(ii)	-	75
(iii)	-	1 720
(iv)	Nil	Nil

(e) Importance of reconciling business bank records with the bank statement

- Ensures that the difference in the cash at bank balance and bank statement balance is only due to timing.
- It reveals the correct amount of cash in the bank and ensures that the correct balance is shown in the balance sheet.
- The bank reconciliation will highlight any discrepancies between the bank's and the firm's records of cash transactions. This allows errors to be detected and corrected.
- If the reconciliation is prepared by somebody other than the cashier (segregation of duties), the risk of fraud or embezzlement of funds is reduced as investigation can be carried out on the long outstanding items.

(f) In accordance with the accrual concept when income is only recognized when earned regardless of receipt. The total fee for Hunks and Babes as the service has not been performed and hence, is not earned. It can only included in the next accounting when the service is performed in August 2022.

In accordance with the Accounting Entity Concept where the owner and the business are separate and distinct, the HDB apartment cannot be considered the business asset as the asset is owned by both Marie and her husband and Marie is not at liberty to contribute to the business. Doing so will violate the Accounting Entity Concept by not keeping personal and business assets separate.

Making the inclusions will impact the professional accountant of acting competently in preparing financial statements. The commission on the loan should not be accepted as it will compromise the independence of the professional accountant in the discharge of her duties. The professional accountant can also be prosecuted for criminal breach of trust in accepting money for falsifying accounts and may not be allowed to practise as a professional accountant by the professional body.