

- 1 Karen and Lee are in partnership sharing profits and losses in the ratio 2:3 respectively. The following balances were available at 28 February 2022.

Trial balance at 28 February 2022

	Debit \$	Credit \$
Administrative expenses	6 020	
Bank interest charges	180	
Bank overdraft		5 910
Capital accounts		
Karen		40 000
Lee		50 000
Carriage inwards	3 880	
Current accounts, 1 March 2021		
Karen		1 220
Lee	1 880	
Drawings		
Karen	17 500	
Lee	19 900	
Insurance	7 740	
Inventory, 1 March 2021	8 250	
Loan from Lee		10 000
Non-current assets		
At cost	160 000	
Provision for depreciation, 1 March 2021		56 000
Provision for doubtful debts, 1 March 2021		260
Purchases	151 440	
Returns	2 200	3 930
Revenue		229 250
Trade payables		14 450
Trade receivables	31 210	
Suspense account	820	
	<u>411 020</u>	<u>411 020</u>

The following information is also available.

- On 28 February 2022, inventory had been valued at cost, \$21 220. This figure included some damaged items which had cost \$1320 and had a sales value of \$2480. The damaged items could be repaired at a cost of \$1300.
- In January 2022, an error had been made recording returns inwards, \$410. This amount had been credited to the returns outwards account.
- Insurance includes \$1410 paid for the three months ended 30 April 2022.
- The loan from Lee had been arranged on 1 November 2021. It was agreed that Lee should be entitled to interest at 6% per annum on the loan. No entries have been made for interest on the loan.
- The provision for doubtful debts should be increased to \$310.
- Non-current assets are to be depreciated by 20% per annum using the reducing balance method.

REQUIRED

- (a) Prepare the income statement for the year ended 28 February 2022. the space provided on the **next page** for your workings.

Karen and Lee
Income statement for the year ended 28 February 2022

This image shows a full page of white paper with horizontal dashed lines, typical of primary-ruled notebook paper. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

Workings:

[9]

(b) Prepare Lee's current account for the year ended 28 February 2022.

Lee
Current Account

	\$		\$

[4]

Additional information

The partners have been considering making a more detailed partnership agreement to include the following terms.

- 1 Interest to be charged on all drawings at 10%.
- 2 Karen to receive a salary of \$8400 per annum.
- 3 Profits and losses would continue to be shared in the ratio Karen:Lee, 2:3 respectively.

REQUIRED

- (c)** Calculate the increase or decrease in Lee's current account balance at 28 February 2022 assuming the new agreement had been in use from 1 March 2021.

[6]

Additional information

Karen and Lee had also considered operating as a limited company.

REQUIRED

(d) Explain **one** advantage of operating as a partnership rather than a limited company.

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(e) Explain **two** advantages of operating as a limited company rather than a partnership.

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[4]

Additional information

The partners are concerned about the business's liquidity position.

Karen believes the problem arises because the business holds too much inventory. She suggests that credit purchases should be reduced for the next three months to ensure inventory levels are lowered.

REQUIRED

- (f)** Advise Lee whether or not he should accept Karen's suggestion. Justify your advice.

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