

MyStudyBro - Revision Exercise Tool

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

Chapters:

Capital and Revenue Reserves - Unit 2 (Pearson Edexcel)

Page 1	(WAC02 or WAC12) 2018 Summer Statement of Changes in Equity
Page 5	(WAC02 or WAC12) 2018 Summer - Answer Also Includes: Statement of Changes in Equity
Page 10	(WAC02 or WAC12) 2018 Autumn
Page 14	(WAC02 or WAC12) 2018 Autumn - Answer
Page 20	(WAC02 or WAC12) 2017 Summer
Page 22	(WAC02 or WAC12) 2017 Summer - Answer
Page 25	(WAC02 or WAC12) 2016 Winter Statement of Changes in Equity
Page 29	(WAC02 or WAC12) 2016 Winter - Answer Also Includes: Statement of Changes in Equity
Page 32	(WAC02 or WAC12) 2014 Winter
Page 34	(WAC02 or WAC12) 2014 Winter - Answer

- 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): (9)
- share premium reserve
 - retained earnings
 - general reserve
 - revaluation reserve.
- (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)

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

- | 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 |

- (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	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
5 (a)	AO2 (6) AO2: Six marks for correct calculation of figures in statement of changes in equity. A - 320 (1) AO2 B - 506 (1) AO2 C - 0 (1) AO2 D - 89 (1) AO2 E - 122 (1of) AO2 F - 572 (1of) AO2	(6)

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

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

Question Number	Answer	Mark
5 (c)	AO1 (1), AO3 (2) AO1: One mark for correct narrative. AO3: Two marks for correct Journal entries The Journal.	(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)	AO1 (1), AO3 (5) AO1: One mark for correct narrative. AO3: Five marks for correct completion of Journal entries.	(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> $\frac{29\,760\,000}{32\,000} = 930 \text{ kilos (1) AO2} \times £11\,000 \text{ per kilo}$ $= £10\,230\,000 \text{ (1) AO2}$ <p><u>Fixed Costs</u></p> $\frac{£135\,000\,000}{15} = £9\,000\,000 \text{ per year (1) AO1}$ $+ £5\,880\,000 = £14\,880\,000 \text{ (1) AO1}$	(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 B

Answer THREE questions from this section.

- 3** Dolphin plc produces a wide range of books. The Statement of Financial Position of Dolphin plc at 30 June 2018 has been drawn up in accordance with International Accounting Standards (IAS) 1 and is shown below.

Statement of Financial Position at 30 June 2018	
ASSETS	£000
Non-current assets	
Intangibles	266
Property, plant and equipment carrying value	<u>14 000</u>
	14 266
Current assets	
Inventories	5 608
Trade receivables	1 846
Other receivables	104
Cash and cash equivalents	<u>249</u>
	7 807
Total Assets	<u><u>22 073</u></u>
Equity	
Share capital - Ordinary shares of £1	11 323
5% Irredeemable preference shares of £1	1 200
Share premium	2 500
Revaluation reserve	2 000
Retained earnings	<u>(578)</u>
Total equity	16 445

Non-current liabilities	
5.75% Debenture	2 500
6.5% Bank loan	<u>800</u>
	3 300
Current liabilities	
Trade payables	1 484
Other payables	51
Current tax payable	393
Provisions	<u>400</u>
	2 328
Total liabilities	5 628
Total Equity and Liabilities	<u><u>22 073</u></u>

Required

- (a) (i) State **two** examples of intangible assets, other than brand names. (1)

The cash balance is £377 000

- (ii) Calculate the bank balance. (2)

Interest on the bank loan is paid monthly. The interest for June 2018 has not been paid.

- (iii) Calculate the amount of interest owing on the bank loan. (2)

Debenture interest is paid in two instalments, every six months.

- (iv) Calculate the value of **one** instalment. (2)

The debenture is secured.

- (v) Explain the meaning of the term **secured**. (2)

The Retained Earnings Account had a debit balance of £743 000 at the start of the financial year. The profit or loss for the year was the only entry into the Retained Earnings Account.

- (vi) Calculate the profit or loss for the year ended 30 June 2018. (2)

- (vii) State under which line item on the Statement of Financial Position you would show each of the following:

- rent paid in advance for the warehouse
- unsold books in the warehouse.

(2)

- (viii) Explain what is meant by the term **irredeemable** when describing the Preference shares.

(2)

- (ix) State **two** examples of provisions that could be included in the figure of £400 000 for Provisions under Current liabilities.

(2)

At the start of the year, the company had property, plant and equipment that cost £15 000 000 with a carrying value of £14 500 000

During the year, the following transactions took place:

- 22 October 2017, sold a property that cost £3 500 000, with accumulated depreciation of £300 000, for £3 800 000 payment being received by cheque
- 20 December 2017, bought printing equipment for £1 600 000 on credit from Crown Printing Machinery Limited
- The Revaluation reserve was created on 3 January 2018.

Required

(b) Prepare the following accounts for the year ended 30 June 2018:

(i) Property, Plant and Equipment Cost Account (3)

(ii) Property, Plant and Equipment Provision for Depreciation Account. (4)

(c) Evaluate whether it is beneficial for a company to create provisions. (6)

(Total for Question 3 = 30 marks)

Question Number	Answer	Mark
3 (a)(i)	<p>AO1 (1)</p> <p>AO1: One mark for correct identification of two variables.</p> <p>Any two from the following (or other correct answers), one mark each Copyright, goodwill, patents, (1)AO1</p>	(1)

Question Number	Answer	Mark
3 (a) (ii)	<p>AO2 (2) AO2: Two marks for correct calculation of bank balance.</p> <p>Bank balance = £377 000 - £249 000 (1) AO2</p> <p style="text-align: right;">= £128 000 overdraft (1) AO2</p>	(2)

Question Number	Answer	Mark
3 (a)(iii)	<p>AO2 (2)</p> <p>AO2: Two marks for correct calculation of interest owing on bank loan.</p> <p>Yearly interest $= 6.5\% \times £800\,000 = £52\,000$ (1) AO2</p> <p>Monthly interest due $= \frac{£52\,000}{12} = £4\,333.33$ (1) AO2</p>	(2)

Question Number	Answer	Mark
3 (a)(iv)	<p>AO2 (2) AO2: Two marks for correct calculation of amount of one instalment of debenture interest.</p> <p>Yearly interest $= 5.75\% \times £2\,500\,000 = £143\,750$ (1) AO2</p> <p>6 month payment $= \frac{£143\,750}{2} = £71\,875$ (1) AO2</p>	(2)

Question Number	Answer	Mark
3 (a)(v)	<p>AO1 (2) AO1: Two marks for explanation of term "secured".</p> <p>If the company fail to meet interest payments or repay the debenture when due (1) AO1 The debenture holder may claim the asset(s) on which the debenture is secured. (1) AO1</p>	(2)

Question Number	Answer	Mark
3 (a)(vi)	<p>AO2 (2) AO2: Two marks for correct calculation of profit or loss for the year.</p> <p>$£743\,000 - £578\,000$ (1) AO2</p> <p>$= £165\,000$ profit (1) AO2</p>	(2)

Question Number	Answer	Mark
3 (a)(vii)	AO1 (2) AO1: Two marks for correct identification of section. Other receivables (1) AO1 Inventory (1) AO1	(2)

Question Number	Answer	Mark
3 (a)(viii)	AO3 (2) AO3: Two marks for correct explanation of term "irredeemable". The shares cannot be bought back (redeemed)(1) AO3 by the company. (1) AO3	(2)

Question Number	Answer	Mark
3 (a)(ix)	AO3 (2) AO3: Two marks for correct identification of provisions. Any two from the following, one mark each - Any damages or costs for court cases or legal claims against the company. -Any payments for future redundancy costs. -Any obligations for the pension fund - Any provisions for taxation. 2 x AO3	(2)

Question Number	Answer	Mark
3 (b) (i)	AO2 (2), AO3 (1) AO2: Two marks for entries in and balances of, the PPE account. AO3: One mark for correct entry of revaluation.	(3)

Property, plant and equipment Account

Balance b/d	15 000 000		Bank (Sale /Disposal of property)	3 500 000	
Crown Printing Machinery Ltd	1 600 000	(1) AO2 both			
Revaluation Reserve	<u>2 000 000</u>	(1) AO3	Balance c/d	<u>15 100 000</u>	(1 of) AO2 both
	<u>18 600 000</u>			<u>18 600 000</u>	
Balance b/d	15 100 000				

Question Number	Answer	Mark
3 (b) (ii)	AO2 (2), AO3 (2) AO2: Two marks for balance at start of year and entry of disposal. AO3: Two marks for entry of depreciation for the year and year end balance.	(4)

Depreciation Account

Property sold/ Disposal	300 000	(1) AO2	Balance b/d	500 000	(1) AO2
Balance c/d	<u>1 100 000</u>		Depreciation for year/ SoCI	<u>900 000</u>	(1 of) AO3
	<u>1 400 000</u>			<u>1 400 000</u>	
			Balance b/d	1 100 000	(1 of) AO3

Question Number	Indicative Content	Mark
3 (c)	<p>AO4 (6)</p> <p><u>Case for creating a provision</u></p> <p>A provision is an amount set aside from profit to meet a specific, although estimated, liability. Examples include provision for depreciation, or bad debts, or damages payable after a court case. Provisions ensure the company follows the prudence concept. Profits are understated, providing for a liability.</p> <p>Provisions may ensure the company follows the matching concept. For example, make a provision against possible bad debts in this accounting period, before the bad debt is realised in the next accounting period.</p> <p>Provisions reduce profit, so may reduce the amount that may be distributed as dividends. This may stop, for example, directors paying large dividends to shareholders, draining the company of funds, before an expensive court case.</p> <p><u>Case against creating a provision</u></p> <p>Provisions reduce profit, so may reduce the amount that may be distributed as dividends. This may make shareholders unhappy, and they may sell their shares.</p> <p>Provisions take time and money and expertise to prepare.</p> <p>Provisions may only be an estimate and may not be accurate.</p> <p><u>Decision</u></p> <p>It is beneficial to create a provision.</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.
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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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- 5 On 1 April 2016, at the start of the financial year, the following balances were in the books of Knightswell Hotels plc:

	£
£1 Ordinary share capital	12 000 000
Share premium reserve	36 000 000
Retained earnings reserve	8 650 000
General reserve	750 000
Foreign exchange reserve	2 000 000

The following transactions took place in the financial year ending 31 March 2017:

- (i) On 23 April 2016 a final dividend for the year ended 31 March 2016 was paid to ordinary shareholders of 4 pence (£0.04) per share.
- (ii) On 15 May 2016 a transfer of £900 000 from the Retained earnings reserve to the General reserve was made.
- (iii) On 8 July 2016 there was a redemption of 1 000 000 £1 ordinary shares at the market value of £4.00 per share.
- (iv) On 23 October 2016 an interim dividend for the year ended 31 March 2017 was paid to ordinary shareholders of 1.1 pence (£0.011) per share.
- (v) On 2 December 2016 a hotel property was revalued from £3 700 000, to a market value of £4 850 000
- (vi) On 25 January 2017 a transfer of £900 000 from the Foreign exchange reserve to the Retained earnings reserve was made.
- (vii) The profit after tax for the year ended 31 March 2017 was £2 450 000

Required

- (a) Prepare the journal entries to show **item (iii)** above recorded in the books. Narratives are **not** required. (6)
- (b) Complete, using the table in the Question Paper, the Statement of Changes in Equity for the year ended 31 March 2017, showing the figures in millions of pounds (£m). You should show totals both horizontally and vertically. (18)
- (c) Evaluate, from the point of view of Knightswell Hotels plc, the redemption of ordinary shares on 8 July 2016. (6)

(Total for Question 5 = 30 marks)

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(b) Complete, using the table below, the Statement of Changes in Equity for the year ended 31 March 2017, showing the figures in millions of pounds (£m).

You should show totals both horizontally and vertically.

(18)

[illegible]

	Question Number	Answer	Mark
	5 (a)	AO2 (2), AO3 (4) AO2: Two marks for ordinary shares/bank entry with at least one date. AO3: Four marks for share premium entry and CRR entry <p style="text-align: center;">The Journal</p>	(6)
		Debit	Credit
8 July 2016	£1 Ordinary share capital	1 000 000 AO2	
	Bank		1 000 000 AO2
	Share premium	3 000 000 AO3	
	Bank		3 000 000 AO3
	Retained earnings	4 000 000 AO3	
	Capital redemption reserve		4 000 000 AO3

Question Number	Answer							Mark
5 (b)	AO1(5), AO2 (10), AO3 (3) AO1: Five marks for Revaluation Reserve and Total Equity headings and and closing balance, and Opening Total balance. AO2: Ten marks for Retained Earnings entries, Ordinary Shares, General Reserve, Foreign Exchange reserve and Revaluation entries AO3: Three marks for Share redemption entries							(18)
Statement of Changes in Equity for y/e 31 March 2017								
Figures are in £ millions	£1 Ordinary share capital £m	Share premium £m	Retained earnings £m	General reserve £m	Foreign Exchange reserve £m	Capital redemption reserve £m	Revaluation reserve £m AO1(all 7 headings)	Total equity £m AO1
Balance at 1 April 2016	12	36	8.65	0.75	2			59.4 AO1 (all 6 entries)
(i) Final 2016 dividend paid in year			(0.48) AO2					(0.48)
(ii) Transfer			(0.9) AO2	0.9 AO2				---
(iii)Redemption of shares	(1)o/f AO2	(3) o/f AO3	(4) o/f AO3			4 o/f AO3		(4)
(iv) Interim dividend			(0.121) AO2					(0.121)
(v)Revaluation of property							1.15 AO2	1.15
(vi) Transfer			0.9 AO2		(0.9) AO2			---
(vii) Compre-hensive income for the year			2.45 AO2					2.45
Balance at 31 March 2017	11	33	6.499 o/f AO2	1.65	1.1	4	1.15 AO1(all 6 totals) o/f	58.399 o/f AO1

Question Number	Indicative Content		Mark
5 (c)	<p>AO4 (6)</p> <p>Answers may include:</p> <p><u>Case For:</u></p> <ul style="list-style-type: none"> Redemption of shares will improve the figure for return on capital employed – a key ratio on which performance of the business is judged. Future dividends /cash leaving the company may be reduced. Company may have surplus funds / excess working capital etc so may afford / be in a position to redeem shares. <p><u>Case Against:</u></p> <ul style="list-style-type: none"> Worsens the gearing ratio. Company may not have surplus funds / excess working capital etc so may not be in an appropriate liquidity position. Working capital is reduced. May upset shareholders who will receive lower future dividends. Also, shareholders appear to be receiving the same amount that they paid for the share, so have made no capital gain. Unhappy shareholders are not usually good for the company. <p><u>Conclusion</u></p> <p>Redemption of shares may/ may not be beneficial for the company</p>		(6)
Level	Mark	Descriptor	
	0	A completely incorrect response.	
Level 1	1-2	Isolated elements of knowledge and understanding that 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.	

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 $\frac{(140\text{m} \times 100)}{700\text{m}} \checkmark = 20\% \checkmark$

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

ie $X \times 1.2 = £144\text{m}$ $X = \frac{£144\text{m}}{1.2} \checkmark = 120\text{m shares} \checkmark$ of ✓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. Kelontan Power plc supplies electricity. The company has an Authorised Share Capital of 40 000 000 £1 Ordinary Shares and 15 000 000 4% Redeemable Preference Shares of £1 each. On 1 January 2013, at the start of the financial year, the following balances were in the books:

	£
Ordinary Share Capital	30 000 000
Share Premium Reserve	7 500 000
4% Redeemable Preference Share Capital	10 000 000
Revaluation Reserve	1 000 000
Retained Earnings Reserve	12 850 000
General Reserve	3 000 000
7% Debenture 2018	5 000 000

The profit after interest, for the year ended 31 December 2013, before adjustments, was £4 572 000.

In December 2013, the directors of Kelontan Power plc agreed to:

1. provide a final dividend to Ordinary shareholders of 3 pence per share. The dividend was paid on 2 December 2013.
2. transfer 80% of the General Reserve to the Retained Earnings Reserve.
3. make a provision to cover an amount to be repaid to customers, overcharged in error. The company has 40 000 customers, who have been overcharged an average of £50 each.
4. redeem 5 000 000 4% Redeemable Preference shares at par.
5. revalue the company head office property from a present value of £4 000 000, to a market value of £5 000 000.
6. pay the final half-yearly interest instalment due to the debenture holders for the year on 29 December 2013.

Required:

- (a) Journal entries to show the items 1–6 above as recorded in the books of Kelontan Power plc. Dates and narratives are **not** required.

(18)

- (b) The Equity section from the Statement of Financial Position after the above items have been entered into the books.

(14)

At a Board of Directors meeting at the start of the year, a director stated:

“I know that Redeemable Preference shares should be treated as Debt, but Preference shares should be treated as Equity. Is it a good idea that the Preference shares we have issued are redeemable?”

Required:

(c) Briefly explain

(i) **two advantages** to Kolatun Power plc of redeeming some of the 4% Redeemable Preference shares.

(4)

(ii) **two disadvantages** to Kolatun Power plc of redeeming some of the 4% Redeemable Preference shares.

(4)

(d) Evaluate the creation and utilisation of a Capital Redemption Reserve.

(12)

(Total 52 marks)

Answer space for question 3 is on pages 16 to 22 of the question paper.

Question 3

- part (a)

	Debit	Credit
(i) Statement of Comprehensive Income / Statement of Changes in Equity / Retained Earnings✓	900 000 ✓	
Ordinary Share Dividend ✓		900 000
Ordinary Share Dividend	900 000 ✓	
Bank		900 000 ✓
(ii) General Reserve	2 400 000 ✓	
Retained Earnings		2 400 000 ✓
(iii) Statement of Comprehensive Income	2 000 000 ✓	
Provision for Customer Repayments		2 000 000 ✓
(iv) 4% Preference Shares	5 000 000 ✓	
Bank		5 000 000 ✓
Retained Earnings / Statement of Comprehensive Income	5 000 000 ✓	
Capital Redemption Reserve		5 000 000 ✓
(v) Property	1 000 000 ✓	
Revaluation Reserve		1 000 000 ✓
(vi) Debenture Interest ✓	175 000 ✓	
Bank ✓		175 000

NOTE:

- (1) Allow 'Statement of Comprehensive Income' OR 'Statement of Changes in Equity' OR Retained Earnings for (i)
- (2) Allow 'Statement of Comprehensive Income' OR 'Retained Earnings' for (iv)

18 marks

- part (b)

Equity	
Authorised Share Capital	
Ordinary Shares of £1	40 000 000
4% £1 Redeemable Preference Shares	15 000 000 ✓ both
Issued Share Capital	
Ordinary Shares of £1	30 000 000 ✓
4% £1 Redeemable Preference Shares	5 000 000 ✓
Share Premium reserve	7 500 000 ✓
Capital Redemption Reserve	5 000 000 ✓✓
Revaluation reserve	2 000 000 ✓
Retained Earnings	11 922 000 ✓✓✓✓✓
General Reserve	600 000 ✓
Total Equity	62 022 000 ✓ o/f

Retained earnings calculation =

$$(12\,850\,000 + 4\,572\,000)✓ + (2\,400\,000 - 2\,000\,000)✓ - 5\,000\,000✓ - 900\,000✓$$

$$= 11\,922\,000 \text{ o/f } ✓$$

14 marks

- part (c) (i)

Advantages

Redeemable shares can be bought back from shareholders, ✓ so will mean less funds leave the company in the form of dividends each year ✓ leaving more funds in the business for operations ✓ or paying dividends to ordinary shareholders ✓ (Max 2 ticks for one point)

Buying back debt ✓ means that the gearing ratio could improve/reduce. ✓ which reduces risk ✓

Statement of Financial Position looks stronger ✓ which could help attract investors ✓

Capital may not be needed ✓

Return on Capital employed will rise ✓

4 marks

- part (c) (ii)

Disadvantages

Buying back the shares ✓ means a large outflow of funds at this time. ✓

Administration costs of buying back shares are high ✓ e.g. staff time, bank fees, postage etc. ✓

Preference shareholders may be unhappy ✓ and may not invest in the future ✓

4 marks

- part (d)

Evaluation of creating and utilising Capital Redemption Reserve (CRR);

Answers may include:

Case For;

CRR acts as a creditors' buffer ✓✓

Capital base is maintained ✓

CRR is a Capital Reserve ✓ so it prevents directors/shareholders ✓ from taking cash/ capital out of the business, ✓ leaving little/nothing for creditors in the event of the company experiencing liquidity/ trading problems. ✓

Cannot be transferred back to the Statement of Comprehensive Income ✓ and then used to pay out dividends ✓

Presence of CRR may help a company obtain credit ✓ or investment/ buying of company shares ✓ as Statement of Financial Position appears stronger ✓

In certain circumstances e.g. redemption of shares, the CRR must be created by company law ✓ therefore should be of benefit. ✓

CRR can be used for a bonus issue of shares ✓

Case Against ;

Creating a CRR takes time and money ✓ and accounting expertise. ✓

Reduces flexibility, ✓ as company may not be able to do what they want to do e.g. redeem shares, ✓ if e.g. insufficient funds in revenue reserves. ✓

Maximum for arguing one side only 8 marks

Conclusion

Capital Redemption Reserve is worthwhile/ useful/ effective. ✓✓

12 marks

Total 52 marks