

MyStudyBro - Revision Exercise Tool

This Revision Handout includes the Questions and Answers of a total of 5 exercises!

Chapters:

Statement of Changes in Equity - Unit 2 (Pearson Edexcel)

Page 1	(WAC02 or WAC12) 2018 Winter
Page 4	(WAC02 or WAC12) 2018 Winter - Answer
Page 11	(WAC02 or WAC12) 2018 Summer Capital and Revenue Reserves
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- 2 The Statement of Changes in Equity of Kandy Tea plc for the year ended 31 December 2017 is being prepared and is shown on page 11 of the Question Paper.

You are the accountant responsible for preparing the Statement of Changes in Equity for Kandy Tea plc.

Required

- (a) Complete, in the Question Paper, the Statement of Changes in Equity, to record the information shown below, for the year ended 31 December 2017.

You may show your workings in the space provided in the Question Paper.

- (1) Balances at 1 January 2017:

£1 Ordinary shares - £750 million

Share premium - £50 million

Retained earnings - £17 million credit

General reserve - £11 million

Capital replacement reserve - £7 million

Total equity figure - to be calculated

- (2) On 1 February 2017 a rights issue of 1 ordinary share of £1 for every 5 ordinary shares of £1 held took place. The issue was at a premium of 14 pence (£0.14) per share. The rights issue was fully subscribed.
- (3) On 14 March 2017 the final dividend for 2016, of 2 pence (£0.02) per share, was paid to shareholders. Only the shareholders who held shares **before** 1 February 2017 were eligible for the dividend.
- (4) On 12 April 2017 the balance on the Capital replacement reserve was transferred to Retained earnings.
- (5) On 23 May 2017 property with a book value of £60 million was revalued upwards by 20% to reflect the market value.
- (6) On 15 July 2017 an amount was transferred from the General reserve to a Foreign exchange reserve to cover falls in the currency. The company was awaiting payments of £125 million and decided to place 8% of this amount in a Foreign exchange reserve.
- (7) On 13 August 2017 the balance on the General reserve was transferred to Retained earnings.
- (8) On 24 September 2017 an interim dividend of 0.9 pence (£0.009) per share was paid to all shareholders.
- (9) The loss for the year ended 31 December 2017 was £2.9 million.
- (10) Complete the balances at 31 December 2017 and the Total equity at that date.

(21)

- (b) State the difference between a revenue reserve and a capital reserve. (2)
- (c) Identify from the Statement of Changes in Equity:
- (i) **two** revenue reserves (2)
 - (ii) **two** capital reserves. (2)
- (d) Calculate the maximum that could be paid per share as a final dividend for 2017. (4)
- (e) Explain **three** reasons why a rights issue of shares may be made. (6)
- (f) Explain **three** roles or activities the auditor should carry out. (6)
- In February the Board of Kandy Tea plc considered an issue of preference shares, but decided to issue ordinary shares.
- (g) Evaluate the decision to issue ordinary shares instead of preference shares, giving advantages and disadvantages of each type of share from the point of view of the company. (12)

(Total for Question 2 = 55 marks)

TOTAL FOR SECTION A = 110 MARKS

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Figures are in £ millions	£1 Ordinary share capital £m	Share premium £m	Retained earnings £m	General reserve £m	Foreign exchange reserve £m	Capital replacement reserve £m	Revaluation reserve £m	Total equity £m
(1) Balance at 1 January 2017								
(2)								
(3)								
(4)								
(5)								
(6)								
(7)								
(8)								
(9)								
(10) Balance at 31 December 2017								



Question Number	Answer	Mark
2 (a)	<p>AO1 (4), AO2 (17) AO1: Two marks for correct insertion of opening balances. Two marks for correct calculation of closing balances. AO2: Seventeen marks for correct calculation and insertion of figures into statement.</p> <p>Workings for (2): $(750m/5)$ (1)AO2 = 150 (1)AO2 (150×0.14)(1)AO2 = 21 (1)AO2 Workings for (3): $(0.02 \times 750m)$(1)AO2 = (15) (1)AO2 Workings for (8): (900×0.009)(1)AO2 = (8.1)(1)AO2</p>	(21)

2 (a) Figures are in £ millions	Ordinary Share £1 Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Foreign Exchange Reserve £m	Capital Replacement Reserve £m	Revaluation Reserve £m	Total Equity £m
(1) Balance at 1 January 2017	750	50	17	11		7		835 (1all six)AO1
(2) Rights Issue	150 (2)AO2	21 (2)AO2						171
(3) Final Dividend 2016			(15) (2)AO2					(15)
(4) Transfer			7 (1)AO2			(7) (1)AO2		--
(5) Revaluation							12 (1)AO2	12
(6) Transfer				(10) (1)AO2	10 (1)AO2			--
(7) Transfer			1 (1)AO2	(1) (1)AO2				--
(8) Interim Dividend 2017			(8.1) (2)AO2					(8.1)
(9) Loss for the year			(2.9) (1)AO2					(2.9)
(10) Balance at 31 December 2017	900	71 (1of both)AO1	(1) (1of)AO2	0	10	0	12 (1of all four)AO1	992 (1of)AO1

Question Number	Answer	Mark
2 (b)	<p>AO1 (2) AO1: Two marks for stating a difference.</p> <p>Revenue reserves are created from undistributed profits (1) AO1. Capital reserves are, for example created by issuing shares above par value (1) AO1.</p> <p>OR revenue reserves are available for redistribution as dividends (1) AO1. Capital reserves are not available for redistribution as dividends (1) AO1.</p>	(2)

Question Number	Answer	Mark
2 (c)(i)	<p>AO1 (2) AO1: Two marks for correct identification of revenue reserves.</p> <p>Any two from: Retained Earnings AO1 General Reserve AO1 Foreign Exchange Reserve AO1 Capital Replacement Reserve AO1</p>	(2)

Question Number	Answer	Mark
2 (c)(ii)	<p>AO1 (2) AO1: Two marks for correct identification of capital reserves.</p> <p>Share Premium AO1 Revaluation Reserve AO1</p>	(2)

Question Number	Answer	Mark
2 (d)	<p>AO1 (4) AO1: Four marks for correct calculation of maximum payable per share</p> <p>Maximum amount payable = $\frac{(-1)(1\text{of}) \text{AO2} + 10 (1\text{of}) \text{AO2}}{900 (1\text{of}) \text{AO2}}$</p> <p>= 1 pence per share AO2 (1of)</p>	(4)

Question Number	Answer	Mark
2 (e)	<p>AO1 (6) AO1: Three marks for correct identification of reason for a rights issue (one per point), and three marks for development (one per point).</p> <p>The company may have a liquidity problem, AO1 so a share issue will bring in cash to solve this problem. AO1</p> <p>The company may have a small statement of financial position/ may wish to make the statement of financial position look larger. AO1 A share issue will increase the size of the equity section. AO1</p> <p>Shareholders are kept happy. AO1 If the company is doing well, then they have the chance for further investment in a successful company. Or, if they do not wish to take up the offer, they can sell the right/ offer is below market price. AO1 (maximum of 2 marks)</p> <p>A rights issue sees existing shareholders maintain control, AO1 whereas a public issue would see their control diluted. AO1</p> <p>To finance investment AO1 for example acquisition of another company, or purchase of land. AO1</p>	(6)

Question Number	Answer	Mark
2 (f)	<p>AO3 (6) AO3: Three marks for correct identification of auditor role (one per point), and three marks for development (one per point).</p> <p>Check that the financial statements are free from material misstatements/present a true and fair view AO3 and express their opinion on this matter. AO3</p> <p>Auditors should plan an audit so they have a reasonable expectation AO3 of detecting material misstatements caused by fraud. AO3</p> <p>Auditors may be asked to report on findings concerning a company's compliance AO3 with the UK Corporate Governance Code. AO3</p> <p>Test systems and controls AO3 to eliminate or minimise the risk of fraud. AO3</p> <p>Auditors should ensure that the financial statements, e.g. Statement of Comprehensive Income, AO3 comply with International Accounting Standards or Generally Accepted Accounting Principles. AO3</p> <p>Auditors should state whether the financial statements have been prepared on the basis of the business AO3 being a going concern or not being a going concern. AO3</p> <p>To ensure that the Director's Report is included with the financial statements AO3 and that the contents are factual, correct and disclose all material points. AO3</p>	(6)

Question Number	Indicative Content	Mark
2 (g)	<p>AO1 (1), AO2 (1), AO3 (4), AO4 (6)</p> <p><u>Ordinary shares</u> Ordinary shares would see an inflow of capital that will help the company's liquidity position and therefore help with the future running of the company.</p> <p>Ordinary shares would allow existing shareholders the right to buy more shares in the company. This would ensure there is no dilution of control if they take up the rights. However, ordinary shares could be purchased on issue by outside parties if existing shareholders do not take up their right to buy the newly issued shares. Outside parties could buy these new shares when second-hand, if they are offered on the open market. Outside parties gaining some control of the company could be to the benefit or detriment of the company.</p> <p>Ordinary shares only have to pay a dividend when the company is in a financial position to do so. This would help the company regarding liquidity, cash flow, and maybe stop revenue reserves being drained. It would appear that Kandy Tea plc is not in a healthy financial position – it made a trading loss this year. There is little in the revenue reserves that could be used to finance a large dividend payment.</p> <p>Ordinary shares decrease the gearing ratio and that may make borrowing easier. This would help the company's liquidity position, if it is having problems borrowing, or with liquidity. Decreasing the gearing ratio also reduces risk to company. It is not possible to state the gearing ratio of Kandy Tea plc as no information is given about LT liabilities.</p> <p><u>Preference shares</u> Preference shares would see an inflow of capital that will help the company's liquidity position and therefore may help with the running of the company.</p> <p>If the company is finding it difficult to raise finance, it may find preference shares are more likely to be taken up by investors than ordinary shares, who may see a potentially larger return. Preference shares would see the holders expecting a regular payment, probably twice a year, at a fixed rate of interest. This should be paid, even if the company is in a poor financial position. If dividends are not paid, the missed dividend may be carried over to a future period i.e. the dividends may be cumulative. Kandy Tea plc appears to be in a position where they would not want a regular payment of dividends to have to be made.</p> <p>Preference shares increase the gearing ratio that may make future borrowing more difficult for the company.</p> <p>Decision Good decision by the board to issue ordinary shares.</p>	(12)

Level	Mark	Descriptor
	0	A completely incorrect response.
Level 1	1-3	Isolated elements of knowledge and understanding recall based. Weak or no relevant application to the scenario set. Generic assertions may be present.
Level 2	4 - 6	Elements of knowledge and understanding, which are applied to the scenario. Chains of reasoning are present, but may be incomplete or invalid. A generic or superficial assessment is present.
Level 3	7 - 9	Accurate and thorough understanding, supported throughout by relevant application to the scenario. Some analytical perspectives are present, with developed chains of reasoning, showing causes and/or effects. An attempt at an assessment is presented, using financial and non-financial information, in an appropriate format and communicates reasoned explanations.
Level 4	10 - 12	Accurate and thorough knowledge and understanding, supported throughout by relevant and effective application to the scenario. A coherent and logical chain of reasoning, showing causes and effects. Assessment is balanced, wide ranging and well contextualised using financial and non-financial information and makes informed recommendations and decisions.

5 The Statement of Changes in Equity of Pontus Transport plc for the year ended 31 March 2018 is shown below.

Figures are in £ millions	Ordinary Share Capital £	Share Premium £	Retained Earnings £	General Reserve £	Foreign Exchange Reserve £	Revaluation Reserve £	Total Equity £
Balance at 1 April 2017	A	55	64	27	10	30	B
Dividends Paid			(23)				(23)
Transfer			(8)		8		C
Profit after Tax			D				89
Balance at 31 March 2018	320	55	E	27	18	30	F

Required

- (a) Complete the Statement of Changes in Equity showing figures calculated for letters A to F in the Question Paper. (6)

- (b) Complete the table showing how the following reserves can be created and give one example of how each can be utilised (used):
 - share premium reserve
 - retained earnings
 - general reserve
 - revaluation reserve.(9)

- (c) Prepare Journal entries, including a narrative, for the transfer of the £8 million shown in the Statement of Changes in Equity. (3)

On 13 May 2018, a property with a book value of £18 million was sold for £20 million.

The property had previously been revalued from £11 million to £18 million in the books.

- (d) Prepare the Journal entries, including a narrative, to show the sale of the property on 13 May 2018.

(6)

The financial statements were presented to the shareholders at the Annual General Meeting. One shareholder stated at the meeting "I think the dividend policy of the company is not very generous to the shareholders".

- (e) Evaluate the statement made by the shareholder.

(6)

(Total for Question 5 = 30 marks)

Source material for Question 5 is on pages 12 and 13 of the source booklet.

If you answer Question 5 put a cross in the box .

5 The Statement of Changes in Equity of Pontus Transport plc for the year ended 31 March 2018 is shown below.

Figures are in £ millions	Ordinary Share Capital £	Share Premium £	Retained Earnings £	General Reserve £	Foreign Exchange Reserve £	Revaluation Reserve £	Total Equity £
Balance at 1 April 2017	A	55	64	27	10	30	B
Dividends Paid			(23)				(23)
Transfer			(8)		8		C
Profit after Tax			D				89
Balance at 31 March 2018	320	55	E	27	18	30	F

(a) Complete the Statement of Changes in Equity showing figures calculated for letters A to F.

(6)

Workings

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(b) Complete the table below showing how the following reserves can be created and give one example of how each can be utilised (used):

- share premium reserve
- retained earnings
- general reserve
- revaluation reserve.

(9)

	Created	Utilised (used)
Share premium reserve		
Retained earnings		
General reserve		
Revaluation reserve		



Level 3	5-6	<p>Accurate and thorough knowledge and understanding. Application to the scenario is relevant and effective. A coherent and logical chain of reasoning, showing causes and effects is present.</p> <p>Evaluation is balanced and wide ranging, using financial and perhaps non-financial information and an appropriate decision is made.</p>
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Question Number	Answer	Mark
5 (a)	<p>AO2 (6) AO2: Six marks for correct calculation of figures in statement of changes in equity.</p> <p>A - 320 (1) AO2 B - 506 (1) AO2 C - 0 (1) AO2 D - 89 (1) AO2 E - 122 (1of) AO2 F - 572 (1of) AO2</p>	(6)

Question Number	Answer	Mark
5 (b)	<p>AO1 (3), AO2 (6) AO1: Three mark for correct reasons for creation of reserve. AO2: Five marks for correct examples of use of reserve. One mark for correct reason for creation of revaluation reserve.</p>	(9)

	Created	Utilised (Used)
Share premium reserve	Issue of ordinary shares above their nominal value (1) AO1	Write off preliminary expenses on formation of company or a share issue. OR Pay premium on redemption of shares or debentures OR Issue Bonus Shares (1) AO2
Retained earnings	Trading profits built up over past and present years (1) AO1	Dividends paid to ordinary shareholders OR Used for growth/expansion of company (1) AO2
General reserve	Transfer from Retained earnings/ profits (1) AO1	Any, perhaps unspecified, use. Issue bonus shares OR Transfer back to Retained earnings (1) AO2
Revaluation reserve	Upward revaluation of non-current asset. (1) AO2	When asset is sold (1) AO2 transferred to Income statement/ retained earnings. (1) AO2

Question Number	Answer	Mark
5 (c)	<p>AO1 (1), AO3 (2) AO1: One mark for correct narrative. AO3: Two marks for correct Journal entries The Journal.</p>	(3)

Figures shown in £ millions	Debit	Credit
Retained earnings	8 (1) AO3	
Foreign Exchange reserve		8 (1) AO3
Being transfer from Retained Earnings to Foreign Exchange reserve (1) AO1		

Question Number	Answer	Mark
5 (d)	<p>AO1 (1), AO3 (5) AO1: One mark for correct narrative. AO3: Five marks for correct completion of Journal entries.</p>	(6)

Figures shown in £ millions	Debit	Credit
Bank	20 (1) AO3	
Property		18 (1) AO3
Statement of Comprehensive Income		2 (1) AO3
Revaluation reserve	7 (1) AO3	
Statement of Comprehensive Income		7 (1) AO3
Being entries to record sale of previously revalued property (1) AO1		

Question Number	Indicative Content		Mark
5 (e)	<p>AO4 (6)</p> <p><u>Case for statement/ i.e. not very generous</u></p> <p>The dividend cover is 3.8. This means about 25% of the profit after tax has been paid as a dividend. Although the dividend per share is about 7 pence, it appears the £1 shares have been issued at a premium. Also, the market price of the share is unknown, so the dividend yield is not clear.</p> <p>The total funds in revenue reserves is £101m at the start of the year and £167m (o/f) at the end of the year, but only £23m is paid out in dividends.</p> <p><u>Case against statement/ i.e. generous dividend policy</u></p> <p>Profit after tax is £89m, of which £23m is paid out in dividends. This represents about 25% of the profit after tax, which could be said to be generous.</p> <p>Profit needs to be retained for expansion, possible future projects, and in case of financial problems in the future.</p> <p>The holder of a £1 share appears to be receiving about 7 pence as a dividend, which looks like a good return.</p> <p><u>Decision</u></p> <p>It is not possible to say exactly if the dividend policy is generous or not, conclusion possibly depends on argument put forward by candidate.</p>		(6)
Level	Mark	Descriptor	
	0	A completely incorrect response.	
Level 1	1-2	Isolated elements of knowledge and understanding which are recall based. Generic assertions may be present. Weak or no relevant application to the scenario set.	
Level 2	3-4	Elements of knowledge and understanding, which are applied to the scenario. Some analysis is present, with developed chains of reasoning, showing causes and/or effects applied to the scenario, although these may be incomplete or invalid. An attempt at an evaluation is presented, using financial and perhaps non-financial information, with a decision.	

Level 3	5-6	Accurate and thorough knowledge and understanding. Application to the scenario is relevant and effective. A coherent and logical chain of reasoning, showing causes and effects is present. Evaluation is balanced and wide ranging, using financial and perhaps non-financial information and an appropriate decision is made.
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Question Number	Answer	Mark
6 (a)	<p>AO1 (5), AO2 (7) AO1: 5 marks for calculation of sales revenue and inclusion and calculation of fixed costs. AO2: 7 marks for calculation of direct labour and direct materials and profit or loss per mine.</p> <p>Workings: <u>Direct materials</u></p> $\frac{29\,760\,000}{32\,000} = 930 \text{ kilos (1) AO2} \times \text{£11 000 per kilo}$ $= \text{£10 230 000 (1) AO2}$ <p><u>Fixed Costs</u></p> $\frac{\text{£135 000 000}}{15} = \text{£9 000 000 per year (1) AO1}$ $+ \text{£5 880 000} = \text{£14 880 000 (1) AO1}$	(12)

	<u>Boksville</u>		<u>Igolide</u>		<u>Orange Deep</u>	
Sales Revenue	22 400 000	(1) AO1	17 600 000	(1) AO1	29 760 000	
Direct Labour	17 500 000		8 800 000	(1) AO2	17 670 000	
Direct Materials	7 000 000		3 300 000	(1) AO2	10 230 000	(2) AO2
Fixed Costs	<u>10 500 000</u>		<u>4 400 000</u>		<u>14 880 000</u>	(2) AO1
Total costs	35 000 000		16 500 000		42 780 000	(1of) AO1
Profit (Loss)	(12 600 000)	(1of) AO2	1 100 000	(1of) AO2	(13 020 000)	(1of) AO2

SECTION A

SOURCE MATERIAL FOR USE WITH QUESTION 1

- 1 You are the accountant for Moratuwa Plastics plc. During the year ended 31 December 2015, the directors of Moratuwa Plastics plc agreed the following:
- (1) The Statement of Comprehensive Income for the year ended 31 December 2015 shows a loss of £8 million.
 - (2) To revalue the company factory from a book value of £120 million, to a market value of £160 million.
 - (3) Provide a final dividend for 2014 to Ordinary shareholders of 1 pence (£0.01) per share. The dividend was paid on 2 February 2015.
 - (4) To transfer £25 million from the General Reserve to the Retained Earnings Reserve.
 - (5) To transfer a sum of £30 million from Retained Earnings Reserve to the Capital Replacement Reserve, in order to replace worn out machinery.
 - (6) Not to pay an interim or final dividend for the year ended 31 December 2015. Instead, the directors decided to issue Bonus Shares at par, at a rate of one share issued for every 50 shares held.

Required:

- (a) Complete Journal entries for items (2) to (6) above. Dates and narratives are **not** required.

(12)

The Statement of Changes in Equity of Moratuwa Plastics plc for the year ended 31 December 2015 is nearing completion and is shown below.

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	A £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		B
Comprehensive Income for the year			C					
Revaluation of property							D	
Final 2014 Dividend paid in year			E					
Transfer			F	G				
Transfer			H		I			
Bonus Issue of £1 ordinary shares	J		K					
Balance at 31 December 2015	L	M	N	O	P	Q	R	S

Required:

- (b) Complete the table in the question paper to show the heading A and figures for the items labelled B to S.

(16)

There has only been one issue of shares in Moratuwa Plastics plc, when the company was started. The Capital Redemption Reserve was created in the year ended 31 December 2014, when a number of shares were redeemed at the same value as their issue. No other shares were issued at the time of the redemption. There have been no other entries made in the Capital Redemption Reserve.

Required:

- (c) Calculate how many shares were redeemed when the Capital Redemption Reserve was created.

(6)

A director asks you "I see we made a loss this year. Can we add the upward revaluation of the factory to the Statement of Comprehensive Income? That would turn the loss into a profit figure. Could we then use this to pay a dividend?"

Required:

- (d) Prepare an explanation to the two questions asked by the director.
- (i) Can the upward revaluation of the factory be added to the Statement of Comprehensive Income? (4)
 - (ii) Can the upward revaluation of the factory then be used to pay dividends? (2)
- (e) Evaluate the decision to issue bonus shares to shareholders instead of paying a dividend on behalf of the company. (12)

(Total for Question 1 = 52 marks)

Answer space for Question 1 is on pages 2 to 7 of the question paper.

(b) Complete the table below to show the heading A and figures labelled B to S.

(16)

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	A £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		B
Comprehensive Income for the year			C					
Revaluation of property							D	
Final 2014 Dividend paid in year			E					
Transfer			F	G				
Transfer			H		I			
Bonus Issue of £1 ordinary shares	J		K					
Balance at 31 December 2015	L	M	N	O	P	Q	R	S

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SECTION A

1(a)

	Debit	Credit
	£m	£m
(2) Property	40 ✓	
Revaluation Reserve		40 ✓
(3) Statement of Comprehensive Income (SOCl) / Retained Earnings	7 ✓	
Ordinary Share Dividend/Dividend Payable		7 ✓
Ordinary Share Dividend/Dividend Payable	7 ✓	
Bank		7 ✓
(4) General Reserve	25 ✓	
SOCl / Retained Earnings		25 ✓
(5) SOCl / Retained Earnings	30 ✓	
Capital Replacement Reserve		30 ✓
(6) SOCl / Retained Earnings	14 ✓	
Ordinary Share Capital £1		14 ✓

(12)

(b)

Figures are in £ millions	£1 Ordinary Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Capital Redemption Reserve £m	Revaluation Reserve ✓ £m	Total Equity £m
Balance at 1 January 2015	700	140	35	25		144		1 044 ✓
Comprehensive Income for the Year			(8) ✓					
Revaluation of property							40 ✓	
Final 2014 Dividend Paid in year			(7) ✓					
Transfer			25 ✓	(25) ✓				
Transfer			(30) ✓		30 ✓			
Bonus Issue of Ordinary £1 shares	14 ✓		(14) ✓					
Balance at 31 December 2015	714 of	140 ✓ (need 2) of	1 ✓ of	0 of	30 ✓ (need 2) of	144 of	40 ✓ (need 2) of	1 069 ✓ of

(16)

(c) Shares issued at premium of $\frac{(140m \times 100)}{700m} \checkmark = 20\% \checkmark$

So X shares at 20% premium to give £144m

ie $X \times 1.2 = £144m \quad X = \frac{£144m}{1.2} \checkmark = 120m \text{ shares } \checkmark \text{ of } \checkmark C$

(6)

(d) Answers could include:

(i) Increase in value of factory cannot be added to profit, ✓ because it is an unrealised gain. ✓ This would go against the concept/principles of realisation ✓ i.e. gain has not been realised until property is sold. ✓ Also goes against prudence. ✓ (4)

(ii) Cannot be used to distribute as a dividend ✓ as in a capital reserve. ✓ (2)

(e) Answers may include

For Bonus Issue

Company has few funds available for dividends. ✓ Only £15m o/f in the Retained Earnings available. ✓

Shareholders are kept happy / quiet ✓ as they would have received free shares ✓ and these shares are eligible for dividends in the future. ✓

Maximum in Revenue reserves ✓ available for dividend is

£15m o/f + £30m = £45m o/f ✓ but reluctant to pay the £30m in Capital Replacement ✓ as this is set aside to replace worn out machinery. ✓

Company may be short of liquid funds ✓ especially if they have made a loss. ✓

May attract new investors (if they hear about the bonus shares). ✓

Bonus shares could be lower in total than the dividend payable. ✓

Makes the company look stronger (SOFP) if shares issued from revenue reserves. ✓

Against Bonus Issue

Bonus shares bring in no cash for the company. ✓

Issue of bonus shares sees share price fall ✓ Shareholders will be unhappy. ✓

Bonus shares will result in more shares eligible for dividends in the future ✓ so greater future payouts, ✓ or dividend per share may fall. ✓

The £14m could be used to give a dividend ✓ of 2 pence per share. ✓

It is possible to pay 6.43 pence per share maximum ✓ as a dividend from Revenue Reserves. ✓

If bonus shares are paid from revenue reserves ✓ this means there will be less funds available for future dividends/emergencies. ✓

Shares may fall in value in the future due to e.g. economic reasons ✓ so shareholders will be unhappy.

Administration/professional costs will rise. ✓

Maximum of 8 ✓ for arguing one side.

Conclusion

Bonus issue may/may not be best option for company ✓✓

(12)

(Total: 52 marks)

SOURCE MATERIAL FOR USE WITH QUESTION 3

- 3** The Statement of Changes in Equity of Chandani Banking plc for the year ended 30 September 2016 is being prepared and is shown below.

Figures are in £ millions	£1 Ordinary Shares £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Revaluation Reserve £m	Total Equity £m
(i) Balance at 1 October 2015							
(ii)							
(iii)							
(iv)							
(v)							
(vi)							
(vii)							
(viii)							
(ix) Balance at 30 September 2016							

The Statement of Changes in Equity on Page 16 of the Question Paper must record the figures in the table for items (i) to (ix).

- (i) Balances at 1 October 2015:
£1 Ordinary Shares – £400 million
Share Premium – £100 million
Retained Earnings – £4 million debit balance
General Reserve – £2 million
Capital Replacement Reserve – £1 million
Revaluation Reserve – £27 million

Enter the opening balances for the year ended 30 September 2016 and the Total Equity figure.

- (ii) On 1 December 2015 a fully subscribed rights issue of 100 million £1 ordinary shares took place, at a premium of 5 pence per share.
- (iii) On 10 December 2015 property that had been revalued from £60 million to £80 million, was sold for £80 million and the appropriate amount transferred to Retained Earnings. (It is usual for this to be shown as a separate item in the Statement of Changes in Equity.)
- (iv) On 20 December 2015 an interim dividend for 2016 of 0.5 pence (£0.005) was paid to shareholders. Only the shareholders who held shares before 1 December 2015 were eligible for the dividend.
- (v) On 31 January 2016 the balance on the General Reserve was transferred back to Retained Earnings.
- (vi) On 10 February 2016 a transfer of £8 million was made from Retained Earnings to the Capital Replacement Reserve.
- (vii) On 11 March 2016 a second interim dividend was paid for 2016. The dividend was 0.8 pence (£0.008) per share and all shareholders were eligible for the dividend.
- (viii) The profit for the year ended 30 September 2016 was £7 million.
- (ix) Show the balances at 30 September 2016 and the Total Equity at that date.

Required:

- (a) Complete the Statement of Changes in Equity on Page 16 in your Question Paper. (20)
- (b) Explain which accounting concept applied in (a) (iii). (4)
- (c) State **two** examples of how the Capital Replacement Reserve could be used. (2)
- (d) Explain why there was no final dividend on Ordinary shares paid for 2015. (2)
- (e) Calculate the maximum that could be paid per Ordinary share as a final dividend for 2016. (4)
- (f) Calculate the percentage premium paid per share on the:
- (i) shares issued before 1 October 2015 (2)
- (ii) shares issued on 1 December 2015. (2)
- (g) Explain why there may be a difference in the percentage premium between the two share issues. (4)

The Marketing Manager commented, 'I noticed that a rights issue of shares took place during the year. Was this really a good idea?'

Required:

- (h) Evaluate the rights issue from the point of view of Chandani Banking plc. (12)

(Total for Question 3 = 52 marks)

Answer space for Question 3 is on pages 16 to 21 of the question paper.

3 (a)

Figures are in £ millions	Ordinary £1 Share Capital £m	Share Premium £m	Retained Earnings £m	General Reserve £m	Capital Replacement Reserve £m	Revaluation Reserve £m	Total Equity £m
(i) Balance at October 1st 2015	400	100 ✓ both	(4) ✓	2	1	27 ✓ all 3	526 ✓
(ii)	100 ✓	5 ✓					105
(iii)			20 ✓			(20) ✓ ✓ correct no	0
(iv)			(2) ✓				(2)
(v)			2 ✓	(2) ✓			0
(vi)			(8) ✓		8 ✓		0
(vii)			(4) ✓				(4)
(viii)			7 ✓				7
Balance at 30 September 2016	500	105 ✓ both	11 ✓	0	9	7 ✓ all 3	632 ✓ o/f

(20)

3(b)

(a)(iii) is an example of the realisation concept. ✓

Profits are not taken into account until realised. ✓

When the property was revalued upwards, the "profit" had not yet been realised. ✓

When it was sold the profit was realised and could be taken to the Statement of Comprehensive Income/retained earnings. ✓

Also acceptable

This is an example of the accruals concept. ✓

Similar argument as above.

(4)

3(c) Two examples of what the Capital Replacement reserve could be spent on (one ✓ per item)

Any 2 from – property plant equipment machinery furniture motor vehicles etc

(2)

3(d) No final dividend was paid because the balance on the Retained Earnings ✓ account was a debit ✓

OR Revenue reserves totalled ✓ a minus/debit figure. ✓

(2)

3(e) Maximum amount payable = $\frac{(11\checkmark + 9\checkmark)}{(400 + 100)\checkmark}$ = 4 pence per share ✓ o/f

(4)

3(f) (i) Before 1 October 2015 = $\frac{100}{400} \times 100 \checkmark = 25\% \checkmark$

(2)

(ii) On 1 December 2015 = $\frac{5}{100} \times 100 \checkmark = 5\% \checkmark$

(2)

(g) Answers could include:

The difference is explained by the market price at the time of issue. ✓

Before October 2015 the market price of a £1 share was/thought to be around £1.25. ✓

In December 2015, the market price was around £1.05. ✓

This is lower because the company made a loss in the year to 30 September 2015. ✓

The market does not have so much confidence in the company in December 2015 when new share issue is made ✓

(4)

(h) Advantages of Rights Issues

Allows the company to raise funds ✓ that can be used for the benefit of the company. ✓

Funds could be used to pay dividends to shareholders ✓ who did not receive a final dividend for 2015 ✓ who may be unhappy. ✓

Existing shareholders get the first rights to buy the shares, ✓ so

- administration costs ✓ will be lower than a public issue, ✓ if the rights are taken up. ✓
- Existing shareholders do not see a dilution ✓ of powers/ownership ✓

The company may appear a "bigger" company ✓ as it has a larger capital base. ✓

A successful rights issue shows the shareholders have confidence in the company. ✓

A rights issue helps banks maintain the capital base ✓ that is required for banks. ✓

Disadvantages of Rights Issues

Costs of administration. ✓

Rights may not all be taken up. ✓ This may mean:

- extra costs of having issue underwritten ✓ by e.g. merchant banks. ✓
- new shareholders take up the shares, ✓ so existing shareholders see powers diluted. ✓

Shareholders were probably unhappy at not receiving a final dividend for 2015, ✓ now they are being asked to pay up more cash, ✓ which will make them even more unhappy. ✓

If the market price of the shares falls below the issue price before the issue, ✓ nobody will take up the rights issue. ✓

Some ratios will now worsen, ✓ due to the larger capital base. ✓

E.g. Return on capital employed ✓ Earnings per share ✓ Dividends per share ✓ Dividend yield ✓ (max 2)

A rights issue may send out a signal to the market ✓ that the company is short of funds, ✓ so confidence in the company falls. ✓ This may effect the Price Earnings ratio, ✓ or even the credit rating of the company. ✓

Maximum of 8 marks for arguing one side.

Conclusion 2 marks

Chandani Banking plc could probably welcome the extra funds, ✓ but they run the risk of upsetting the shareholders and the market with a rights issue. ✓

(12)

Total for Question 3 = 52 marks

SOURCE MATERIAL FOR USE WITH QUESTION 3

3. The Statement of Changes in Equity of Barisal Industrials plc for the year ended 31 March 2014 is being prepared and is shown below.

Figures are in £ millions

	Ordinary Shares £1 Capital £	Share Premium £	Capital Redemption Reserve £	Retained Earnings £	General Reserve £	Foreign Exchange Reserve £	Total Equity £
Balance at 1 April 2013	1 100	300	50	623	85	20	2 178
(i)							
(ii)							
(iii)							
(iv)							
(v)							
(vi)							
Balance at 31 March 2014							

You are the Finance Director for Barisal Industrials plc.

Required:

- (a) Complete the Statement of Changes in Equity in the Answer Booklet to show the figures for the following changes for the year ended 31 March 2014. You should show your workings in the lined space available.

- (i) Comprehensive Income for the year ended 31 March 2014 was £348 million.
 - (ii) A sum of £35 million was transferred to the General Reserve from Retained Earnings.
 - (iii) The balance on the Foreign Exchange Reserve was transferred back to Retained Earnings.
 - (iv) In May 2013, the final dividend of 2.8 pence per Ordinary Share for the year ended 31 March 2013 was paid.
 - (v) In July 2013 80 million Ordinary Shares of £1 each, issued at a premium of 30 pence per share, were redeemed at the same price at which they were issued.
 - (vi) In October 2013, an interim dividend of 0.7 pence per Ordinary Share was paid.
- (22)**

Barisal Industrials plc redeemed some shares during the year.

(b) Explain:

- (i) **two** advantages to a company of redeeming Ordinary Shares.
- (ii) **two** disadvantages to a company of redeeming Ordinary Shares.

(8)

Over lunch, a new member of the Finance Department asks “What are the differences between reserves, provisions, and liabilities?”

Required:

(c) Explain the following terms, including how each is created:

- (i) reserves
- (ii) provisions
- (iii) liabilities

(10)

At a board meeting, the Human Resources Director asked “Do you think the payment of the total dividend of 3.5 pence per share in the last financial year was generous?”

Required:

(d) On behalf of **the company**, evaluate whether the total dividend of 3.5 pence per share paid in the last financial year was generous.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 18 to 24 of the question paper.

Q3 Mark Scheme**(a)**

Figures are in £ millions

	Ordinary Share £1 Capital	Share Premium	Capital Redemption Reserve	Retained Earnings	General Reserve	Foreign Exchange Reserve	Total Equity
Balance at 1 April 2013	1 100	300	50	623	85	20	2 178
(i) Comprehensive Income for the Year				348 ✓			348
(ii) Transfer				(35) ✓	35 ✓		--
(iii) Transfer				20 ✓		(20) ✓	--
(iv) Final dividend				(30.8) ✓✓			(30.8) ✓ both
(v) Redemption of Shares	(80) ✓	(24) ✓	104 ✓✓	(104) ✓✓			(104)
(vi) Interim dividend				(7.14) ✓✓			(7.14) ✓ both
Balance at 31 March 2014	1 020 o/f	276 ✓ both o/f	154 o/f	814.06 ✓o/f	120 ✓ both o/f	--	2 384.06 ✓o/f ✓C

(22)

There are four occasions where the word 'both' is used in the mark scheme for Q3a.

The couplings are:

- Balance of share premium 276 goes with balance of ordinary share capital 1,020;
- Balance of general reserve 120 goes with balance of capital redemption reserve 154;
- Final dividend (30.8) in total equity column goes with comprehensive income 348 in total equity column; and
- Interim dividend (7.14) in total equity column goes with redemption of shares (104) in total equity column.

(b)Advantages of redeeming shares:

Company may have excess/large amounts of cash, ✓ which they feel would be best used / no better use than redeeming shares. ✓

Less funds will have to be paid out in the future ✓ in terms of dividends. ✓

Certain ratios will improve, ✓ eg Return on Capital Employed, Earnings per share. ✓ (need one)

This will make managers and directors and company look better. ✓

The share price will rise ✓ as less shares are on the market. ✓

Disadvantages of redeeming shares:

Drain on company's liquid resources. ✓ ie cash and cash equivalents. ✓

Liquidity ratios will worsen. ✓ eg Current ratio, and Acid ratio ✓

Gearing ratio will worsen. ✓ as Debts is a larger percentage of capital employed. ✓

The company's Statement of Financial Position has a smaller equity base ✓ which gives the impression of a smaller company ✓

Maximum of 2 marks for each advantage and disadvantage.

(8)**(c)****Reserves**

Revenue reserves ✓ are appropriation of retained profit ie created after net profit has been calculated. ✓ Eg General reserve ✓

Capital reserves ✓ may arise for a specific reason. ✓ Eg issuing shares at a premium, ✓ or revaluing a non-current asset, ✓ or redeeming own shares without an issue of new shares. ✓ (max 2 examples).

Provisions

Provisions are amounts set aside before arriving at net profit ✓ eg for depreciation. ✓ Provisions reduce the value of assets. ✓ The reason for the provision will be specific ✓ eg for damages in a court case, ✓ but the amount of the provision would be an estimate. ✓

Provisions follow the concept of prudence ✓

Provisions enable a true and fair view to be shown/using matching concepts ✓

Liabilities

Liabilities are debts that have been incurred by the business ✓ and must be paid. ✓

Short term (current) liabilities must be paid back within one year. ✓ Eg trade payables to suppliers. ✓

Long term liabilities are to be repaid in a term greater than one year. ✓ Eg long term bank loan. ✓

Maximum of 4 marks for each term, maximum of 10 for the section.

(10)

(d)

Dividend payment is generous

3.5% return on nominal value of share £1 ✓ may be higher than interest rate in a bank. ✓

May be higher than other companies. ✓

May be a good return for this industry. ✓

Dividend payment is not generous

3.5p may be a lower return than what could have been gained on a debenture ✓ or bond. ✓

Other factors (could appear on either side or argument)

Need to know the price paid/market price for the share, ✓ which will tell us the yield ✓ ie true return on investment. ✓

Need to know the state of the world/national economy. ✓ If a boom year, then 3.5p is low. ✓ If a recession, 3.5p could be regarded as high. ✓

How does 3.5p compare to previous year's dividends? ✓ May be seen as higher or lower. ✓

Maximum of 8 ✓s for arguing one side.

Conclusion

3.5p dividend is/is not generous. ✓✓

(12)

Total 52 marks