OCR
RECOGNISING ACHIEVEMENT

14-19 CHANGES
A LEVEL

Additional Support Materials

A2 Level Accounting H411:

Unit F013

OCR examination questions and mark scheme extracts

This booklet contains the following additional support materials:
- **OCR examination questions**
- **Mark scheme extracts**

AS/A Level Accounting

Contents

Introduction

Background

A new structure of assessment for A Level has been introduced, for first teaching from September 2008. Some of the changes include:

- The introduction of stretch and challenge (including the new A* grade at A2) – to ensure that every young person has the opportunity to reach their full potential
- The reduction or removal of coursework components for many qualifications – to lessen the volume of marking for teachers
- A reduction in the number of units for many qualifications – to lessen the amount of assessment for learners
- Amendments to the content of specifications – to ensure that content is up-to-date and relevant.

OCR has produced an overview document, which summarises the changes to Accounting. This can be found at **www.ocr.org.uk**, along with the new specification.

In order to help you plan effectively for the implementation of the new specification OCR has produced a Scheme of Work and Sample Lesson Plans for the A2 Level Accounting H411 Unit F013. The Support Materials are contained within the booklet *Support Materials A2 Level Accounting H411: Unit F013.*

http://www.ocr.org.uk/qualifications/asa_levelgceforfirstteachingin2008/accounting/documents.html#Support_materials

These Support Materials are designed for guidance only and play a secondary role to the Specification.

This booklet contains additional Support Materials designed to accompany and complement the Unit F013 Scheme of Work. It contains the OCR examination questions referenced within the Scheme of Work Unit together with relevant mark scheme extracts.

The Specification is the document on which assessment is based and specifies what content and skills need to be covered in delivering the course. At all times, therefore, this Support Material booklet should be read in conjunction with the Specification. If clarification on a particular point is sought then that clarification should be found in the Specification itself.

Financing: Types of Finance

Financing: Types of Finance

F013 Specimen Bounty Question 3

3 The following is an extract from the Balance Sheet of Bounty plc as at 31 December 2006.

Capital and Reserves

	£
600,000 Ordinary shares at 25 pence each	150,000
Share Premium	75,000
Profit and Loss	80,000

Bounty plc needed £200,000 additional capital to replace machinery.

On 15 July 2007 Bounty plc made a rights issue of 200,000 ordinary shares at a premium of 25 pence per share. All the cash was received in July 2007.

On 1 August 2007 Bounty plc made a bonus issue of one ordinary share for every two ordinary shares in existence on 1 August 2007. The Share Premium Account was utilised to provide for the bonus issue.

The remaining funds required to purchase the machinery were raised by a bank loan on 10 August 2007.

Assume that no additional profits were generated by Bounty plc from 31 December 2006 to 10 August 2007.

REQUIRED

(a) Prepare the following ledger accounts, including the balance carried down in **each** case.

(i) Ordinary Share Capital **[7]**

(ii) Share Premium **[6]**

(iii) Loan **[3]**

(b)* Bounty plc is planning a further expansion of the business during 2008. This will require additional fixed assets costing £250,000. Evaluate the suitability of leasing and debentures for acquiring these additional fixed assets in 2008. **[14]**

Total Marks [30]

Paper Total [80]

F013 Specimen Bounty Question 3 Mark scheme

3(a)

Ordinary share capital

Bal c/d		300,000	**[2]**	Bal b/d		150,000	**[1]**	
				Bank	**[1]**	50,000	**[1]**	
				Share premium	**[1]**	100,000	**[1]**	
		300,000				300,000		
								[7]

Share premium

Share capital	**[1]**	100,000	**[1]**	Bal b/d		75,000	**[1]**	
Bal c/d		25,000	**[1]**	Bank	**[1]**	50,000	**[1]**	
		125,000				125,000		
								[6]

Loan

Bal c/d		100,000	**[1]**	Bank	**[1]**	100,000	**[1]**	
		100,000				100,000		
								[3]

3(b)*

Advantages and disadvantages of leasing

Will improve the cash flow position of the company because no large cash outflows would be required for the purchase of fixed assets.

A regular payment would be made each month to the leasing company which allows the company to budget each month.

The contract would cover repairs and maintenance which would reduce the cost of repairs and help the cash flow.

A company can have an option to purchase the fixed asset at the end of the lease period and will have to make available the cash required for the purchase.

The type of lease agreement could mean that the company does not own the asset and therefore it will not be shown on the balance sheet.

Financing: Types of Finance

F013 Specimen Bounty Question 3 Mark scheme continued

Advantages and disadvantages of debentures

Debentures are long term loan capital and bond holders will not have a vote at the annual general meeting.

Debenture holders will be paid a fixed rate of interest.

The debenture bond can be taken out for a long period of time before the debenture must be repaid.

Debentures are long term debt capital and secured on the assets of the business.

Debenture interest is an expense of the business and must be repaid regardless of the profit or loss situation.

The business must make provision to have the cash available to repay the debentures.

Comparison and recommendation

The nature of the fixed assets to be acquired can influence funding. If long term, then debentures may be preferred. If medium term then leasing may be preferred.

If a lease is taken out for a long period, then cost can be high, sometimes higher than outright purchase. In such cases debentures would be preferred.

A lease agreement may be easier to obtain than the issue of debentures, however the fixed asset acquired would remain the property of the leasing company. Funding from a debenture issue may be used to acquire ownership of fixed assets.

A recommendation may be influenced by the type of fixed asset, its term and ease of acquiring funding.

(Up to 4 marks for advantages and disadvantages of leasing)
(Up to 4 marks for advantages and disadvantages of debentures)
(Up to 4 marks for a comparison and a recommendation)

NB Up to an additional two marks can be awarded for the candidate's quality of written communication (narrative responses) **[14]**

Total Marks	**[30]**
Paper Total	**[80]**

Financing: Types of Finance

2505 Jan 2007 Ponting Question 3

3 Ponting plc has an authorised share capital of £8 000 000. On 1 November 2006, it had already issued 6 000 000 fully paid ordinary shares at a par value of £0.50 each. It has offered the public a further 4 000 000 ordinary shares at £1.25 each.

The terms of the issue were £0.50 payable on application, £0.60 on allotment and the balance at a later date.

On 6 November 2006 applications were received for 5 000 000 ordinary shares. On 12 November 2006 applications for 500 000 shares were rejected and the application monies returned to the applicants.

The remainder of the excess application money was retained to be set off on a pro rata basis against the amount due on allotment. The amount due on allotment money was received in full on 20 November 2006.

REQUIRED

(a) The ledger accounts to record the above transactions to 20 November 2006 (balancing of the accounts is not required). [17]

(b) Using illustrations from the information above explain each of the following:

(i) par value; [2]
(ii) authorised share capital; [2]
(iii) share premium. [2]

(c) In addition to the ordinary share issue, Ponting plc is also considering an issue of debentures. Discuss the implications to Ponting plc of an issue of debentures. [6]

Total marks [29]

2505 Jan 2007 Ponting Question 3 Mark scheme

3 (a)

Bank

Application & allotment		2 500 000	**(1)**	Application & allotment	250 000	**(1)**
Application & allotment	**(1)**	2 150 000	**(1)**			

Application & allotment

Bank		250 000	**(1)**	Bank	2 500 000	**(1)**
Share premium	**(1)**	3 000 000	**(1)**	Bank	2 150 000	**(2)**
Share capital	**(1)**	1 400 000	**(2)**			

Share capital

				Bal b/d	3 000 000	**(1)**
				Application & allotment	1 400 000	**(1)**

Share premium

				Application & allotment	3 000 000	**(2)**

[17]

(b) (i) Par value is the issue price of the shares and is also called the nominal value of the share. Ponting Ltd has a par value of £0.50 per share.

(ii) Authorised share Capital is the amount stated in the Memorandum of Association. Ponting Ltd can issue a maximum of 6 000 000 shares at a par value of £0.50.

(iii) Share premium is the difference between the par value and the price of the share. Ponting Ltd has a share premium of £0.75 on each share.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

(c) An alternative to the raising of finance by an issue of ordinary shares.
Debentures are long term loan capital and would increase the debt capital of the company.
Debentures pay a fixed rate of interest and the amount borrowed is charged on the assets of the company.
Debentures are a higher risk and the debenture interest is an expense to the profit and loss account and must be paid regardless of the profit position but ordinary dividends are an appropriation of profit.
Debenture holders do not have voting rights unlike the ordinary shareholders.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

Total marks [29]

Financing: Types of Finance

2505 Jan 2006 Spring Question 1

1 The following balances were extracted from the books of Spring plc on 31 December 2005.

	Dr	Cr
	£	£
Purchases	400 000	
Turnover		1 192 000
Stock	30 000	
Sales returns	6 000	
£1 Ordinary shares		500 000
General administration expenses	150 000	
General distribution costs	190 000	
Discounts	12 000	14 000
Rent received		30 000
Profit and Loss		42 000
Debtors	62 000	
Creditors		48 000
Land and buildings	744 200	
Office equipment	90 000	
Delivery vehicles	120 000	
Provision for depreciation – office equipment		38 000
Provision for depreciation – delivery vehicles		42 000
General reserve		130 000
Share premium		100 000
Bank	190 000	
Provision for doubtful debts		3 200
Salaries	145 000	
	2 139 200	2 139 200

Additional information:

(i) The closing stock was valued at £72 000.

(ii) General administration expenses prepaid £6 800.
General distribution costs owing £5 000.

(iii) Salaries are split equally between distribution and administration.

(iv) Rent receivable of £3 400 is outstanding for the year.

(v) Provision for doubtful debts is to be increased by £800.

2505 Jan 2006 Spring Question 1 continued

(vi) Depreciation is to be provided as follows:
(a) office equipment 20% per annum on cost;
(b) delivery vehicles 20% per annum reducing balance method.
Delivery vehicles are treated under distribution. Office equipment is split equally between distribution and administration.

(vii) The directors recommend a transfer to the general reserve of £50 000 and an ordinary share dividend of £140 000.

(viii) Corporation tax for the year is estimated at £120 000.

REQUIRED

(a) The Profit and Loss Account for the year ended 31 December 2005 (in accordance with the minimum required for publication). [23]

(b) The Balance Sheet as at 31 December 2005 (in accordance with the minimum required for publication). [13]

(c) Explain the importance of the Auditor's Report to the shareholders of a plc. [4]

(d) Spring plc is planning an expansion of the business during 2006 which will require additional fixed assets. Discuss the advantages and disadvantages of the following methods of finance:

(i) leasing; [6]

(ii) ordinary share issue. [6]

Total marks [52]

Financing: Types of Finance

2505 Jan 2006 Spring Question 1 Mark scheme

1(b)

Balance Sheet as at 31 December 2005

Fixed Assets				
Land and buildings			744,200	
Office equipment			34,000	**(1)**
Delivery vehicles			62,400	**(1)**
			840,600	
Current Assets				
Stock	72,000			
Prepaid	6,800	**(1)**		
Debtors	61,400	**(2)**		
Bank	190,000			
	330,200			
Creditors due in less than 1 year **(1)**				
Creditors	48,000			
Accruals	5,000	**(1)**		
Tax	120,000	**(1)**		
Dividends	140,000	**(1)**		
	313,000			
Net Current Assets **(1)**			17,200	
			857,800	
Capital and reserves				
Issued Share Capital			500,000	
Share Premium			100,000	**(1)**
General Reserve			180,000	**(1)**
Retained profit			77,800	**(1 of)**
			857,600	

[13]

2505 Jan 2006 Spring Question 1 Mark scheme continued

1(c)
The Auditor's report is important for the users of accounting information contained in the final accounts.

The report must state whether or not the accounts of the company present a true and fair view of the financial position of the company.

The shareholders will rely upon this report and the statement given by the auditors
(2 x 2 marks) **[4]**

1(d)(i)
Would improve the cash flow of the company.
No large cash outflows would be required for the purchase of fixed assets
A regular payment would be made each month to the leasing company
The contract would cover repairs and maintenance
Can have an option to purchase at the end of the lease
Company does not own the asset
Effect on the company balance sheet
(3 x 2 marks) **[6]**

1(d)(ii)
Would give a large cash inflow to the company
An alternative to borrowing from the bank which would charge the assets and increase the gearing
Could consider a rights issue instead of a full issue
Extra shares would effect the control of the company because of more votes
Would a share offer be attractive to investors and would they be able to sell at a premium.
The cost of a full issue of shares and the prospectus
(3 x 2 marks) **[6]**

Total marks [52]

Financing: Types of Finance

2505 Jan 2005 Gwilliam Question 3

3 On 31 December 2004 the following balances were extracted from the books of Gwilliam Ltd.

	£
Stocks 1 January 2004:	
Raw materials	41 000
Work in progress	52 200
Finished goods	66 880
Purchases: Raw materials	1 200 000
Sales	2 036 000
Direct wages	280 000
Indirect wages	60 000
Debtors	220 000
Debenture interest	2 500
Rates and Insurance	15 000
Administration expenses	58 000
Premises at cost	500 000
Rent receivable	4 000
Provision for depreciation – Premises	60 000
10% Debentures (1999–2009)	50 000
Plant and machinery at cost	150 000
Provision for depreciation – Plant and Machinery	60 000
Provision for unrealised profit in goods manufactured	6 080
Provision for doubtful debts	4 400
Issued Share Capital £1 Ordinary Shares	600 000

2505 Jan 2005 Gwilliam Question 3 continued

Additional information:

(I) Stocks as at 31 December 2004:

Raw materials	43 000
Work in progress	26 100

The company transfers finished goods from the factory to the Trading Account at a cost of £704 per unit, this being factory cost plus 10% manufacturing profit. These figures have been unchanged for the last two years.

Provision is to be made for unrealised profit on the stock of finished goods at 31 December 2004.

(II) Provision is to be made for depreciation as follows:
Premises: 2% per year on cost apportioned 60:40 between factory and administration.

Plant and machinery: 20% reducing balance method.

(III) Sales have been at a constant price during the year with 2545 units sold.

(Iv) Rates and insurance are to be apportioned between factory and administration in the ratio of 70:30. Insurance of £2000 is owing.

(v) Provision for doubtful debts is to be provided at 2.5% of debtors.

REQUIRED

(a) The Manufacturing, Trading and Profit and Loss Account for the year ended 31 December 2004 (internal use only, not for publication). [30]

(b) Gwilliam Ltd has just received an additional large order. The Directors are considering the possibility of raising more short term funds to purchase the required stock. Evaluate whether it would be better to fund the purchase of the stock through either a bank overdraft or factoring. [8]

Total marks [38]

2505 Jan 2005 Gwilliam Question 3 Mark scheme

3 **(a)**

Gwilliam Ltd
Manufacturing, Trading and Profit and Loss Account for the year ended 31 December 2004 **(1)**

Opening stock of materials			41 000	**(1)**
Purchases			1 200 000	**(1)**
			1 241 000	
Closing stock			43 000	**(1)**
Cost of raw materials consumed			1 198 000	
Direct wages			280 000	**(1)**
Prime Cost **(1)**			1 478 000	
Factory Overheads				
Indirect wages	60 000	**(1)**		
Rates	11 900	**(2)**		
Depreciation premises	6 000	**(2)**		
Depreciation plant and machinery	18 000	**(2)**	95 900	
			1 573 900	
Work in progress at start			52 200	
Work in progress at the end			(26 100)	**(1)**
Production cost of finished goods			1 600 000	
Manufacturing profit			160 000	**(1of)**
Finished goods transferred to trading account			1 760 000	
Sales			2 036 000	**(1)**
Less cost of sales				
Opening stock of finished goods	66 880	**(1)**		
Transfer of manufactured goods	1 760 000	**(1of)**		
	1 826 880			
Closing stock of finished goods	35 200	**(2)(1of)**	1 791 680	
Gross profit			244 320	
Rent receivable			4 000	**(1)**
			248 320	
Debenture interest	5 000	**(1)**		
Rates	5 100	**(1)**		
Administration expenses	58 000	**(1)**		
Depreciation Premises	4 000	**(2)**		
Increase in doubtful debts provision	1 100	**(1)**	73 200	
			175 120	
Manufacturing profit	160 000	**(1)**		
Decrease in provision for unrealised profit	2 880	**(2)**		
			162 880	
Net profit			338 000	

[30]

2505 Jan 2005 Gwilliam Question 3 Mark scheme continued

(b)

Overdraft:

- Short term borrowing requirement to help with short term cash flow problems such as payment to trade suppliers.
- Easy to arrange with low interest rates
- Not secured on the assets of a company such as a mortgage or loan.
- An overdraft is repayable on demand by the bank
- Problems with the bank if overdraft limit is exceeded

Factoring:

- Improves the cash flow by selling debts to factoring company and will receive an agreed percentage on their invoices.
- Reduces bad debts and administration cost of the sales ledger
- Will reduce the profits of the company because of the charges made by the factoring company.
- Will need to measure profitability against liquidity.
- Some debts may be of very high risk and can not be factored

(4 x 2 marks)
(1 for point plus 1 for development)

[8]

Total marks [38]

Financing: Types of Finance

2501 Jan 2002 Jan Kokes Question 3

3 Jan Kokes commenced business several years ago selling soft furnishings from a small shop. Jan prepared the following Cash Book for the year ended 31 December 2001:

	£		£
Balance b/d	6 200	Trade creditors	54 000
Sales	158 000	Rent	3 200
Capital	6 000	Rates	1 800
		General expenses	2 800
		Wages	9 000
		Drawings	20 000

Additional information:

(i) Discounts received from trade creditors for the year ended 31 December 2001 were £1600.

(ii) In addition to the items mentioned above, the assets and liabilities of Jan Kokes were as follows:

	31 December 2000	31 December 2001
	£	£
Stock	7 000	5 000
Fixtures (net book value)	3 700	2 800
Rent pre-paid	800	500
Wages owing	350	480
Trade creditors	4 300	5 900

REQUIRED

(a) The Trading and Profit and Loss Account for the year ended 31 December 2001 and the Balance Sheet as at that date. [28]

(b) Jan is considering expanding her business by buying new premises and expanding her range of products.

Evaluate:

(i) two methods of short term finance available to Jan Kokes; [6]

(ii) two methods of long term finance available to Jan Kokes. [6]

Total marks [40]

2501 Jan 2002 Jan Kokes Question 3 Mark scheme

3 (a) Jan Kokes

Trading and Profit and Loss Account for the year ended 31 December 2001 (1)

			£	
Sales			158,000	(1)
	£			
Opening stock	7000	(1)		
Purchases (54,000+5900(1)+1,600 (1))–4300 (1))	57,200			
	64,200			
Closing stock	5,000	(1)	59,200	
Gross profit			98,800	
Discount received			1,600	(1)
			100,400	
	£			
Rent (3200+800-500)	3,500	(2)		
Rates	1,800	(1)		
General Expenses	2,800	(1)		
Wages (4000-350+480)	9,130	(2)		
Depreciation fixtures	900	(1)	18,130	
Net Profit			82,270	

(b) Balance Sheet as at 31 December 2001

Fixed Assets			£	
Fixtures			2,800	(1)
Current Assets	£			
Stock	5,000	(1)		
Prepaid	500	(1)		
Bank	79,400	(2)		
	84,900			
Current Liabilities				
Creditors	5,900	(1)		
Accruals	480	(1)		
	6,380		78,520	
Working Capital				
Net Assets			81,320	
Opening Capital			13,050	(2)
+ Capital introduced			6,000	(1)
+ Net Profit			82,270	(1 of)
Drawings			(20,000)	(2)
			81,320	

2505 Jan 2002 Jan Kokes Question 3 Mark scheme continued

(c) **(i)** Overdraft – short term borrowing facility. Interest paid on overdraft amount repayable on demand.

Trade credit – purchase of goods from trade creditors.
Terms of payment 28 days before paying invoice.
Discount can be received for early payment.

Factoring – sale of debts to factoring firm. Helps with cash flow.
Factoring firms pay a percentage of invoice value. Will reduce profit because of payments to factoring firm.
(1 mark for identification of point plus up to 2 for development)
(2 x 3 marks) **[6]**

(ii) Long-term loan/mortgage secured on property. Payment of interest on principal sum. Interest rates can vary. Could lose business if loan is not repaid.

Unsecured loan – repaid over a specified time limit. Higher rate of interest paid on loans not secured on property.

Leasing – finance and operating leases fixed payment made. No large capital outlay required.
(1 mark for identification of point plus up to 2 for development)
(2 x 3 marks) **[6]**

Total marks 40

Financing: Reserves, Provisions and Liabilities

Financing: Reserves, Provisions and Liabilities

2505 Jun 2006 Darnell Question 2

2 The following data was taken from the accounting records of Darnell plc for the year ended 31 May 2006.

		£
(i)	Tangible fixed assets at cost 1 June 2005:	
	Land and buildings (land £300 000)	550 000
	Machinery	280 000
	Office equipment	180 000
(ii)	Depreciation at 1 June 2005:	
	Land and buildings	80 000
	Machinery	140 000
	Office equipment	90 000

Darnell plc depreciates fixed assets at the following rates per annum:

Buildings 2% straight line on cost;
Machinery 10% reducing balance;
Office equipment 10% straight line on cost.

Land is not depreciated. A full year's depreciation is provided in the year of purchase, but none in the year of sale.

(iii) On 13 August 2005, the land was revalued at £380 000 .

(iv) During July 2005, office equipment originally purchased at a cost of £12 000 and with a written down value of £3 800 was sold at a profit of £1 000.

(v) During the year ended 31 May 2006, the following fixed assets were bought:

Machinery	£8 000
Office equipment	£15 000

With the exception of some office equipment which was bought at a cost of £3 000 in 1994, all other office equipment has been purchased since 1997.

2505 Jun 2006 Darnell Question 2 continued

REQUIRED

(a) The Schedule of Fixed Assets for Darnell plc for the year ended 31 May 2006. [20]

(b) **(i)** State the ledger accounting entries for the revaluation of land. [2]

(ii) Explain how the revaluation of land should be treated in the final accounts. [2]

(c) A revaluation reserve is a capital reserve.

(i) Identify **two** other capital reserves. [2]

(ii) State the ledger entries for the creation of each reserve identified in part **(i)**. [4]

(iii) Explain why each reserve identified in part **(i)** would be created. [6]

Total marks [36]

Financing: Reserves, Provisions and Liabilities

2505 Jun 2006 Darnell Question 2 Mark scheme

2 The following data was taken from the accounting records of Darnell plc for the year ended 31 May 2006.

		£
(i)	Tangible fixed assets at cost 1 June 2005:	
	Land and buildings (land £300 000)	550 000
	Machinery	280 000
	Office equipment	180 000
(ii)	Depreciation at 1 June 2005:	
	Land and buildings	80 000
	Machinery	140 000
	Office equipment	90 000

Darnell plc depreciates fixed assets at the following rates per annum:

Buildings 2% straight line on cost;
Machinery 10% reducing balance;
Office equipment 10% straight line on cost.

Land is not depreciated. A full year's depreciation is provided in the year of purchase, but none in the year of sale.

(iii) On 13 August 2005, the land was revalued at £380 000 .

(iv) During July 2005, office equipment originally purchased at a cost of £12 000 and with a written down value of £3 800 was sold at a profit of £1 000.

(v) During the year ended 31 May 2006, the following fixed assets were bought:

Machinery	£8 000
Office equipment	£15 000

With the exception of some office equipment which was bought at a cost of £3 000 in 1994, all other office equipment has been purchased since 1997.

2505 Jun 2006 Darnell Question 2 Mark scheme continued

(c) **(i)** Share premium **(1)**
Capital redemption reserve **(1)** **[2]**

(ii) Share premium — Debit bank **(1)**
Credit share premium **(1)**

Redemption reserve — debit profit and loss/general reserves **(1)**
credit redemption reserve **(1)** **[4]**

(iii) Share premium account is created when shares are issued at the par value plus a premium. It is a requirement of the Company Act to create a capital reserve for the amount of the premium. This is done to protect the creditors of the company.
(1 plus 2 for development)

A redemption reserve is created when the company redeems shares from shareholders. The company is required to create a reserve from profits equal to the amount of the redemption if there is no new issue of shares. Protects the creditors of the company by reducing the amount of profit that could be used to pay dividends.
(1 plus 2 for development) **[6]**

Total marks [36]

Financing: Reserves, Provisions and Liabilities

2505 Jan 2005 Kimmitt Question 2

2 The Balance Sheets for Kimmitt Ltd for the last two years are shown below.

Balance Sheets as at:

	31 December 2003		31 December 2004	
Fixed Assets	£	£	£	£
Goodwill		60 000		–
Tangible fixed assets at cost	500 000		720 000	
Depreciation	280 000	220 000	360 000	360 000
Investments		100 000		60 000
		380 000		420 000
Current Assets				
Stock	150 000		160 000	
Debtors	32 000		38 000	
Bank	45 000		–	
Cash	6 000		4 000	
	233 000		202 000	
Creditors falling due in less than one year				
Creditors	94 000		38 000	
Corporation tax	62 000		43 000	
Bank overdraft	–		26 000	
Dividends	34 000		18 000	
	190 000		125 000	
Net Current Assets	43 000			77 000
Total Assets less current liabilities	423 000			497 000
Capital and Reserves				
£1 Ordinary Shares		250 000		262 500
Share Premium		125 000		137 500
General Reserve		20 000		38 000
Profit and Loss Account		28 000		59 000
		423 000		497 000

Tangible fixed assets originally costing £42 000 with a book value of £9 000 were sold for £3 000 cash during the year ended 31 December 2004.

An interim dividend of £20 000 was paid during the year ended 31 December 2004.

2505 Jan 2005 Kimmitt Question 2 continued

REQUIRED

(a) The Cash Flow Statement in accordance with good accounting format for the year ended 31 December 2004. [24]

(b) **(i)** Explain the difference between the Share Premium and General Reserve. [4]

(ii) How can the balance on each of these accounts be used? [4]

Total marks [32]

Financing: Reserves, Provisions and Liabilities

2505 Jan 2005 Kimmitt Question 2 Mark scheme

2 (a)

Net Profit Before Tax			130 000	
Tax			43 000	**(1)**
			87 000	
Profit & Loss b/f			28 000	**(1)**
			115 000	
Dividends	38 000	**(1)**		
General Reserves	18 000	**(1)**		
			56 000	
Profit and loss c/f			59 000	**(1)**

Net Cash Flow From Operating Activities		
Net Profit	130 000	**(5)**
+ Depreciation	113 000	**(2)**
+ Loss	6 000	**(2)**
+ Goodwill	60 000	**(1)**
Increase Stock	(10 000)	**(1)**
Increase Debtors	(6 000)	**(1)**
Decrease Creditors	(56 000)	**(1)**
	237 000	**(1)**

Kimmitt Ltd

Cash Flow Statement for the year ended 31 December 2004 **(1)**

Net Cash Flow from Operating Activities	237 000	**(14)**
Returns on Investment and Servicing of Finance		
Taxation		
Corporation tax	(62 000)	**(1)**
Capital Expenditure		
Purchase of fixed assets	(262 000)	**(2)**
Proceeds of sale of fixed assets	3 000	**(1)**
Sale of investments	40 000	**(1)**
Equity Dividends		
Dividends paid	(54 000)	**(2)**
Financing		
Issue of Shares	25 000	**(1)**
Decrease in cash	(73 000)	**(1)**

[24]

2505 Jan 2005 Kimmitt Question 2 Mark scheme continued

(b) (i)

- The Share Premium Account is a Capital Reserve
- The Share Premium exists because the company has issued share above the par value
- The Share Premium Account cannot be used to pay cash dividends
- The balance on the Share Premium can be used to issue bonus shares and write off the expenses of a new issue

(2 x 2 marks)
(1 for point plus 1 for development) **[4]**

(ii)

- The General Reserve is an example of a Revenue Reserve
- The General Reserve is retained profit that is kept back by the directors and paid as cash dividends
- The balance on the reserve is the property of the Equity holders and can be used in the future to pay a dividend

(2 x 2 marks) **[4]**
(1 for point plus 1 for development)

Total marks [32]

Financing: Reserves, Provisions and Liabilities

2505 Jun 2004 Gozzard Question 3

3 Gozzard plc prepared the following Trial Balance for the year ended 31 December 2003.

	Dr	Cr
	£	£
Turnover		850 000
Stock as at 1 January 2003	25 000	
Purchases	225 000	
Administrative expenses (excluding depreciation)	270 000	
Distribution costs (excluding depreciation)	240 000	
0.50 pence Ordinary Shares		160 000
Land and Buildings	233 000	
Fixtures at cost	40 000	
Motor vehicles at cost	30 000	
Provision for depreciation – Fixtures		16 000
– Motor vehicles		6 000
Debtors	12 000	
Creditors		18 000
Bank	25 000	
Profit and Loss Account		50 000
	1 100 000	1 100 000

The following information is relevant:

(i) Closing stock as at 31 December 2003 was valued at £30 000.

(ii) Depreciation is to be provided on fixed assets as follows:
Fixtures 20% cost straight line.
Motor vehicles 20% reducing balance.
Motor vehicles are used solely for the delivery of goods.

(iii) Land and Buildings must be revalued to £400 000.

(iv) Corporation tax of £30 000 is to be provided.

(v) The directors have declared a proposed ordinary dividend of 0.25 pence per share.

REQUIRED

(a) **(i)** A Profit and Loss Account for the year ended 31 December 2003 in accordance with the minimum required for publication. **[15]**

(ii) A Balance Sheet as at that date in accordance with the minimum required for publication. [11]

(b) Gozzard plc has revalued its land and buildings. A director has suggested that the revaluation gain should be used to pay additional dividends to shareholders. Comment on the appropriateness of this suggestion. [8]

Total marks **[34]**

Financing: Reserves, Provisions and Liabilities

2505 Jun 2004 Gozzard Question 3 Mark scheme

3 (a) (i) Gozzard plc

Profit and Loss Account for the year ended 31 December 2003 **(1)**

Turnover			850,000	**(1)**
Cost of sales (25,000+225,000-30,000)			220,000	**(2)**
Gross profit			630,000	
Distribution costs **(1)**	244,800	**(2)**		
Administrative expenses	278,000	**(2)**	522,800	
Profit on ordinary activities before tax			107,200	
Corporation tax			30,000	**(1)**
Profit after tax			77,200	
Profit and loss a/c b/f **(1)**			50,000	**(1)**
			127,200	
Dividends			80,000	**(2)**
Retained profit			47,200	**(1)**

[15]

(ii) Balance Sheet as at 31 December 2003

Fixed Assets				
Land and buildings			400,000	**(2)**
Fixtures			16,000	
Motor vehicles			19,200	
			435,200	
Current Assets				
Stock	30,000			
Debtors	12,000			
Bank	25,000			
	67,000	**(1)**		
Creditors due in less than 1 year **(1)**				
Creditors	18,000			
Dividends	80,000	**(1of)**		
Corporation tax	30,000	**(1)**		
	128,000			
Net current assets **(1)**			(61,000)	
			374,200	
Capital and Reserves				
Called up share capital			160,000	**(1)**
Revaluation reserve **(1)**			167,000	**(1)**
Profit and Loss			47,200	**(1 of)**
			374,200	

[11]

Financing: Reserves, Provisions and Liabilities

2505 Jun 2004 Gozzard Question 3 Mark scheme continued

(b) Revaluation of fixed assets is a capital reserve.
A book entry in the ledger.
No cash has been generated by increasing reserves.
Capital reserves cannot be used to pay cash dividends.
Cash can only be realised if Gozzard plc sell the land.

(4 x 3 marks) max 8
(1 for point plus up to 2 for development) **[8]**

Total marks [34]

Financing: Reserves, Provisions and Liabilities

2505 Jun 2002 Pyle Question 2

1 The following balances were extracted from the books of Pyle plc on the 31 December 2001:

	Debit	Credit
	£	£
Sales		3 000 000
Purchases	1 420 000	
Discounts	6 000	3 000
Returns	8 000	5 000
Stock 1 January 2001	85 000	
£1 Ordinary shares		400 000
General administration expenses	320 000	
Rent received		30 000
General distribution costs	230 000	
Profit and loss		25 000
Debtors	80 000	
Creditors		48 000
Provision for doubtful debts		4 000
Land and buildings	941 000	
Delivery vehicles	310 000	
Office equipment	80 000	
Salaries	270 000	
Bank	50 000	
Provision for depreciation – office equipment		35 000
Provision for depreciation – delivery vehicles		50 000
Share premium		80 000
General reserve		120 000
	3 800 000	3 800 000

2505 Jun 2002 Pyle Question 2 continued

Additional information:

(i) Closing stock was valued at £62 000.

(ii) General administration expenses prepaid £4000

General distribution costs owing £2000

(iii) The provision for doubtful debts to be increased by £1200.

(iv) Salaries are split equally between administration and distribution.

(v) Rent receivable of £6000 is outstanding for the year.

(vi) Depreciation is to be provided as follows:

Delivery vehicles 20% per annum reducing balance method
Office equipment 12.5% per annum on cost.

(vii) The directors recommend a transfer to general reserve of £200 000 and an ordinary share dividend £0.60 per share. The corporation tax on ordinary activities is estimated at £180 000.

REQUIRED

(a) The Profit and Loss Account for the year ended 31 December 2001 in accordance with the minimum required for publication. [24]

(b) Distinguish between a capital reserve and a revenue reserve in the final accounts of Pyle plc. [10]

Total marks [34]

Financing: Reserves, Provisions and Liabilities

2505 Jun 2002 Pyle Question 2 Mark scheme

1 (a) Pyle plc
Profit and Loss Account for the year ended 31 December 2001 **(1)**

Turnover				2,992,000	**(1)**
Cost of Sales				1,438,000	**(4)**
				1,554,000	
Distribution Costs **(1)**	419,000	**(4)**			
Administrative Expenses	465,200	**(7)**			
				884,200	
				669,800	
Other Operating Income **(1)**				36,000	
Profit on Ordinary Activities before Tax				705,800	
Corporation Tax			**(1)**	180,000	
Profit After Tax				525,800	
Profit and Loss b/f **(1)**			**(1)**	25,000	
				550,800	
Transfer to General Reserve	200,000	**(1)**			
Proposed Ordinary Dividend	240,000	**(1)**			
				440,000	
Retained Profit				110,800	
					[24]

Cost of Sales
85,000 **(1)** + 1,420,000 **(1)** – 62,000 **(1)** – 5,000 **(1)** = 1,438,000

Administrative expenses
320,000 **(1)** – 4,000 **(1)** + 6,000 **(1)** – 3000 **(1)** + 1200 **(1)** + 135,000 **(1)** + 10,000 **(1)** = 465,200

Distribution Costs
230,000 **(1)** + 2,000 **(1)** + 135,000 **(1)** + 52,000 **(1)** = 419,000

(b) A revenue reserve is profit retained by the directors
A revenue reserve is the property of the Ordinary Share Holders
Revenue reserve can be used to pay cash dividends
Example of revenue reserve £200,000
(2 x 2 marks plus 1 mark for relating to Pyle)
(1 for point plus 1 for development)

Capital reserve requirement of company law
Capital reserves are created to protect creditors
Capital reserves can not be used to pay cash dividends
Example of capital reserve share premium £80,000
Can be used to give bonus shares
(2 x 2 marks plus 1 mark for relating to Pyle)
(1 for point plus 1 for development) **[10]**

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

F013 Specimen Spice Question 1

Answer **all** questions.

1 The following balances were extracted from the books of Spice plc on 31 December 2006.

	Dr	Cr
	£	£
Purchases	500,000	
Turnover		1,200,000
Stock	40,000	
Sales returns	8,000	
£1 Ordinary shares		600,000
General administrative expenses	160,000	
General distribution costs	180,000	
Discounts	14,000	2,000
Rent received		24,000
Profit and Loss		38,000
Debtors	58,000	
Creditors		54,000
Land and buildings	800,000	
Office equipment	85,000	
Delivery vehicles	130,000	
Provision for depreciation of office equipment		40,000
Provision for depreciation of delivery vehicles		44,000
General reserve		159,000
Share premium		150,000
Bank	190,000	
Provision for doubtful debts		4,000
Salaries	150,000	
	2,315,000	2,315,000

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

F013 Specimen Spice Question 1 continued

Additional information:

(i) The closing stock was valued at £90,000.

(ii) General administrative expenses prepaid £6,800

General distribution costs owing £4,000

(iii) Salaries are split equally between distribution and administration.

(iv) Rent receivable of £6,200 is outstanding for the year.

(v) Provision for doubtful debts is to be reduced by £600.

(vi) Depreciation is to be provided as follows:

(a) office equipment 20% per annum on cost

(b) delivery vehicles 20% per annum reducing balance method

Delivery vehicles are treated under distribution. Office equipment is split equally between distribution and administration.

(vii) The directors recommend a transfer to the general reserve of £60,000 and an ordinary share dividend of £70,000.

(viii) Corporation tax for the year is estimated at £130,000.

REQUIRED

(a)* The Profit and Loss Account for the year ended 31 December 2006 and the Balance Sheet as at 31 December 2006 both in accordance with the minimum required for publication **[32]**

(b) Explain the importance of the Auditors Report to the shareholders of a plc. **[4]**

Total Marks [36]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

F013 Specimen Spice Question 1 Mark scheme

Question Number	Answer					Max Mark
1(a)*	<u>Spice plc</u>					
	<u>Profit and Loss Account for the year ended 31 December 2006</u>					
	Turnover			1,192,000	[1]	
	Cost of Sales			450,000	[2]	
	Gross Profit			742,000		
	Distribution Costs	284,700	[4]			
	Administration Expenses	248,100	[7]	532,800		
	Operating Profit			209,200		
	Other Income			30,200	[2]	
	Profit before tax			239,400		
	Corporation tax			130,000	[1]	
	Profit after tax			109,400		
	Profit and Loss Account b/d			38,000	[1]	
				147,400		
	Dividends	70,000	[1]			
	Reserves	60,000	[1]	130,000		
	Retained profit			17,400		
	Cost of sales (40,000 + 500,000 – 90,000)					
	Distribution costs (180,000 +4,000 + 75,000 + 17,200 + 8,500)					
	Administrative expenses (160,000 + 14,000 – 2,000 – 6,800 + 75,000 – 600 + 8,500)					

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

F013 Specimen Spice Question 1 Mark scheme continued

1(a)* cont'd	Balance Sheet as at 31 December 2006				
	Fixed Assets				
	Land and buildings		800,000		
	Office equipment		28,000		
	Delivery vehicles		68,800		
			896,800	[1]	
	Current Assets				
	Stock	90,000			
	Prepaid	6,800 [1]			
	Rent owing	6,200 [1]			
	Debtors	54,600 [1]			
	Bank	190,000			
		347,600			
	Creditors due in less than 1 year				
	Creditors	54,000			
	Accruals	4,000 [1]			
	Tax	130,000 [1]			
	Dividends	70,000 [1]			
		258,000			
	Net Current Assets		89,600		
			986,400		
	Capital and reserves				
	Issued share capital		600,000		
	Share premium		150,000	[1]	
	General reserve		219,000	[1]	
	Retained profit		17,400	[1]	
			986,400		
	NB Up to an additional two marks can be awarded for the candidate's quality of written communication (numerical responses)				[32]
1(b)	The report must state whether or not the accounts of the company present a true and fair view of the financial position of the company. The shareholders will rely upon this report and the statement given by the auditors to make important decisions regarding their investment. *(2 x 2 marks)* *(1 for point plus 1 for development)*				[4]
	Total Marks				**[36]**

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2007 Lusby Question 1

1 The following balances were extracted from the books of Lusby plc on 31 December 2006.

	Dr	Cr
	£	£
Purchases	300 000	
Sales		1 500 000
Stock 1 January 2006	51 500	
Discounts	4 200	2 300
Sales returns	5 300	
Ordinary shares at £1 each		1 200 000
Administrative expenses	84 000	
Distribution costs	76 000	
Rent receivable		15 000
Profit and Loss	32 000	
Debtors	48 500	
Creditors		32 000
Land and buildings	1 900 000	
Office equipment	420 000	
Delivery vehicles	310 000	
Provision for depreciation – office equipment		172 000
Provision for depreciation – delivery vehicles		115 000
Share premium		600 000
Bank	174 800	
Salaries	230 000	
	3 636 300	3 636 300

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2007 Lusby Question 1 continued

Additional information:

(i) The closing stock was valued at £53 000.

(ii) Administrative expenses prepaid £10 200.
Distribution costs owing £8 400.

(iii) Rent receivable of £1 200 is outstanding for the year.

(iv) Salaries are to be split equally between administrative expenses and distribution costs.

(v) A provision for doubtful debts of £2 300 is to be created.

(vi) An independent surveyor has revalued the land and buildings to £2 100 000. No entry has been made in the accounts for this revaluation. Land and buildings are not depreciated.

(vii) Depreciation is to be provided as follows:
delivery vehicles 20% per annum on cost;
office equipment 10% per annum on the written down value.
Depreciation on delivery vehicles is included under distribution costs, while depreciation on office equipment is split equally between administrative expenses and distribution costs.

(viii) The directors recommend a transfer to a general reserve of £150 000 and an ordinary share dividend of £230 000. Corporation tax for the year is estimated at £148 000.

REQUIRED

(a) The Profit and Loss Account for the year ended 31 December 2006 (in accordance with the minimum requirements for publication). [21]

(b) The Balance Sheet as at 31 December 2006. [16]

Total marks [37]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2007 Lusby Question 1 Mark scheme

1 (a)

Lusby plc

Profit and Loss Account for the year ended 31 December 2006 **(1)**

Turnover			1 494 700	**(2)**
Cost of sales			298 500	**(2)**
Gross profit			1 196 200	
Administrative expenses	205 400	**(6)**		
Distribution costs	273 800	**(4)**	479 200	
Profit on ordinary activities			717 000	
Other income			16 200	**(2)**
Profit on ordinary activities before tax			733 200	
Corporation tax			148 000	**(1)**
Profit after tax			585 200	
Profit and Loss b/f			(32 000)	**(1)**
			553 200	
Dividends	230 000	**(1)**		
General reserve	150 000	**(1)**	380 000	
Retained profit			173 200	
				[21]

Cost of sales
51 500 + 300 000 – 53 000 = 298 500

Administrative expenses
84 000 + 4 200 + 2 300 – 10 200 + 115 000 + 12 400 – 2 300 = 205 400

Distribution costs
76 000 + 115 000 + 12 400 + 8 400 + 62 000 = 273 800

2505 Jan 2007 Lusby Question 1 Mark scheme continued

1 (b)

Balance sheet as at 31 December 2006				
Fixed assets				
Land and buildings			2 100 000	**(1)**
Office equipment			223 200	**(1)**
Delivery vehicles			133 000	**(1)**
			2 456 200	
Current assets				
Stock	53 000			
Debtors	46 200	**(2)**		
Rent received owing	1 200	**(1)**		
Prepaid	10 200	**(1)**		
Bank	174 800			
	285 400			
Creditors falling due in less than one year				
Creditors	32 000			
Accruals	8 400	**(1)**		
Dividends	230 000	**(1)**		
Taxation	148 000	**(1)**		
	418 400			
Net current assets **(1)**			(133 000)	
			2 323 200	
Capital and reserves				
Share capital			1 200 000	**(1)**
Revaluation reserve			200 000	**(1)**
Share premium			600 000	**(1)**
General reserve			150 000	**(1)**
Profit and loss			173 200	**(1of)**
			2 323 200	
				[16]

Total marks [37]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2007 Agrawel Question 2

2 The following data was taken from the accounting records of Agrawel Ltd for the year ended 31 December 2006.

(i) Tangible fixed assets at cost 1 January 2006 were:

	£
Land and buildings (Land £250 000)	400 000
Motor vehicles	180 000
Office equipment	70 000

(ii) Depreciation at 1 January 2006:

Land and buildings	30 000
Motor vehicles	90 000
Office equipment	20 000

Agrawel Ltd depreciates fixed assets as follows:

Buildings 2% per annum on cost using the straight line method.
Motor vehicles 20% per annum using the reducing balance method.
Office equipment 10% per annum on cost using the straight line method.
A full year's depreciation is charged in the year of purchase and none in the year of sale.
Land is not depreciated.

(iii) On 12 January 2006, the land was revalued at £400 000.

(iv) During May 2006, office equipment originally purchased at a cost of £2 000, with a written down value of £500, was sold for a profit of £150.

(v) A motor vehicle purchased on 1 July 2004 for £15 000 was sold for £2 500 during November 2006.

(vi) During the year the following assets were bought:

Motor vehicles	£34 000
Office equipment	£12 000

2505 Jan 2007 Agrawel Question 2 continued

REQUIRED

(a) A Schedule of Fixed Assets for the year ended 31 December 2006. [20]

(b) Agrawel Ltd is considering a new product for launch in 2008 and this will require a substantial investment in research and development. Discuss how research and development expenditure should be treated in the final accounts of Agrawel Ltd. [6]

(c) Other than the issue of shares, discuss ways in which Agrawel Ltd could finance an investment in research and development. [8]

Total marks [34]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2007 Agrawel Question 2 Mark scheme

2 **(a)** Agrawel Ltd

Schedule of Fixed Assets for the year ended 31 December 2006

	Land and buildings	Motor vehicles	Office equipment
Cost at 1 January	400 000	180 000	70 000 **(1)**
Additions		34 000 **(1)**	120 000 **(1)**
Disposals		(15 000) **(1)**	(2 000) **(1)**
Revaluation **(1)**	150 000 **(1)**		
Cost at 31 Dec	550 000	199 000	80 000 **(1)**
Depreciation 1 Jan	30 000	90 000	20 000 **(1)**
Disposals		(5 400) **(2)**	(1 500) **(1)**
Profit and loss	3 000 **(2)**	22 880 **(2)**	8 000 **(1)**
Depreciation 31 Dec	33 000	107 480	26 500 **(1)**
Book value 31 Dec	517 000	91 520	53 500 **(2)**

[20]

(b) A distinction must be made between the types of research and development.
Pure and applied research must be written off to the profit and loss as an expense.
A development cost can be capitalized and shown as a fixed asset.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

Preference shares and the different types of preference share depending on the risk. Shares could be cumulative, non-cumulative.
A secured loan or debenture charged on the assets of the company.
Agrawel has land and buildings worth £550 000 after the revaluation and this could be used for a long term loan or mortgage.
Leasing agreements if the investment required new machinery. A leasing agreement could be in the form of a finance lease or operating lease.
A short term borrowing facility from the bank by agreeing an overdraft limit.
Agrawel should investigate the possibility of obtaining a grant for the new investment. It could qualify for a regional, national or a European grant.

(4 x 2 marks) **[8]**
(1 for point plus 1 for development)

Total marks [34]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2006 Darnell Question 2

2 The following data was taken from the accounting records of Darnell plc for the year ended 31 May 2006.

		£
(i)	Tangible fixed assets at cost 1 June 2005:	
	Land and buildings (land £300 000)	550 000
	Machinery	280 000
	Office equipment	180 000
(ii)	Depreciation at 1 June 2005:	
	Land and buildings	80 000
	Machinery	140 000
	Office equipment	90 000

Darnell plc depreciates fixed assets at the following rates per annum:
Buildings 2% straight line on cost;
Machinery 10% reducing balance;
Office equipment 10% straight line on cost.

Land is not depreciated. A full year's depreciation is provided in the year of purchase, but none in the year of sale.

(iii) On 13 August 2005, the land was revalued at £380 000 .

(iv) During July 2005, office equipment originally purchased at a cost of £12 000 and with a written down value of £3 800 was sold at a profit of £1 000.

(v) During the year ended 31 May 2006, the following fixed assets were bought:

Machinery	£8 000
Office equipment	£15 000

With the exception of some office equipment which was bought at a cost of £3 000 in 1994, all other office equipment has been purchased since 1997.

2505 Jun 2006 Darnell Question 2 continued

REQUIRED

(a) The Schedule of Fixed Assets for Darnell plc for the year ended 31 May 2006. [20]

(b) **(i)** State the ledger accounting entries for the revaluation of land. [2]

(ii) Explain how the revaluation of land should be treated in the final accounts. [2]

(c) A revaluation reserve is a capital reserve.

(i) Identify **two** other capital reserves. [2]

(ii) State the ledger entries for the creation of each reserve identified in part **(i)**. [4]

(iii) Explain why each reserve identified in part **(i)** would be created. [6]

Total marks [36]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2006 Darnell Question 2 Mark scheme

2 **(a)** Darnell plc
Schedule of Fixed Assets for the year ended 31 May 2006 **(1)**

	Land and buildings		Machinery		Office Equipment	
Cost 1 June 2005	550,000		280,000		180,000	**(1) line**
Additions			8,000	**(1)**	15,000	**(1)**
Revaluations	80 000	**(2)**				
Disposals					(12,000)	**(1)**
Cost 31 May 2006	630,000		288,000		183,000	**(1) line**
Total depreciation 1 June 2005	80,000		140,000		90,000	**(1)**
Disposals					(8,200)	**(2)**
Profit and loss	5,000	**(2)**	14 800	**(2)**	18,000	**(2)**
Total depreciation 31 May 2006	85,000		154,800		99,800	**(1) line**
Net book value at 31 May 2006	545,000		133,200		83,200	**(2)(1of)**

[20]

(b) **(i)** Debit Land and buildings **(1)**
Credit Revaluation reserve **(1)** **[2]**

(ii) The land and buildings revalued amount shown in the balance sheet **(1)**
Revaluation reserve shown under reserves in the balance sheet **(1)** **[2]**

2505 Jun 2006 Darnell Question 2 Mark scheme continued

(c) **(i)** Share premium **(1)**
Capital redemption reserve **(1)** **[2]**

(ii) Share premium — Debit bank **(1)**
Credit share premium **(1)**

Redemption reserve — debit profit and loss/general reserves **(1)**
credit redemption reserve **(1)** **[4]**

(iii) Share premium account is created when shares are issued at the par value plus a premium. It is a requirement of the Company Act to create a capital reserve for the amount of the premium. This is done to protect the creditors of the company.
(1 plus 2 for development)

A redemption reserve is created when the company redeems shares from shareholders. The company is required to create a reserve from profits equal to the amount of the redemption if there is no new issue of shares. Protects the creditors of the company by reducing the amount of profit that could be used to pay dividends.
(1 plus 2 for development) **[6]**

Total marks [36]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2006 Spring Question 1

1 The following balances were extracted from the books of Spring plc on 31 December 2005.

	Dr	Cr
	£	£
Purchases	400 000	
Turnover		1 192 000
Stock	30 000	
Sales returns	6 000	
£1 Ordinary shares		500 000
General administration expenses	150 000	
General distribution costs	190 000	
Discounts	12 000	14 000
Rent received		30 000
Profit and Loss		42 000
Debtors	62 000	
Creditors		48 000
Land and buildings	744 200	
Office equipment	90 000	
Delivery vehicles	120 000	
Provision for depreciation – office equipment		38 000
Provision for depreciation – delivery vehicles		42 000
General reserve		130 000
Share premium		100 000
Bank	190 000	
Provision for doubtful debts		3 200
Salaries	145 000	
	2 139 200	2 139 200

Additional information:

(i) The closing stock was valued at £72 000.

(ii) General administration expenses prepaid £6 800.
General distribution costs owing £5 000.

(iii) Salaries are split equally between distribution and administration.

(iv) Rent receivable of £3 400 is outstanding for the year.

(v) Provision for doubtful debts is to be increased by £800.

2505 Jan 2006 Spring Question 1 continued

(vi) Depreciation is to be provided as follows:
(a) office equipment 20% per annum on cost;
(b) delivery vehicles 20% per annum reducing balance method.
Delivery vehicles are treated under distribution. Office equipment is split equally between distribution and administration.

(vii) The directors recommend a transfer to the general reserve of £50 000 and an ordinary share dividend of £140 000.

(viii) Corporation tax for the year is estimated at £120 000.

REQUIRED

(a) The Profit and Loss Account for the year ended 31 December 2005 (in accordance with the minimum required for publication). [23]

(b) The Balance Sheet as at 31 December 2005 (in accordance with the minimum required for publication). [13]

(c) Explain the importance of the Auditor's Report to the shareholders of a plc. [4]

(d) Spring plc is planning an expansion of the business during 2006 which will require additional fixed assets. Discuss the advantages and disadvantages of the following methods of finance:

(i) leasing; [6]

(ii) ordinary share issue. [6]

Total marks [52]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2006 Spring Question 1 Mark scheme

1(b)

Balance Sheet as at 31 December 2005

Fixed Assets				
Land and buildings			744,200	
Office equipment			34,000	**(1)**
Delivery vehicles			62,400	**(1)**
			840,600	
Current Assets				
Stock	72,000			
Prepaid	6,800	**(1)**		
Debtors	61,400	**(2)**		
Bank	190,000			
	330,200			
Creditors due in less than 1 year **(1)**				
Creditors	48,000			
Accruals	5,000	**(1)**		
Tax	120,000	**(1)**		
Dividends	140,000	**(1)**		
	313,000			
Net Current Assets **(1)**			17,200	
			857,800	
Capital and reserves				
Issued Share Capital			500,000	
Share Premium			100,000	**(1)**
General Reserve			180,000	**(1)**
Retained profit			77,800	**(1 of)**
			857,600	

[13]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2006 Spring Question 1 Mark scheme continued

1(c)
The Auditor's report is important for the users of accounting information contained in the final accounts.

The report must state whether or not the accounts of the company present a true and fair view of the financial position of the company.

The shareholders will rely upon this report and the statement given by the auditors
(2 x 2 marks) **[4]**

1(d)(i)
Would improve the cash flow of the company.
No large cash outflows would be required for the purchase of fixed assets
A regular payment would be made each month to the leasing company
The contract would cover repairs and maintenance
Can have an option to purchase at the end of the lease
Company does not own the asset
Effect on the company balance sheet
(3 x 2 marks) **[6]**

1(d)(ii)
Would give a large cash inflow to the company
An alternative to borrowing from the bank which would charge the assets and increase the gearing
Could consider a rights issue instead of a full issue
Extra shares would effect the control of the company because of more votes
Would a share offer be attractive to investors and would they be able to sell at a premium.
The cost of a full issue of shares and the prospectus
(3 x 2 marks) **[6]**

Total marks [52]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2006 Hilgerson Question 3

3 The following is an extract from the Balance Sheet of Hilgerson plc as at 31 December 2004.

Capital and Reserves	£
550 000 Ordinary shares at 25 pence each	137 500
Share Premium	55 000
Profit and Loss	60 000

Hilgerson plc needed £50 000 additional capital to replace machinery.

On 20 July 2005 Hilgerson plc made a rights issue of 50 000 ordinary shares at a premium of 25 pence per share. All the cash was received in July 2005.

On 1 August 2005 Hilgerson plc made a bonus issue of one ordinary share for every six ordinary shares in existence on 1 August 2005. The Share Premium Account was utilised to provide for the bonus issue.

The remaining funds required to purchase the machinery were raised by a bank loan on 10 August 2005.

Assume that no additional profits were generated by Hilgerson plc from 31 December 2004 to 10 August 2005.

REQUIRED

(a) Prepare the following ledger accounts, including the balance carried down in **each** case:

(i) ordinary share capital; [7]

(ii) share premium; [7]

(iii) loan. [3]

(b) Prepare a Balance Sheet extract to show the Capital and Reserves section of Hilgerson plc as at 10 August 2005. [3]

(c) **(i)** Identify **three** options which are available to a company for the appropriation of its profits. [3]

(ii) Discuss the circumstances in which **each** option would be appropriate. [9]

Total marks [32]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jan 2006 Hilgerson Question 3 Mark scheme

3(a)(i)

Ordinary share capital

Bal c/d	175,000 **(1)**	Bal b/d	137,500 **(1)**
		Bank **(1)**	12,500 **(1)**
		Share premium **(1)**	25,000 **(2)**
	175,000		175,000

[7]

3(a)(ii)

Share Premium

Share capital(1)	25,000 **(1)**	Bal b/d	55,000 **(1)**
Bal c/d	42,500 **(1)**	Bank (1)	12,500 **(2)**
	67,500		67,500

[7]

3(a)(iii)

Loan

Bal c/d	25,000 **(1)**	Bank **(1)**	25,000 **(1)**
	25,000		25,000

[3]

3(b)

Ordinary shares	175,000 **(1of)**
Share premium	42,500 **(1of)**
Profit and loss	60,000 **(1)**

[3]

2505 Jan 2006 Hilgerson Question 3 Mark scheme continued

3(b)

Ordinary shares	175,000 **(1of)**	
Share premium	42,500 **(1of)**	
Profit and loss	60,000 **(1)**	**[3]**

3(c)

(i) Payment of cash dividends to shareholders.
Transfer to a revenue/retention of profit.
Issue bonus shares. **[3]**

(ii) The payments of cash dividends to shareholders if the company has the cash to cover the dividend payment. Profits are good and expectation of shareholders is high.
The effect on the market price of the share if a cash dividend is not made to the shareholders.

Transfer to a revenue reserve and retain the profits instead of using to pay cash dividends.
Retain profits or transfer to general reserve will help cash flow if dividends are not paid. The cash could be used for other investments.
Increasing the reserves will improve the equity of the company and will reduce the gearing.

Consider the issue of bonus shares if the cash reserves of the company will not allow a cash dividend.
Bonus shares could also be given to employees as part of a bonus package.
Would increase the share capital and dilute the market price of the share.

(3 x 3 marks) **[9]**

(1 for point plus up to 2 for development) **Total marks [32]**

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2005 Woodman Question 2

2 The following data were taken from the accounting records of Woodman Ltd for the year ended 31 March 2005.

(i) Tangible fixed assets at cost at 1 April 2004 were:

	£
Land and buildings (Land £400 000)	1 000 000
Motor vehicles	320 000
Office equipment	200 000

(ii) Depreciation at 1 April 2004:

Land and buildings	48 000
Motor vehicles	150 000
Office equipment	80 000

Woodman Ltd depreciates fixed assets as follows:

Buildings 1% per annum on cost using the straight line method.
Motor vehicles 20% per annum using the reducing balance method.
Office equipment 15% per annum on cost using the straight line method.

All fixed assets held at 31 March 2005 had been purchased since 2002.

A full year's depreciation is provided in the year of purchase but none in the year of sale. Land is not depreciated.

(iii) During the year ended 31 March 2005 the following assets were bought:

	£
Motor vehicles	30 000
Office equipment	15 000

(iv) During July 2004 a motor vehicle with an original cost of £20 000 was sold for £3 000 cash. The motor vehicle was purchased on 1 October 2001.

(v) During January 2005 office equipment was sold for £4 000 cash. A profit of £1 500 was made on the sale. Woodman Ltd had charged £3 600 for depreciation on this equipment.

(vi) On 1 January 2005 land was revalued at £600 000.

2505 Jun 2005 Woodman Question 2 continued

REQUIRED

(a) The Schedule of Fixed Assets for Woodman Ltd for the year ended 31 March 2005. [20]

(b) Profit is of interest to all users of final accounts. What other information from the final accounts of Woodman Ltd would be of interest to each of the following?

- **(i)** Shareholders [2]
- **(ii)** Banks [2]
- **(iii)** Employees [2]

Total marks [26]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2005 Woodman Question 2 Mark scheme

2 (a)

Woodman Ltd
Schedule of Fixed Assets for the year ended 31 March 2005

	Land & buildings		Motor vehicles		Office equipment	
Cost at 1 April	1 000 000		320 000		200 000	**(1) line**
Additions			30 000	**(1)**	15 000	**(1)**
Disposals			(20 000)	**(1)**	(6 100)	**(2)**
Revaluations	200 000	**(1)**				
Cost at 31 March	1 200 000		330 000		208 900	**(1) line**
Dep at 1 April	48 000		150 000		80 000	**(1)**
Disposals			(9 760)	**(2)**	(3 600)	**(1)**
Profit and loss	6 000	**(1)**	37 952	**(2)**	31 335	**(2)**
Dep at 31 March	54 000		178 192		107 735	**(1) line**
Book val at 31 Mar	1 146 000		151 808		101 165	**(2)(1of) line**

[20]

(b)

Shareholders – profits, dividends, and return on capital employed
Banks – cash flow, profits and gearing
Employees – sales, profits, cash flow and directors pay
(3 x 2 marks) **[6]**

Total marks [26]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2004 Gozzard Question 3

3 Gozzard plc prepared the following Trial Balance for the year ended 31 December 2003.

	Dr	Cr
	£	£
Turnover		850 000
Stock as at 1 January 2003	25 000	
Purchases	225 000	
Administrative expenses (excluding depreciation)	270 000	
Distribution costs (excluding depreciation)	240 000	
0.50 pence Ordinary Shares		160 000
Land and Buildings	233 000	
Fixtures at cost	40 000	
Motor vehicles at cost	30 000	
Provision for depreciation – Fixtures		16 000
– Motor vehicles		6 000
Debtors	12 000	
Creditors		18 000
Bank	25 000	
Profit and Loss Account		50 000
	1 100 000	1 100 000

The following information is relevant:

(i) Closing stock as at 31 December 2003 was valued at £30 000.

(ii) Depreciation is to be provided on fixed assets as follows:
Fixtures 20% cost straight line.
Motor vehicles 20% reducing balance.
Motor vehicles are used solely for the delivery of goods.

(iii) Land and Buildings must be revalued to £400 000.

(iv) Corporation tax of £30 000 is to be provided.

(v) The directors have declared a proposed ordinary dividend of 0.25 pence per share.

REQUIRED

(a) (i) A Profit and Loss Account for the year ended 31 December 2003 in accordance with the minimum required for publication. [15]

(ii) A Balance Sheet as at that date in accordance with the minimum required for publication. [11]

(b) Gozzard plc has revalued its land and buildings. A director has suggested that the revaluation gain should be used to pay additional dividends to shareholders. Comment on the appropriateness of this suggestion. [8]

Total marks [34]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2004 Gozzard Question 3 Mark scheme

3 (a) (i) Gozzard plc
Profit and Loss Account for the year ended 31 December 2003 **(1)**

Turnover			850,000	**(1)**
Cost of sales (25,000+225,000-30,000)			220,000	**(2)**
Gross profit			630,000	
Distribution costs **(1)**	244,800	**(2)**		
Administrative expenses	278,000	**(2)**	522,800	
Profit on ordinary activities before tax			107,200	
Corporation tax			30,000	**(1)**
Profit after tax			77,200	
Profit and loss a/c b/f **(1)**			50,000	**(1)**
			127,200	
Dividends			80,000	**(2)**
Retained profit			47,200	**(1)**

[15]

(ii) Balance Sheet as at 31 December 2003

Fixed Assets				
Land and buildings			400,000	**(2)**
Fixtures			16,000	
Motor vehicles			19,200	
			435,200	
Current Assets				
Stock	30,000			
Debtors	12,000			
Bank	25,000			
	67,000	**(1)**		
Creditors due in less than 1 year **(1)**				
Creditors	18,000			
Dividends	80,000	**(1of)**		
Corporation tax	30,000	**(1)**		
	128,000			
Net current assets **(1)**			(61,000)	
			374,200	
Capital and Reserves				
Called up share capital			160,000	**(1)**
Revaluation reserve **(1)**			167,000	**(1)**
Profit and Loss			47,200	**(1 of)**
			374,200	

[11]

2505 Jun 2004 Gozzard Question 3 Mark scheme continued

(b) Revaluation of fixed assets is a capital reserve.
A book entry in the ledger.
No cash has been generated by increasing reserves.
Capital reserves cannot be used to pay cash dividends.
Cash can only be realised if Gozzard plc sell the land.

(4 x 3 marks) max 8
(1 for point plus up to 2 for development) **[8]**

Total marks [34]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2003 Lightyear Question 1

1 The following balances were extracted from the books of Lightyear plc on 31 March 2003.

	Debit	Credit
	£	£
Purchases	700 000	
Sales		1 800 000
Stock 1 April 2002	35 000	
Discounts	8 000	10 000
Sales returns	20 000	
Rent received		30 000
£1 Ordinary shares		500 000
General administration expenses	320 000	
General distribution costs	230 000	
Debtors	90 000	
Creditors		60 000
Profit and loss account		40 000
Land and buildings	662 500	
Delivery vehicles	200 000	
Office equipment	120 000	
Provision for doubtful debts		3 500
Salaries	110 000	
Bank	130 000	
Provision for depreciation – Office equipment		20 000
Provision for depreciation – Delivery vehicles		50 000
General reserve		12 000
Share premium		100 000
	2 625 500	2 625 500

2505 Jun 2003 Lightyear Question 1 continued

Additional information:

(i) The closing stock was valued at £30 000.

(ii) General administration expenses owing: £3600

General distribution costs prepaid: £3300

(iii) Salaries are to be split equally between administration and distribution.

(iv) The provision for doubtful debts account is to be reduced to £1800.

(v) Depreciation is to be provided as follows:

(a) delivery vehicles 20% reducing balance;

(b) office equipment 15% on cost.

(vi) Rent receivable of £1600 is outstanding for the year.

(vii) The directors have decided to declare an ordinary dividend of £60 000 and transfer £15 000 to the General Reserve Account.

(viii) Lightyear plc has had its land and buildings revalued to £800 000 and an adjustment must be made in the books to reflect the revaluation.

(ix) Corporation tax for the year on profit from ordinary activities is estimated to be £180 000.

REQUIRED

In accordance with the minimum requirements for publication:

(a) The Profit and Loss Account for the year ended 31 March 2003. [24]

(b) The Balance Sheet as at 31 March 2003. [18]

Total marks [42]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2003 Lightyear Question 1 Mark scheme

1 **(a)** Lightyear plc
Profit and Loss Account for the Year Ended 31 March 2003 **(1)**

Turnover **(1)**			1,780,000	**(2)**
Cost of Sales (35,000 + 700,000 – 30,000)			705,000	**(2)**
Gross Profit			1,075,000	
Distribution Costs **(1)** (230,000-3,300+30,000+55,000)	311,700	**(3)**		
Administrative Expenses **(1)** (320,000+3,600+55,000+8,000+18,000-1,700-10,000)	392,900	**(6)**	704,600	
Other Income			370,400	
Profit on Ordinary Activities Before Tax			31,600	**(2)**
			402,000	
Corporation Tax			180,000	**(1)**
Profit on Ordinary Activities After Tax			222,000	
Profit and Loss b/f **(1)**			40,000	**(1)**
			262,000	
Dividends	60,000	**(1)**		
General Reserves	15,000	**(1)**	75,000	
Profit and Loss c/f			187,000	

[24]

2505 Jun 2003 Lightyear Question 1 Mark scheme continued

(b) Balance Sheet as at 31 March 2003

Fixed Assets				
Land and Buildings			800,000	**(1)**
Office Equipment			82,000	**(1)**
Delivery Vehicles			120,000	**(1)**
			1,002,000	
Current Assets				
Stock	30,000	**(1)**		
Debtors (88,200 + 1,600)	89,800	**(2)**		
Prepaid	3,300	**(1)**		
Bank	130,000			
	253,100			
Creditors Due in Less Than One Year (1)				
Creditors	60,000			
Accruals	3,600	**(1)**		
Tax	180,000	**(1)**		
Dividends	60,000	**(1)**		
	303,600			
Net Current Assets			(50,500)	
			951,500	
Capital and Reserves				
Called up Share Capital			500,000	**(1)**
Share Premium **(1)**			100,000	**(1)**
Revaluation Reserve			137,500	**(2)**
Reserves			27,000	**(1)**
Profit and Loss			187,000	**(1 of)**
			951,500	

[18]

Total marks [42]

The Preparation of Final Accounts for Limited Companies: Final Accounts for Internal Use & Final Accounts for Publication

2505 Jun 2002 Pyle Question 1

1 The following balances were extracted from the books of Pyle plc on the 31 December 2001:

	Debit	Credit
	£	£
Sales		3 000 000
Purchases	1 420 000	
Discounts	6 000	3 000
Returns	8 000	5 000
Stock 1 January 2001	85 000	
£1 Ordinary shares		400 000
General administration expenses	320 000	
Rent received		30 000
General distribution costs	230 000	
Profit and loss		25 000
Debtors	80 000	
Creditors		48 000
Provision for doubtful debts		4 000
Land and buildings	941 000	
Delivery vehicles	310 000	
Office equipment	80 000	
Salaries	270 000	
Bank	50 000	
Provision for depreciation – office equipment		35 000
Provision for depreciation – delivery vehicles		50 000
Share premium		80 000
General reserve		120 000
	3 800 000	3 800 000

2505 Jun 2002 Pyle Question 1 continued

Additional information:

(i) Closing stock was valued at £62 000.

(ii) General administration expenses prepaid £4000

General distribution costs owing £2000

(iii) The provision for doubtful debts to be increased by £1200.

(iv) Salaries are split equally between administration and distribution.

(v) Rent receivable of £6000 is outstanding for the year.

(vi) Depreciation is to be provided as follows:

Delivery vehicles 20% per annum reducing balance method
Office equipment 12.5% per annum on cost.

(vii) The directors recommend a transfer to general reserve of £200 000 and an ordinary share dividend £0.60 per share. The corporation tax on ordinary activities is estimated at £180 000.

REQUIRED

(a) The Profit and Loss Account for the year ended 31 December 2001 in accordance with the minimum required for publication. [24]

(b) Distinguish between a capital reserve and a revenue reserve in the final accounts of Pyle plc. [10]

Total marks [34]

2505 Jun 2002 Pyle Question 1 Mark scheme

1 (a) Pyle plc
Profit and Loss Account for the year ended 31 December 2001 **(1)**

Turnover				2,992,000	**(1)**
Cost of Sales				1,438,000	**(4)**
				1,554,000	
Distribution Costs **(1)**	419,000	**(4)**			
Administrative Expenses	465,200	**(7)**			
				884,200	
				669,800	
Other Operating Income **(1)**				36,000	
Profit on Ordinary Activities before Tax				705,800	
Corporation Tax			**(1)**	180,000	
Profit After Tax				525,800	
Profit and Loss b/f **(1)**			**(1)**	25,000	
				550,800	
Transfer to General Reserve	200,000	**(1)**			
Proposed Ordinary Dividend	240,000	**(1)**			
				440,000	
Retained Profit				110,800	

[24]

Cost of Sales
85,000 **(1)** + 1,420,000 **(1)** – 62,000 **(1)** – 5,000 **(1)** = 1,438,000

Administrative expenses
320,000 **(1)** – 4,000 **(1)** + 6,000 **(1)** – 3000 **(1)** + 1200 **(1)** + 135,000 **(1)** + 10,000 **(1)** = 465,200

Distribution Costs
230,000 **(1)** + 2,000 **(1)** + 135,000 **(1)** + 52,000 **(1)** = 419,000

(b) A revenue reserve is profit retained by the directors
A revenue reserve is the property of the Ordinary Share Holders
Revenue reserve can be used to pay cash dividends
Example of revenue reserve £200,000
(2 x 2 marks plus 1 mark for relating to Pyle)
(1 for point plus 1 for development)

Capital reserve requirement of company law
Capital reserves are created to protect creditors
Capital reserves can not be used to pay cash dividends
Example of capital reserve share premium £80,000
Can be used to give bonus shares
(2 x 2 marks plus 1 mark for relating to Pyle)
(1 for point plus 1 for development) **[10]**

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2007 Bedford Question 1

1 On 28 February 2007 the following balances were extracted from the books of Bedford Manufacturing Ltd.

	£
Stocks 1 March 2006	
Raw materials	42 500
Work in progress	38 300
Finished goods	52 500
Purchases of raw materials	620 000
Direct expenses	73 100
Indirect wages	41 000
Direct wages	153 200
Sales	1 500 000
Debtors	95 000
Sales returns	4 000
Loan interest	1 200
Rent and rates	20 000
Insurance	2 000
Office expenses	140 500
Premises at cost	130 000
Provision for depreciation – premises	26 000
Plant and equipment at cost	90 000
Provision for depreciation – plant and equipment	44 000
Provision for unrealised profit	2 500
Bad debts	1 100
Provision for doubtful debts	4 500
Loan (10% interest per annum)	24 000

2505 Jun 2007 Bedford Question 1 continued

Additional information.

(I) Stocks as at 28 February 2007:

Raw materials	£39 300
Work in progress	£37 550
Finished goods	£78 750

(II) The business transfers finished goods from the factory to the trading account at cost plus 5% profit on manufacturing. A provision is to be made for unrealised profit on the stock of finished goods at 28 February 2007 of £3 750.

(III) The loan was taken out on 1 March 2006.

(Iv) Rent and rates are apportioned between the factory and the office on the basis of 4:1. Rent of £5 000 is outstanding.

(v) Insurance which includes a prepayment of £200, is apportioned between the factory and the office on the basis of 5:1.

(vI) Provision for depreciation is to be made as follows:

Premises 5% on cost to be apportioned 4:1 between the factory and the office.
Plant and equipment 20% on the written down value to be apportioned 7:1 between the factory and the office.

(vII) Provision for doubtful debts is to be provided at 5% of debtors.

REQUIRED

(a) A Manufacturing, Trading and Profit and Loss Account for the year ended 28 February 2007 (internal use). [32]

(b) Bedford Manufacturing Ltd is considering revaluing its land. It has been suggested that it could use the gain to pay a dividend to the shareholders. Discuss whether or not this suggestion is appropriate. [6]

Total marks [38]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2007 Bedford Question 1 Mark scheme

1

Bedford Manufacturing Limited
Manufacturing Trading and Profit and Loss Account for the year ended 28 February 2007 **(1)**

Opening stock of raw materials			42,500	
Purchases of raw materials			620,000	
			662,500	
Closing stock of raw materials			39,300	
Direct materials			623,200	**(2)**
Direct wages			153,200	**(1)**
Direct expenses			73,100	**(1)**
Prime cost **(1)**			849,500	
Indirect wages	41,000	**(1)**		
Rent and rates	20,000	**(2)**		
Insurance	1,500	**(2)**		
Depreciation premises	5,200	**(2)**		
Depreciation plant and equipment	8,050	**(2)**	75,750	
			925,250	
Work in progress at start			38,300	
			963,550	
Work in progress at end			37,550	**(1)**
Production cost of finished goods			926,000	
Manufacturing profit			46,300	**(1)**
Transfer to the Trading Account			972,300	
Sales			1,500,000	
Sales returns			4,000	
			1,496,000	**(1)**
Opening stock of finished goods	52,500			
Transfer from Manufacturing Account	972,300	**(1of)**		
	1,024,800			
Closing stock of finished goods	78,750			
Gross profit			946,050	
Cost of sales			549,950	
Loan interest	2,400	**(2)**		
Rent and rates	5,000	**(1)**		
Insurance	300	**(1)**		
Office expenses	140,500	**(1)**		
Bad debts	1,100	**(1)**		
Depreciation premises	1,300	**(1)**		
Depreciation plant and equipment	1,150	**(1)**		
Provision for doubtful debts	250	**(2)**	152,000	**(1)**
			397,950	
Manufacturing profit	46,300	**(1of)**		
Provision for unrealised profit	1,250	**(1)**	45,050	
Net profit			443,000	

[32]

2505 Jun 2007 Bedford Question 1 Mark scheme continued

(b) The revaluation is a capital reserve.
Capital reserves are not allowed to be used for the payment of a cash dividend.
The creation of a revaluation is a book entry and no cash has been generated for the payment of dividends.
The capital reserve will increase the asset value of the company and the shareholders interests and is in the accounts to reflect a true and fair view of the company accounts.
Cash can only be realised if the asset is sold.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

Total marks [38]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2006 Proctor Question 3

3 Ponting plc has an authorised share capital of £8 000 000. On 1 November 2006, it had already issued 6 000 000 fully paid ordinary shares at a par value of £0.50 each. It has offered the public a further 4 000 000 ordinary shares at £1.25 each.

The terms of the issue were £0.50 payable on application, £0.60 on allotment and the balance at a later date.

On 6 November 2006 applications were received for 5 000 000 ordinary shares. On 12 November 2006 applications for 500 000 shares were rejected and the application monies returned to the applicants.

The remainder of the excess application money was retained to be set off on a pro rata basis against the amount due on allotment. The amount due on allotment money was received in full on 20 November 2006.

REQUIRED

(a) The ledger accounts to record the above transactions to 20 November 2006 (balancing of the accounts is not required). [17]

(b) Using illustrations from the information above explain each of the following:

(i) par value; [2]
(ii) authorised share capital; [2]
(iii) share premium. [2]

(c) In addition to the ordinary share issue, Ponting plc is also considering an issue of debentures. Discuss the implications to Ponting plc of an issue of debentures. [6]

Total marks [29]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2006 Proctor Question 3 Mark scheme

1 (a)

Net Profit before tax		142,000	
Tax		52 000	**(1)**
		90,000	
Profit & Loss b/f		23 000	**(1)**
		113,000	
Dividends	41,000 **(1)**		
Reserves	50,000 **(1)**	91,000	
Profit & Loss c/f		22,000	**(1)**

Net cash flow from operating activities

Net profit	142,000	
Depreciation	80,000	**(2)**
Loss on sale	7,000	**(2)**
Increase in stock	(20,000)	**(1)**
Increase in debtors	(18,000)	**(1)**
Increase in creditors	4,000	**(1)**
Increase in accruals	2,000	**(1)**
	197,000	**(1)**

Kingdom plc
Cash Flow Statement for the year ended 31 May 2006 **(1)**

Net cash flow from operating activities	197,000	
Taxation	(42,000)	**(2)**
Capital expenditure		
Purchase of fixed assets	(352,000)	**(4)**
Proceeds of sale	5,000	**(1)**
Equity dividends paid	(39,000)	**(2)**
Financing		
Issue of shares	100,000	**(1)**
Loan	100,000	**(1)**
Increase/decrease in cash	(31,000)	**(1)**

[27]

(b)

Current ratio	1.11:1 **(1)**	1.01:1 **(1)**	
Acid test	0.53:1 **(1)**	0.40:1 **(1)**	**[4]**

2505 Jun 2006 Proctor Question 3 Mark scheme continued

(c) The cash flow position has weakened as evidenced by the liquidity ratios.
The expansion has reduced the liquidity from having a bank deposit of £20,000 to an overdraft of £9,000.
The cash flow has also weakened by the high stock holding which has increased by £20,000.

The purchase of fixed assets cost £352,000 of which £200,000 resulted in extra capital from the loan issue and share issue. £152,000 was paid from cash generated from trading and proceeds of sale.

(4 x 2 marks)
(1 per point, plus 1 for development) **[8]**

Total marks [39]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2005 Wastling Question 3

3 The following Trial Balance was extracted from the books of Wastling Ltd on 31 March 2005.

	£	£
Stocks at 1 April 2004:		
Raw materials	38 000	
Work in progress	42 000	
Finished goods	53 000	
Purchase of raw materials	520 000	
Direct wages	150 000	
Indirect wages	75 000	
Debtors	82 000	
Creditors		53 000
Sales		1 800 000
Plant and machinery at cost	180 000	
Provision for depreciation of plant and machinery		80 000
General office expenses	170 000	
Bad debts	3 000	
Provision for doubtful debts		5 000
Profit and Loss Account b/d	25 000	
General reserves		30 000
Ordinary shares (50 pence each)		300 000
Rates and insurance	18 000	
Debenture interest	4 000	
8% Debentures (1999-2009)		100 000
Bank	98 000	
Factory overheads	74 000	
Premises	836 000	
	2 368 000	2 368 000

2505 Jun 2005 Wastling Question 3 continued

Additional information:

(i) Stocks as at 31 March 2005:

	£
Raw materials	32 000
Work in progress	54 000
Finished goods	60 000

(ii) Plant and machinery purchased on 1 April 2004 for £20 000 had been incorrectly debited to the purchase of raw materials. No correction has been made.

(iii) Plant and machinery is used only in the factory. Depreciation is to be provided using the reducing balance method, at a rate of 20% per annum. No depreciation is charged on premises.

(iv) The premises were revalued to £900 000 on 1 March 2005. No entries have been made in the accounts.

(v) Rates and insurance are apportioned between the factory and the office on the basis of 70:30. Insurance of £3 000 is prepaid.

(vi) Indirect wages of £4 800 are owing at 31 March 2005.

(vii) Provision for doubtful debts is to be provided at 5% of debtors.

(viii) Corporation tax is estimated at £220 000.

(ix) The directors have recommended an ordinary dividend of 60 pence per share and a transfer to general reserves of £50 000.

REQUIRED

(a) A Manufacturing, Trading and Profit and Loss Account for Wastling Ltd for the year ended 31 March 2005 (for internal use). [29]

(b) A Balance Sheet as at 31 March 2005. [15]

2505 Jun05

Total marks [44]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jun 2005 Wastling Question 3 Mark scheme

3 (a) Wastling Ltd
Manufacturing Trading and Profit and Loss Account for year ended 31-March 2005 **(1)**

Opening stock of material			38,000	**(1)**
Purchase of raw materials			500,000	**(1)**
			538,000	
Closing stock			32,000	**(1)**
Cost of direct material			506,000	**(1)**
Direct wages			150,000	**(1)**
Prime cost **(1)**			656,000	
Indirect wages	79,800			**(1)**
Depreciation plant and machinery	24,000			**(2)**
Rates and insurance	10,500			**(2)**
Factory overheads	74,000			**(1)**
			188,300	
Production cost			844,300	
Opening stock of work in progress			42,000	
Closing stock of work in progress			(54,000)	**(1)**
Production cost of finished goods			832,300	
Sales			1,800,000	**(1)**
Opening stock of goods	53,000			
Production cost	832,300	**(1of)**		
	885,300			
Closing of stock	(60,000)			
			825,300	
Gross profit			974,700	
Provision for doubtful debts			900	**(2)**
			975,600	
Rates and insurance	4,500	**(2)**		
General Office expenses	170,000	**(1)**		
Bad debts	3,000	**(1)**		
Debenture interest	8,000	**(2)**	185,500	
Profit before tax			790,100	
Corporation tax			220,000	**(1)**
Profit after tax			570,100	
Profit and Loss			(25,000)	**(1)**
			545,100	
Reserves	50,000	**(1)**		
Proposed dividends	360,000	**(2)**	410,000	
Retained profit			135,100	

[29]

2505 Jun 2005 Wastling Question 3 Mark scheme continued

(b) Balance Sheet as at 31 March 2005

Fixed Assets					
Premises				900,000	**(1)**
Machinery				96,000	**(1)**
				996,000	
Current Assets					
Stock:					
Materials	32,000				
Work in progress	54,000				
Finished goods	60,000	146,000	**(1)**		
Debtors		77,900	**(1)**		
Prepaid		3,000			
Bank		98,000			
		324,900			
Creditors due in less than 1 year					
Creditors		53,000			
Accruals		4,800	**(1)**		
Interest		4,000	**(1)**		
Taxation		220,000	**(1)**		
Dividends		360,000	**(1)**		
		641,800			
Net current assets				(316,900)	
				679,100	
Creditors due in more than 1 year	**(1)**				
8% Debentures				(100,000)	**(1)**
				579,100	
Finance by:					
Ordinary shares				300,000	**(1)**
General reserve				80,000	**(1)**
Revaluation reserve **(1)**				64,000	**(1)**
Retained profit				135,100	**(1of)**
				579,100	

[15]

Total marks [44]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jan 2005 Gwilliam Question 3

3 On 31 December 2004 the following balances were extracted from the books of Gwilliam Ltd.

	£
Stocks 1 January 2004:	
Raw materials	41 000
Work in progress	52 200
Finished goods	66 880
Purchases: Raw materials	1 200 000
Sales	2 036 000
Direct wages	280 000
Indirect wages	60 000
Debtors	220 000
Debenture interest	2 500
Rates and Insurance	15 000
Administration expenses	58 000
Premises at cost	500 000
Rent receivable	4 000
Provision for depreciation – Premises	60 000
10% Debentures (1999–2009)	50 000
Plant and machinery at cost	150 000
Provision for depreciation – Plant and Machinery	60 000
Provision for unrealised profit in goods manufactured	6 080
Provision for doubtful debts	4 400
Issued Share Capital £1 Ordinary Shares	600 000

2505 Jan 2005 Gwilliam Question 3 continued

Additional information:

(I) Stocks as at 31 December 2004:

Raw materials	43 000
Work in progress	26 100

The company transfers finished goods from the factory to the Trading Account at a cost of £704 per unit, this being factory cost plus 10% manufacturing profit. These figures have been unchanged for the last two years.

Provision is to be made for unrealised profit on the stock of finished goods at 31 December 2004.

(II) Provision is to be made for depreciation as follows:
Premises: 2% per year on cost apportioned 60:40 between factory and administration.

Plant and machinery: 20% reducing balance method.

(III) Sales have been at a constant price during the year with 2545 units sold.

(Iv) Rates and insurance are to be apportioned between factory and administration in the ratio of 70:30. Insurance of £2000 is owing.

(v) Provision for doubtful debts is to be provided at 2.5% of debtors.

REQUIRED

(a) The Manufacturing, Trading and Profit and Loss Account for the year ended 31 December 2004 (internal use only, not for publication). [30]

(b) Gwilliam Ltd has just received an additional large order. The Directors are considering the possibility of raising more short term funds to purchase the required stock. Evaluate whether it would be better to fund the purchase of the stock through either a bank overdraft or factoring. [8]

Total marks [38]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jan 2005 Gwilliam Question 3 Mark scheme

3 **(a)**

Gwilliam Ltd
Manufacturing, Trading and Profit and Loss Account for the year ended 31 December 2004 **(1)**

Opening stock of materials			41 000	**(1)**
Purchases			1 200 000	**(1)**
			1 241 000	
Closing stock			43 000	**(1)**
Cost of raw materials consumed			1 198 000	
Direct wages			280 000	**(1)**
Prime Cost **(1)**			1 478 000	
Factory Overheads				
Indirect wages	60 000	**(1)**		
Rates	11 900	**(2)**		
Depreciation premises	6 000	**(2)**		
Depreciation plant and machinery	18 000	**(2)**	95 900	
			1 573 900	
Work in progress at start			52 200	
Work in progress at the end			(26 100)	**(1)**
Production cost of finished goods			1 600 000	
Manufacturing profit			160 000	**(1of)**
Finished goods transferred to trading account			1 760 000	
Sales			2 036 000	**(1)**
Less cost of sales				
Opening stock of finished goods	66 880	**(1)**		
Transfer of manufactured goods	1 760 000	**(1of)**		
	1 826 880			
Closing stock of finished goods	35 200	**(2)(1of)**	1 791 680	
Gross profit			244 320	
Rent receivable			4 000	**(1)**
			248 320	
Debenture interest	5 000	**(1)**		
Rates	5 100	**(1)**		
Administration expenses	58 000	**(1)**		
Depreciation Premises	4 000	**(2)**		
Increase in doubtful debts provision	1 100	**(1)**	73 200	
			175 120	
Manufacturing profit	160 000	**(1)**		
Decrease in provision for unrealised profit	2 880	**(2)**		
			162 880	
Net profit			338 000	

[30]

2505 Jan 2005 Gwilliam Question 3 Mark scheme continued

(b)

Overdraft:

- Short term borrowing requirement to help with short term cash flow problems such as payment to trade suppliers.
- Easy to arrange with low interest rates
- Not secured on the assets of a company such as a mortgage or loan.
- An overdraft is repayable on demand by the bank
- Problems with the bank if overdraft limit is exceeded

Factoring:

- Improves the cash flow by selling debts to factoring company and will receive an agreed percentage on their invoices.
- Reduces bad debts and administration cost of the sales ledger
- Will reduce the profits of the company because of the charges made by the factoring company.
- Will need to measure profitability against liquidity.
- Some debts may be of very high risk and can not be factored

(4 x 2 marks)
(1 for point plus 1 for development)

[8]

Total marks [38]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jan 2002 George Edwards Question 1

1 On 30 April 2001 the following balances were extracted from the books of George Edwards Manufacturing:

		£
Stocks 1 May 2000	Raw materials	12 050
	Work in progress	8 300
	Finished goods	80 000
Purchases of raw materials		85 000
Manufacturing wages		50 050
Sales		240 000
Provision for doubtful debts		2 500
Rent, lighting and heating		3 230
Direct manufacturing expenses		6 700
Indirect manufacturing expenses		27 470
Plant and equipment at cost		80 000
Provision for depreciation – plant and machinery		27 000
Office fixtures at cost		45 000
Provision for depreciation – office fixtures		15 000
Debtors		34 000

Additional information:

(i) Stocks as at 30 April 2001:

Raw materials	£11 800
Work in progress	£5 370
Finished goods	£55 000

(ii) Rent, lighting and heating are apportioned between the factory and office on the basis of 4:1. Heating of £770 was owed at 30 April 2001.

(iii) Provision for depreciation is to be made as follows:
Plant and equipment: 20% on cost, apportioned 9:1 between factory and office.
Office fixtures: 25% on the reducing balance basis.

(iv) Manufactured goods were transferred to the Trading Account at a value of £195 000 for the year ended 30 April 2001.

2505 Jan 2002 George Edwards Question 1 continued

Additional information:

(i) Stocks as at 30 April 2001:

Raw materials	£11 800
Work in progress	£5 370
Finished goods	£55 000

(ii) Rent, lighting and heating are apportioned between the factory and office on the basis of 4:1. Heating of £770 was owed at 30 April 2001.

(iii) Provision for depreciation is to be made as follows:

Plant and equipment:	20% on cost, apportioned 9:1 between factory and office.
Office fixtures:	25% on the reducing balance basis.

(iv) Manufactured goods were transferred to the Trading Account at a value of £195 000 for the year ended 30 April 2001.

REQUIRED

(a) The Manufacturing and Trading Account for the year ended 30 April 2001. [28]

(b) George Edwards Manufacturing makes provisions for doubtful debts and depreciation of fixed assets.

Explain **two** accounting concepts, in each case, that are applied when making provisions for

(i) doubtful debts

(ii) depreciation

[8]

Total marks [36]

The Preparation of Final Accounts for Limited Companies: Manufacturing Organisations

2505 Jan 2002 George Edwards Question 1 Mark scheme

1 (a) George Edwards Manufacturing
Manufacturing and Trading Account for the year ended 30 April 2001 (1)

	£		£	
Opening stock of raw materials			12,050	(1)
Purchases of raw materials			85,000	(1)
			97,050	
Closing stock of raw materials			11,800	(1)
Cost of raw materials consumed			85,250	(1)
Manufacturing wages			50,050	(1)
Direct manufacturing expenses			6,700	(2)
Prime cost (1)			142,000	(1 of)
Overheads:				
Rent, lighting and heating	3,200	(2)		
Indirect manufacturing expense	27,470	(1)		
Plant and equipment	14,400	(2)		
			45,070	(1)
			187,070	
Work in Progress				
At start	8,300	(1)		
At close	(5,370)	(1)		
			190,000	
Manufacturing Profit			5,000	(2)
Transfer to Trading Account			195,000	(1)
Sales			240,000	(1)
Less				
Opening stock of finished goods	80,000	(1)		
Goods Transferred from Manufacturing Account	195,000	(1)		
	275,000			
Closing stock of finished goods	55,000	(1)		
Cost of Sales (1)			220,000	
Gross Profit			20,000	(2)

[28]

2505 Jan 2002 George Edwards Question 1 Mark scheme cont

(b) Matching/Accruals **(1)**
The allocation of expenditure to the accounting period(s) in which the benefit of that expenditure has been accrued. **(1)**
Prudence **(1)**
The exercise of caution in the identification of profits through the provision for anticipated losses and only recording profits when materialised. **(1)**
Consistency **(1)**
Whatever method is used this method should be used consistently year after year.**(1)**
Going concern **(1)**
Assumption made that the business is going to continue to trade. **(1)**

(i) Provision for bad debts, primarily the application of prudence concept, accruals reasoning relating concepts above.

(ii) Provision for depreciation primarily the application of matching/going concern/consistency concepts and reasoning relating concepts above. **[8]**

Question Total [36]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2007 Lister Question 2

2 Lister plc planned to implement an expansion programme during the year ended 31 December 2006. The Balance Sheets at 31 December 2005 and 2006 are shown below.

	31 December 2005		31 December 2006	
	£	£	£	£
Fixed Assets (net)		1 000 000		1 700 000
Current Assets				
Stock	420 000		480 000	
Debtors	210 000		180 000	
Prepayment	20 000		10 000	
Bank	130 000		–	
	780 000		670 000	
Creditors falling due within one year				
Creditors	118 000		150 000	
Corporation tax	90 000		70 000	
Bank overdraft	–		110 000	
Dividends	60 000		80 000	
	268 000		410 000	
Net Current Assets		512 000		260 000
		1 512 000		1 960 000
Creditors falling due after more than one year				
Loans		150 000		220 000
		1 362 000		1 740 000
Capital and Reserves				
Ordinary Shares		700 000		900 000
Share Premium		350 000		450 000
Revaluation Reserve		–		100 000
General Reserve		200 000		200 000
Profit and Loss		112 000		90 000
		1 362 000		1 740 000

Additional information.

(I) The total depreciation included in the accounts was £420 000 at 31 December 2005 and £530 000 at 31 December 2006.

(II) During the year ended 31 December 2006 a fixed asset costing £300 000, book value £90 000, was sold for £40 000 cash. No other disposals took place.

(III) The revaluation reserve represents a revaluation of premises during the year ended 31 December 2006.

2505 Jun 2007 Lister Question 2 continued

REQUIRED

(a) A Cash Flow Statement in accordance with FRS1 for the year ended 31 December 2006. [25]

(b) Comment on the financial implications for Lister plc of its expansion plans. [8]

Total marks [33]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2007 Lister Question 2 Mark scheme

2 Lister plc planned to implement an expansion programme during the year ended 31 December 2006. The Balance Sheets at 31 December 2005 and 2006 are shown below.

	31 December 2005		31 December 2006	
	£	£	£	£
Fixed Assets (net)		1 000 000		1 700 000
Current Assets				
Stock	420 000		480 000	
Debtors	210 000		180 000	
Prepayment	20 000		10 000	
Bank	130 000		–	
	780 000		670 000	
Creditors falling due within one year				
Creditors	118 000		150 000	
Corporation tax	90 000		70 000	
Bank overdraft	–		110 000	
Dividends	60 000		80 000	
	268 000		410 000	
Net Current Assets		512 000		260 000
		1 512 000		1 960 000
Creditors falling due after more than one year				
Loans		150 000		220 000
		1 362 000		1 740 000
Capital and Reserves				
Ordinary Shares		700 000		900 000
Share Premium		350 000		450 000
Revaluation Reserve		–		100 000
General Reserve		200 000		200 000
Profit and Loss		112 000		90 000
		1 362 000		1 740 000

Additional information.

(I) The total depreciation included in the accounts was £420 000 at 31 December 2005 and £530 000 at 31 December 2006.

(II) During the year ended 31 December 2006 a fixed asset costing £300 000, book value £90 000, was sold for £40 000 cash. No other disposals took place.

(III) The revaluation reserve represents a revaluation of premises during the year ended 31 December 2006.

2505 Jun 2007 Lister Question 2 Mark scheme continued

(b) A large decrease in the cash balance as a result of the expansion plans.
Problems with short term liquidity the current ratio has fallen from 2.9:1 to 1.6.
The acid test shows a problem with the payment of short term debts it has fallen from 1.3:1 to 0.5:1.
The company has increased long term borrowing which has increased the gearing ratio from 10% to 11%.
Lister plc is still a low geared company and low risk.
Investment in fixed assets is the main reason for a negative cash balance.
New investment may increase the profits of the company and return on capital employed.
An increase in share capital of £300,000 will increase the amount of cash required to meet the extra dividend payments to ordinary shareholders.

(4 x 2 marks)
(1 for point plus 1 for development) **[8]**

Total marks [33]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2006 Kinghorn Question 1

1 The Balance Sheets for the last two years for Kinghorn plc are shown below. Kinghorn plc implemented an expansion programme during the year ended 31 May 2006.

	31 May 2005		31 May 2006	
	£	£	£	£
Fixed assets (net)		300 000		600 000
Current assets				
Stock	70 000		90 000	
Debtors	38 000		56 000	
Bank	20 000		–	
Cash	8 000		6 000	
	136 000		152 000	
Creditors due in less than one year				
Creditors	38 000		42 000	
Corporation Tax	42 000		52 000	
Overdraft	–		9000	
Dividends	39 000		41 000	
Accruals	4000		6000	
	123 000		150 000	
Net current assets		13 000		2 000
		313 000		602 000
Creditors due in more than one year				
Loans		50 000		150 000
		263 000		452 000
Capital and Reserves				
£1 Ordinary shares		150 000		200 000
Share premium		50 000		100 000
General reserve		40 000		90 000
Revaluation reserve		–		40 000
Profit and loss		23 000		22 000
		263 000		452 000

2505 Jun 2006 Kinghorn Question 1 continued

Additional information:

(i) The total depreciation provision incorporated in the Balance Sheets was £90 000 at 31 May 2005 and £152 000 at 31 May 2006.

(ii) During the year ended 31 May 2006 a fixed asset costing £30 000, book value £12 000, was sold for £5 000. No other disposals took place.

(iii) The revaluation reserve represents a revaluation of premises during the year ended 31 May 2006.

REQUIRED

(a) The Cash Flow Statement in accordance with good accounting format for the year ended 31 May 2006. [27]

(b) Calculate the current ratio and the liquid ratio as at 31 May for **each** year. [4]

(c) Evaluate the effects of the expansion policy on the liquidity position of Kinghorn plc. [8]

Total marks [39]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2006 Kinghorn Question 1 Mark scheme

1 (a)

Net Profit before tax		142,000	
Tax		52 000	**(1)**
		90,000	
Profit & Loss b/f		23 000	**(1)**
		113,000	
Dividends	41,000 **(1)**		
Reserves	50,000 **(1)**	91,000	
Profit & Loss c/f		22,000	**(1)**

Net cash flow from operating activities

Net profit	142,000	
Depreciation	80,000	**(2)**
Loss on sale	7,000	**(2)**
Increase in stock	(20,000)	**(1)**
Increase in debtors	(18,000)	**(1)**
Increase in creditors	4,000	**(1)**
Increase in accruals	2,000	**(1)**
	197,000	**(1)**

Kingdom plc
Cash Flow Statement for the year ended 31 May 2006 **(1)**

Net cash flow from operating activities	197,000	
Taxation	(42,000)	**(2)**
Capital expenditure		
Purchase of fixed assets	(352,000)	**(4)**
Proceeds of sale	5,000	**(1)**
Equity dividends paid	(39,000)	**(2)**
Financing		
Issue of shares	100,000	**(1)**
Loan	100,000	**(1)**
Increase/decrease in cash	(31,000)	**(1)**

[27]

(b)

Current ratio	1.11:1 **(1)**	1.01:1 **(1)**
Acid test	0.53:1 **(1)**	0.40:1 **(1)**

[4]

2505 Jun 2006 Kinghorn Question 1 Mark scheme continued

(c) The cash flow position has weakened as evidenced by the liquidity ratios. The expansion has reduced the liquidity from having a bank deposit of £20,000 to an overdraft of £9,000.
The cash flow has also weakened by the high stock holding which has increased by £20,000.

The purchase of fixed assets cost £352,000 of which £200,000 resulted in extra capital from the loan issue and share issue. £152,000 was paid from cash generated from trading and proceeds of sale.

(4 x 2 marks)
(1 per point, plus 1 for development) **[8]**

Total marks [39]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jan 2005 Kimmitt Question 2

2 The Balance Sheets for Kimmitt Ltd for the last two years are shown below.

Balance Sheets as at:

	31 December 2003		31 December 2004	
Fixed Assets	£	£	£	£
Goodwill		60 000		–
Tangible fixed assets at cost	500 000		720 000	
Depreciation	280 000	220 000	360 000	360 000
Investments		100 000		60 000
		380 000		420 000
Current Assets				
Stock	150 000		160 000	
Debtors	32 000		38 000	
Bank	45 000		–	
Cash	6 000		4 000	
	233 000		202 000	
Creditors falling due in less than one year				
Creditors	94 000		38 000	
Corporation tax	62 000		43 000	
Bank overdraft	–		26 000	
Dividends	34 000		18 000	
	190 000		125 000	
Net Current Assets	43 000			77 000
Total Assets less current liabilities	423 000			497 000
Capital and Reserves				
£1 Ordinary Shares		250 000		262 500
Share Premium		125 000		137 500
General Reserve		20 000		38 000
Profit and Loss Account		28 000		59 000
		423 000		497 000

Tangible fixed assets originally costing £42 000 with a book value of £9 000 were sold for £3 000 cash during the year ended 31 December 2004.

An interim dividend of £20 000 was paid during the year ended 31 December 2004.

2505 Jan 2005 Kimmitt Question 2 continued

REQUIRED

(a) The Cash Flow Statement in accordance with good accounting format for the year ended 31 December 2004. [24]

(b) **(i)** Explain the difference between the Share Premium and General Reserve. [4]

(ii) How can the balance on each of these accounts be used? [4]

Total marks [32]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jan 2005 Kimmitt Question 2 Mark scheme

2 (a)

Net Profit Before Tax			130 000	
Tax			43 000	**(1)**
			87 000	
Profit & Loss b/f			28 000	**(1)**
			115 000	
Dividends	38 000	**(1)**		
General Reserves	18 000	**(1)**		
			56 000	
Profit and loss c/f			59 000	**(1)**

Net Cash Flow From Operating Activities		
Net Profit	130 000	**(5)**
+ Depreciation	113 000	**(2)**
+ Loss	6 000	**(2)**
+ Goodwill	60 000	**(1)**
Increase Stock	(10 000)	**(1)**
Increase Debtors	(6 000)	**(1)**
Decrease Creditors	(56 000)	**(1)**
	237 000	**(1)**

Kimmitt Ltd

Cash Flow Statement for the year ended 31 December 2004 **(1)**

Net Cash Flow from Operating Activities	237 000	**(14)**
Returns on Investment and Servicing of Finance		
Taxation		
Corporation tax	(62 000)	**(1)**
Capital Expenditure		
Purchase of fixed assets	(262 000)	**(2)**
Proceeds of sale of fixed assets	3 000	**(1)**
Sale of investments	40 000	**(1)**
Equity Dividends		
Dividends paid	(54 000)	**(2)**
Financing		
Issue of Shares	25 000	**(1)**
Decrease in cash	(73 000)	**(1)**

[24]

2505 Jan 2005 Kimmitt Question 2 Mark scheme continued

(b) (i)

- The Share Premium Account is a Capital Reserve
- The Share Premium exists because the company has issued share above the par value
- The Share Premium Account cannot be used to pay cash dividends
- The balance on the Share Premium can be used to issue bonus shares and write off the expenses of a new issue

(2 x 2 marks)
(1 for point plus 1 for development) **[4]**

(ii)

- The General Reserve is an example of a Revenue Reserve
- The General Reserve is retained profit that is kept back by the directors and paid as cash dividends
- The balance on the reserve is the property of the Equity holders and can be used in the future to pay a dividend

(2 x 2 marks) **[4]**
(1 for point plus 1 for development)

Total marks [32]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2002 Sharma Question 2

2 The Balance Sheets as at 31 December of Sharma plc are shown below.

	2000		2001	
	£	£	£	£
Fixed assets (net)		420 000		530 000
Current assets				
Stock	42 000		46 000	
Debtors	28 000		20 000	
Cash at bank	10 000		3 000	
	80 000		69 000	
Creditors for less than 1 year				
Creditors	16 000		25 000	
Corporation tax	40 000		42 000	
Dividends	20 000		30 000	
	76 000		97 000	
Net current assets		4 000		(28 000)
		424 000		502 000
Capital and reserves				
£1 ordinary shares		300 000		350 000
General reserve		44 000		77 000
Profit and loss		80 000		75 000
		424 000		502 000

Additional information:

1 Tangible fixed assets costing £180 000 were purchased during the year ended 31 December 2001. There were no disposals of fixed assets.

2 Sharma plc paid an interim dividend of £18 000 during the year ended 31 December 2001.

REQUIRED

(a) Prepare a Cash Flow Statement, in accordance with good accounting practice, for the year ended 31 December 2001. [22]

(b) Evaluate the usefulness of a cash flow statement for Sharma plc. [8]

(c) Assess the liquidity position of Sharma plc. [10]

Total marks [40]

The Preparation of Final Accounts for Limited Companies: Cash Flow Statements

2505 Jun 2002 Sharma Question 2 Mark scheme

2 (a) Calculation of Net Profit

Net Profit	118,000	**(1)**	Net Profit	118000	
Taxation	(42,000)	**(1)**	Depreciation	70000	**(2)**
	76,000		Stock	(4000)	**(1)**
Profit and Loss b/f	80,000	**(1)**	Debtors	8000	**(1)**
	156,000		Creditors	9000	**(1)**
Reserves	(33,000)	**(1)**			
Dividend	(48,000)	**(1)**			
	75,000			201,000	

Sharma plc
Cash Flow Statement for year ended 31 December 2001 **(1)**

Net cash flow from operating activities **(1)**	201,000	**(10)**	
Returns on investment and servicing of finance			
Dividends payable	(38,000)	**(2)**	
Taxation			
Corporation Tax	(40,000)	**(2)**	
Investing Activities			
Purchase of Fixed Assets	(180,000)	**(2)**	
Net cash outflow before Financing	(57,000)		
Financing			
Issue of Shares	50,000	**(2)**	
Decrease in Cash **(1)**	(7,000)	**(1)**	**[22]**

2505 Jun 2002 Sharma Question 2 Mark scheme continued

(b)

- Shows all the cash inflow and outflows for the financial year.
- Allows the user of accounting information to evaluate the liquidity of Sharma plc.
- The cash flow statement is prepared using cash accounting and therefore must be adjusted for book entries prepayments and accruals.
- The cash flow statement shows the user of accounting information increase or decrease in cash and not the transactions that relate to profit.
- Profit and Loss Account prepared using accrual accounting.

(4 x 2 marks)
(1 for point plus 1 for development) **[8]**

(c)

Current Ratio	$\frac{69,000}{97,000}$ = 0.71:1 **(2)**	$\frac{80,000}{76,000}$ = 1.05:1 **(2)**
Acid Test	$\frac{23,000}{97,000}$ = 0.24:1 **(2)**	$\frac{38,000}{76,000}$ 0.5:1 **(2)**

- Poor liquidity position declined from previous year. Acid test from 2000 showed 0.5:1. A problem with paying short–term debts.
- Increase in dividends and corporation tax and creditors.
- Difficulty on paying proposed dividends.
- Shortage of cash due to purchase of fixed assets.

(5 x 2 marks)
(Ratios maximum 6 marks)
(Narrative 1 for point plus 1 for development) **[10]**

Financing: Accounting for Changes in Capital Structure

Financing: Accounting for changes in Capital Structure

F013 Specimen Bounty Question 3

3 The following is an extract from the Balance Sheet of Bounty plc as at 31 December 2006.

Capital and Reserves

	£
600,000 Ordinary shares at 25 pence each	150,000
Share Premium	75,000
Profit and Loss	80,000

Bounty plc needed £200,000 additional capital to replace machinery.

On 15 July 2007 Bounty plc made a rights issue of 200,000 ordinary shares at a premium of 25 pence per share. All the cash was received in July 2007.

On 1 August 2007 Bounty plc made a bonus issue of one ordinary share for every two ordinary shares in existence on 1 August 2007. The Share Premium Account was utilised to provide for the bonus issue.

The remaining funds required to purchase the machinery were raised by a bank loan on 10 August 2007.

Assume that no additional profits were generated by Bounty plc from 31 December 2006 to 10 August 2007.

REQUIRED

(a) Prepare the following ledger accounts, including the balance carried down in **each** case.

(i) Ordinary Share Capital **[7]**

(ii) Share Premium **[6]**

(iii) Loan **[3]**

(b)* Bounty plc is planning a further expansion of the business during 2008. This will require additional fixed assets costing £250,000. Evaluate the suitability of leasing and debentures for acquiring these additional fixed assets in 2008. **[14]**

Total Marks [30]

Paper Total [80]

Financing: Accounting for changes in Capital Structure

F013 Specimen Bounty Question 3 Mark scheme

3(a)

Ordinary share capital

Bal c/d		300,000	**[2]**	Bal b/d		150,000	**[1]**	
				Bank	**[1]**	50,000	**[1]**	
				Share premium	**[1]**	100,000	**[1]**	
		300,000				300,000		**[7]**

Share premium

Share capital	**[1]**	100,000	**[1]**	Bal b/d		75,000	**[1]**	
Bal c/d		25,000	**[1]**	Bank	**[1]**	50,000	**[1]**	
		125,000				125,000		**[6]**

Loan

Bal c/d		100,000	**[1]**	Bank	**[1]**	100,000	**[1]**	
		100,000				100,000		**[3]**

3(b)*

Advantages and disadvantages of leasing

Will improve the cash flow position of the company because no large cash outflows would be required for the purchase of fixed assets.

A regular payment would be made each month to the leasing company which allows the company to budget each month.

The contract would cover repairs and maintenance which would reduce the cost of repairs and help the cash flow.

A company can have an option to purchase the fixed asset at the end of the lease period and will have to make available the cash required for the purchase.

The type of lease agreement could mean that the company does not own the asset and therefore it will not be shown on the balance sheet.

Financing: Accounting for changes in Capital Structure

F013 Specimen Bounty Question 3 Mark scheme continued

	Advantages and disadvantages of debentures Debentures are long term loan capital and bond holders will not have a vote at the annual general meeting. Debenture holders will be paid a fixed rate of interest. The debenture bond can be taken out for a long period of time before the debenture must be repaid. Debentures are long term debt capital and secured on the assets of the business. Debenture interest is an expense of the business and must be repaid regardless of the profit or loss situation. The business must make provision to have the cash available to repay the debentures. **Comparison and recommendation** The nature of the fixed assets to be acquired can influence funding. If long term, then debentures may be preferred. If medium term then leasing may be preferred. If a lease is taken out for a long period, then cost can be high, sometimes higher than outright purchase. In such cases debentures would be preferred. A lease agreement may be easier to obtain than the issue of debentures, however the fixed asset acquired would remain the property of the leasing company. Funding from a debenture issue may be used to acquire ownership of fixed assets. A recommendation may be influenced by the type of fixed asset, its term and ease of acquiring funding. *(Up to 4 marks for advantages and disadvantages of leasing)* *(Up to 4 marks for advantages and disadvantages of debentures)* *(Up to 4 marks for a comparison and a recommendation)* NB Up to an additional two marks can be awarded for the candidate's quality of written communication (narrative responses)	**[14]**
	Total Marks	**[30]**
	Paper Total	**[80]**

Financing: Accounting for changes in Capital Structure

2505 Jan 2007 Ponting Question 3

3 Ponting plc has an authorised share capital of £8 000 000. On 1 November 2006, it had already issued 6 000 000 fully paid ordinary shares at a par value of £0.50 each. It has offered the public a further 4 000 000 ordinary shares at £1.25 each.

The terms of the issue were £0.50 payable on application, £0.60 on allotment and the balance at a later date.

On 6 November 2006 applications were received for 5 000 000 ordinary shares. On 12 November 2006 applications for 500 000 shares were rejected and the application monies returned to the applicants.

The remainder of the excess application money was retained to be set off on a pro rata basis against the amount due on allotment. The amount due on allotment money was received in full on 20 November 2006.

REQUIRED

(a) The ledger accounts to record the above transactions to 20 November 2006 (balancing of the accounts is not required). [17]

(b) Using illustrations from the information above explain each of the following:

(i) par value; [2]
(ii) authorised share capital; [2]
(iii) share premium. [2]

(c) In addition to the ordinary share issue, Ponting plc is also considering an issue of debentures. Discuss the implications to Ponting plc of an issue of debentures. [6]

Total marks [29]

Financing: Accounting for changes in Capital Structure

2505 Jan 2007 Ponting Question 3 Mark scheme

3 (a)

Bank

Application & allotment		2 500 000	**(1)**	Application & allotment	250 000	**(1)**
Application & allotment	**(1)**	2 150 000	**(1)**			

Application & allotment

Bank		250 000	**(1)**	Bank	2 500 000	**(1)**
Share premium	**(1)**	3 000 000	**(1)**	Bank	2 150 000	**(2)**
Share capital	**(1)**	1 400 000	**(2)**			

Share capital

				Bal b/d	3 000 000	**(1)**
				Application & allotment	1 400 000	**(1)**

Share premium

				Application & allotment	3 000 000	**(2)**

[17]

(b) **(i)** Par value is the issue price of the shares and is also called the nominal value of the share. Ponting Ltd has a par value of £0.50 per share.

(ii) Authorised share Capital is the amount stated in the Memorandum of Association. Ponting Ltd can issue a maximum of 6 000 000 shares at a par value of £0.50.

(iii) Share premium is the difference between the par value and the price of the share. Ponting Ltd has a share premium of £0.75 on each share.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

(c) An alternative to the raising of finance by an issue of ordinary shares.
Debentures are long term loan capital and would increase the debt capital of the company.
Debentures pay a fixed rate of interest and the amount borrowed is charged on the assets of the company.
Debentures are a higher risk and the debenture interest is an expense to the profit and loss account and must be paid regardless of the profit position but ordinary dividends are an appropriation of profit.
Debenture holders do not have voting rights unlike the ordinary shareholders.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

Total marks [29]

Financing: Accounting for changes in Capital Structure

2505 Jan 2006 Hilgerson Question 3

3 The following is an extract from the Balance Sheet of Hilgerson plc as at 31 December 2004.

Capital and Reserves	£
550 000 Ordinary shares at 25 pence each	137 500
Share Premium	55 000
Profit and Loss	60 000

Hilgerson plc needed £50 000 additional capital to replace machinery.

On 20 July 2005 Hilgerson plc made a rights issue of 50 000 ordinary shares at a premium of 25 pence per share. All the cash was received in July 2005.

On 1 August 2005 Hilgerson plc made a bonus issue of one ordinary share for every six ordinary shares in existence on 1 August 2005. The Share Premium Account was utilised to provide for the bonus issue.

The remaining funds required to purchase the machinery were raised by a bank loan on 10 August 2005.

Assume that no additional profits were generated by Hilgerson plc from 31 December 2004 to 10 August 2005.

REQUIRED

(a) Prepare the following ledger accounts, including the balance carried down in **each** case:

(i) ordinary share capital; [7]

(ii) share premium; [7]

(iii) loan. [3]

(b) Prepare a Balance Sheet extract to show the Capital and Reserves section of Hilgerson plc as at 10 August 2005. [3]

(c) **(i)** Identify **three** options which are available to a company for the appropriation of its profits. [3]

(ii) Discuss the circumstances in which **each** option would be appropriate. [9]

Total marks [32]

Financing: Accounting for changes in Capital Structure

2505 Jan 2006 Hilgerson Question 3 Mark scheme

3(a)(i)

Ordinary share capital

Bal c/d	175,000 **(1)**	Bal b/d	137,500 **(1)**
		Bank **(1)**	12,500 **(1)**
		Share premium **(1)**	25,000 **(2)**
	175,000		175,000

[7]

3(a)(ii)

Share Premium

Share capital(1)	25,000 **(1)**	Bal b/d	55,000 **(1)**
Bal c/d	42,500 **(1)**	Bank (1)	12,500 **(2)**
	67,500		67,500

[7]

3(a)(iii)

Loan

Bal c/d	25,000 **(1)**	Bank **(1)**	25,000 (1)
	25,000		25,000

[3]

3(b)

Ordinary shares	175,000 **(1of)**
Share premium	42,500 **(1of)**
Profit and loss	60,000 **(1)**

[3]

Financing: Accounting for changes in Capital Structure

2505 Jan 2006 Hilgerson Question 3 Mark scheme continued

3(b)

Ordinary shares	175,000 **(1of)**	
Share premium	42,500 **(1of)**	
Profit and loss	60,000 **(1)**	**[3]**

3(c)

(i) Payment of cash dividends to shareholders.
Transfer to a revenue/retention of profit.
Issue bonus shares. **[3]**

(ii) The payments of cash dividends to shareholders if the company has the cash to cover the dividend payment. Profits are good and expectation of shareholders is high.
The effect on the market price of the share if a cash dividend is not made to the shareholders.

Transfer to a revenue reserve and retain the profits instead of using to pay cash dividends.
Retain profits or transfer to general reserve will help cash flow if dividends are not paid. The cash could be used for other investments.
Increasing the reserves will improve the equity of the company and will reduce the gearing.

Consider the issue of bonus shares if the cash reserves of the company will not allow a cash dividend.
Bonus shares could also be given to employees as part of a bonus package.
Would increase the share capital and dilute the market price of the share.

(3 x 3 marks) **[9]**

(1 for point plus up to 2 for development) **Total marks [32]**

Financing: Accounting for changes in Capital Structure

2505 Jun 2004 Strange Question 1

1 Strange plc has an issued share capital of 800 000 fully paid ordinary shares of £0.25 each. All of these shares were issued at par value.

The directors of Strange plc decided to offer a further 400 000 ordinary shares at a price of £0.50 per share. The terms of the issue were:

	£
Payable on application	0.10
Payable on allotment (including the premium)	0.35
First and final call	0.05

Strange plc received applications for 600 000 shares from the general public. Strange plc returned the application money for 200 000 shares. All the remaining applicants were allotted shares to the full issue amount.

All the monies due on allotment were received. All the call money was received apart from the money due on 500 shares.

REQUIRED

(a) Journal entries to record all of the above transactions (narratives are not required). [24]

(b) Explain the terms *authorised share capital* and *issued share capital*. [4]

(c) The directors of Strange plc are considering the possibility of a bonus issue of shares.

(i) Explain the term *bonus issue*. [2]

(ii) Assess the reasons why the directors might consider issuing bonus shares. [6]

Total marks [36]

Financing: Accounting for changes in Capital Structure

2505 Jun 2004 Strange Question 1 Mark scheme

1 **(a)**

	DR		CR	
Bank	60,000	**(1)**		
Application and allotment			60,000	**(1)**
Application and allotment	20,000	**(1)**		
Bank			20,000	**(1)**
Bank **(1)**	140,000	**(1)**		
Application and allotment **(1)**			140,000	**(1)**
Application and allotment **(1)**	100,000	**(1)**		
Share premium **(1)**			100,000	**(1)**
Application allotment **(1)**	80,000	**(1)**		
Share capital **(1)**			80,000	**(1)**
Bank **(1)**	19,975	**(1)**		
Final call **(1)**			19,975	**(1)**
Final call **(1)**	20,000	**(1)**		
Share capital **(1)**			20,000	**(1)**

[24]

Financing: Accounting for changes in Capital Structure

2505 Jun 2004 Strange Question 1 Mark scheme

(b) Maximum legal amount a company can issue. Stated in the Memorandum of Association.

(2 x 1 mark)

Amount issued and taken up by investors. Appears on the face of the balance sheet at the par value/nominal value.

(2 x 1 mark) **[4]**

(c) **(i)** Free issue of shares. To existing shareholders or employees.

(2 x 1 mark) **[2]**

(ii) Give to ordinary shareholders in place of a dividend.
Bonus shares are considered if cash reserves are not sufficient for payment of dividends.
Give to existing shareholders to reward loyalty.
Used to reward managers in a bonus system.
Consider bonus shares to dilute market value.
Capitalisation of reserves if proportion of ordinary share capital is high to existing reserves.

(2 x 3 marks)
(1 for point plus up to 2 for development) **[6]**

Total marks [36]

Financing: Accounting for changes in Capital Structure

2505 Jun 2003 Soundworks Question 2

2 Soundworks plc has an authorized share capital of 10 000 000 ordinary shares of £0.50 each. As at 1 December 2002 it had already issued 6 000 000 fully paid ordinary shares at par.

The Directors had decided to offer to the public a further 2 000 000 ordinary shares of £0.50 each at £1 each including the premium. The terms of the issue are £0.25 payable on application, £0.60 on allotment and the balance at a later date.

By 6 December 2002 applications had been received for 3 000 000 shares, and on 12 December 2002 applications for 500 000 shares were rejected. The application money was returned to the unsuccessful applicants. The remainder of the excess application money was retained to set off on a pro rata basis against the amount due on allotment. The remainder of the allotment money was received on 28 December 2002.

REQUIRED

(a) Prepare journal entries to record the above transactions up to 28 December 2002. (No narrative required.) [20]

(b) The Directors of Soundworks plc have considered the possibility of a rights issue or a bonus issue. Assess the relative merits of a rights issue and a bonus issue. [8]

Total marks [28]

Financing: Accounting for changes in Capital Structure

2505 Jun 2003 Soundworks Question 2 Mark scheme

2 (a)

Journal

	DR		**CR**	
Bank **(1)**	750,000	**(1)**		
Application & Allotment **(1)**			750,000	**(1)**
Application & Allotment **(1)**	125,000	**(1)**		
Bank **(1)**			125,000	**(1)**
Bank **(1)**	1,075,000	**(1)**		
Application & Allotment **(1)**			1,075,000	**(1)**
Application & Allotment **(1)**	1,000,000	**(1)**		
Share Premium **(1)**			1,000,000	**(1)**
Application & Allotment **(1)**	700,000	**(1)**		
Ordinary Share Capital **(1)**			700,000	**(1)**

[20]

(b) Rights issue involves a cash transaction
Extra capital to improve liquidity of the business
An alternative to fixed interest debt capital
Will improve the gearing ratio
Will cost less than a full issue of shares

Bonus issue free issue of shares
An alternative to using a cash dividend if liquidity is a problem
Can be given for loyalty and increase motivation of employees
Both rights and bonus issue will effect control and voting

(4 x 3 marks maximum of 8)
(1 point plus 2 for development) **[8]**

Total marks [28]

Financing: Accounting for changes in Capital Structure

2505 Jun 2002 Anderson Question 3

3 Anderson Ltd has an issued share capital of 600 000 fully paid ordinary shares of £0.50 each. These were issued at par value.

It offers a further 200 000 ordinary shares to the public at a price of £0.75 per share. The terms of the issue are:

	£
Payable on application	0.30
Payable on allotment (including the premium)	0.35
First and final call	0.10

Applications were received for 300 000 shares. It was decided to return application monies to applicants for 100 000 shares. The remaining applicants were allotted shares exactly to the full issue amount.

All the monies due on allotment and the first and final call were received in full.

REQUIRED

(a) Prepare the following ledger accounts to record these transactions. The balancing of accounts is not required.

- **(i)** Bank [4]
- **(ii)** Application and Allotment [7]
- **(iii)** Ordinary Share Capital [5]
- **(iv)** Share Premium [2]
- **(v)** First and Final Call. [2]

(b) **(i)** Explain the term **bonus issue of shares**. [4]

(ii) State the accounting entries that would be made to record a bonus issue of shares. [2]

Total marks [26]

Financing: Accounting for changes in Capital Structure

2505 Jun 2002 Anderson Question 3 Mark scheme

3 (a)

Bank

A & A	90,000 **(1)**	A & A	30,000 **(1)**
A & A	70,000 **(1)**		
First and Final Call	20,000 **(1)**		

Application and Allotment

Bank	30,000 **(1)**	Bank	90,000 **(1)**
Ordinary Share Capital **(1)**	80,000 **(1)**	Bank	70,000 **(1)**
Share Premium **(1)**	50,000 **(1)**		

Ordinary Share Capital

		Balance b/d	300,000 **(1)**
		A & A **(1)**	80,000 **(1)**
		First and Final Call **(1)**	20,000 **(1)**

Share Premium

		A & A **(1)**	50,000 **(1)**

First and Final Call

Ordinary Share Capital	20,000 **(1)**	Bank	20,000 **(1)**

[20]

(b) **(i)** Free issue of shares
No cash transaction
Given to existing shareholders or employees
(2 x 2 marks)
(1 for point plus 1 for development) **[4]**

(ii) Debit – Share premium **(1)**
Credit – Ordinary Shares **(1)**
Or Debit Revenue Reserves **[2]**

Total [26]

Analysis and Interpretation of Accounts

Analysis and Interpretation of Accounts

F013 Specimen Rose Question 2

2 The following financial data was taken from the accounts of Rose Ltd for the last two financial years ended 31 December.

	2005	2006
	£	£
Sales	6,000,000	8,000,000
Net profit	1,000,000	2,000,000
Capital employed	4,000,000	6,000,000

REQUIRED

(a) Calculate for **each** year:

- the return on capital employed.
- two other profitability ratios. **[6]**

(b) Explain the importance of the return on capital employed percentage to a limited company. **[8]**

Total Marks [14]

F013 Specimen Rose Question 2 Mark scheme

Question Number	Answer	Max Mark
2(a)		
	2005 / 2006 Return on capital employed 25% **[1]** 33.33% **[1]** Net profit as a %age of sales 16.6% **[1]** 25% **[1]** Sales/capital employed 1.5 times **[1]** 1.33 times **[1]**	**[6]**
2(b)	Return on capital employed is the key profitability ratio which shows how much profit is earned for every £ employed. Return on capital employed percentage can be use to compare with previous years and a trend in the profitability over a period of time can be identified A business can use the return on capital employed ratio to compare the return on alternative investments. Investments with a high forecast return on capital can be identified as high risk but high return. A business can compare the return on capital employed percentage with interest rates and the cost of borrowing. The return on capital employed percentage can be used to carry out an interfirm comparison with similar types of firm. For example Tesco and Asda. *(4 x 2 marks)* *(1 for point plus 1 for development)*	**[10]**
	Total Marks	**[16]**

Analysis and Interpretation of Accounts

2505 Jun 2007 Crossan Question 2

3 The following is a summary of the final accounts of Crossan plc for the year ended 31 March 2007.

Profit and Loss Account for the year ended 31 March 2007

	£	£
Turnover		600 000
Cost of sales		280 000
Gross profit		320 000
Distribution costs	90 000	
Administrative expenses	120 000	210 000
Operating profit		110 000
Interest payable		30 000
Profit before tax		80 000
Corporation tax		25 000
Profit after tax		55 000
Profit and loss brought forward		15 000
		70 000
Ordinary dividend	50 000	
Transfer to reserves	10 000	60 000
Retained profit		10 000

Balance Sheet as at 31 March 2007

	£	£
Fixed Assets		900 000
Current Assets		
Stock	220 000	
Debtors	50 000	
Bank	30 000	
	300 000	
Creditors falling due in less than one year		
Creditors	130 000	
Dividends	50 000	
Taxation	25 000	
	205 000	
Net Current Assets		95 000
		995 000
Creditors falling due in more than one year		
5% Debentures		600 000
		395 000
Capital and Reserves		
Ordinary shares of £1		200 000
Share premium		50 000
General reserve		135 000
Retained profit		10 000
		395 000

Authorised share capital is 800 000 £1 shares. The current market value is £2.50 per share.

2505 Jun 2007 Crossan Question 2 continued

REQUIRED

(a) Calculate each of the following (where appropriate calculations should be to two decimal places):

(i) return on capital employed; [2]
(ii) current ratio; [2]
(iii) liquid ratio; [2]
(iv) interest cover; [3]
(v) gearing ratio; [3]
(vi) earnings per share; [2]
(vii) dividend yield; [4]
(viii) price earnings ratio. [3]

(b) The directors of Crossan plc are considering a rights issue of a further 200 000 ordinary shares at £1.50 per share. Discuss how this would affect:

(i) the gearing ratio; [4]
(ii) the capital structure. [4]

Total marks [29]

2505 Jun 2007 Crossan Question 2 Mark scheme

3

(a)

(i)	ROCE	$\frac{110,000}{995,000}$ **(1)** **(1)**	x 100 = 11.1%	
(ii)	Current ratio	$\frac{300,000}{205,000}$ **(1)** **(1)**	= 1.46:1	
(iii)	Acid test	$\frac{80,000}{205,000}$ **(1)** **(1)**	= 0.39:1	
(iv)	Interest cover	$\frac{110,000}{30,000}$ **(1)** **(1)**	= 3.67 times **(1)**	
(v)	Gearing ratio	$\frac{600,000}{995,000}$ **(1)** **(1)**	x 100 = 60.3% **(1)**	Alternative answer: $\frac{600,000}{395,000}$ X 100 = 1.52 =152%
(vi)	EPS	$\frac{55,000}{200,000}$ **(1)** **(1)**	= 27.5 pence	
(vii)	Dividend yield	$\frac{1}{2.5}$ **(2)**	x 25% **(1)** = 10% **(1)**	
(viii)	PE ratio	$\frac{2.5}{0.28}$ **(1)** **(1)**	= 8.9 years **(1)**	Alternative answer: $\frac{2.50}{0.275}$ = 9.09 years

[21]

(b)

(i) The present gearing position is 60.3%.
The issue of ordinary shares will reduce the gearing ratio.

$\frac{600,000}{1,295,000}$ = 46.3%

(2 x 2 marks) **[4]**
(1 for point plus 1 for development)

(ii) Ordinary share capital would increase by £200,000 to £400,000
Equity would be increased by £300,000.
The ordinary shares are issued at a premium which would be £100,000.

(2 x 2 marks) **[4]**
(1 for point plus 1 for development)

Total marks [29]

2505 Jan 2006 Hempinstall Question 2

2 The following financial data was taken from the accounts of Hempinstall Ltd for the last two financial years ended 31 December.

	2004	2005
	£	£
Sales	8 000 000	10 000 000
Net profit	2 000 000	2 000 000
Capital employed	5 000 000	6 000 000

REQUIRED

(a) Calculate for **each** year:

- the return on capital employed
- **two other** profitability ratios. [6]

(b) **(i)** Explain the importance of the return on capital employed to a limited company. [4]

(ii) Describe how the return on capital employed is related to the other ratios calculated in part **(a)**. [2]

(iii) Explain why the return on capital employed for Hempinstall Ltd has declined between 2004 and 2005. [4]

Total marks [16]

Analysis and Interpretation of Accounts

2505 Jan 2006 Hempinstall Question 2 Mark scheme

2(a)

	2004	2005
Return on capital employed	40%(1)	33.33%(1)
Net profit as a % of sales	25%(1)	20%(1)
Sales to capital employed	1.6 times(1)	1.66 times(1)

[6]

2(b)(i)
Return on capital employed is the key profitability ratio which shows how much profit is earned for every £ employed

Very important to be able to compare like with like:

- Previous years results
- Alternative investments and interest rates
- Interfirm

(2 x 2 marks) **[4]**
(1 for point plus 1 for development)

2(b)(ii)
$$\text{Return on capital employed} = \frac{\text{Sales}}{\text{Capital employed}} \times \frac{\text{Net profit}}{\text{Sales}}$$ **[2]**

2(b)(iii)
Net profit margin has fallen by 6.66% to 33.33%.
Large decrease in net profit percentage compared to sales/capital employed.
Sales/capital employed – very small increase. **[4]**

(2 x 2 marks)

Total marks [16]

Analysis and Interpretation of Accounts

2505 Jun 2005 Scholey Question 1

1 The following is a summary of the final accounts of Scholey plc for the year ended 31 March 2005, its first year of trading.

Profit and Loss Account for the year ended 31 March 2005

	£	£
Sales		3 000 000
Cost of Sales		1 500 000
Gross Profit		1 500 000
Expenses		500 000
Net profit before tax		1 000 000
Taxation		400 000
Net profit after tax		600 000
Proposed ordinary dividend	300 000	
Transfer to general reserve	200 000	
		500 000
Retained profit		100 000

Balance Sheet as at 31 March 2005

	£	£
Fixed Assets		600 000
Current Assets		
Stock	500 000	
Debtors	300 000	
Bank	100 000	
	900 000	
Creditors due in less than 1 year		
Creditors	100 000	
Taxation	400 000	
Ordinary dividend	300 000	
	800 000	
Net Current Assets		100 000
		700 000
Financed by		
£1 Ordinary Shares		400 000
General Reserve		200 000
Profit and Loss Account		100 000
		700 000

2505 Jun 2005 Scholey Question 1 continued

Additional information:

(1) All sales and purchases were on a credit basis.

(2) Purchases for the year were £2 000 000.

(3) The market price of one ordinary share is £2.00.

(4) The authorised share capital is 900 000 £1 ordinary shares.

REQUIRED

(a) Calculate the following:

(i) Current ratio; [2]

(ii) Liquid (acid test) ratio; [2]

(iii) Debtor collection period in days; [2]

(iv) Creditor payment period in days; [2]

(v) Earnings per share; [2]

(vi) Dividend cover; [3]

(vii) Dividend yield. [3]

(b) Assess what actions the management of Scholey plc could take regarding each of the following issues for the company:

(i) Liquidity; [6]

(ii) Financing. [6]

(c) Explain the significance of the dividend cover to the ordinary shareholders of Scholey plc. [2]

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jun 2005 Scholey Question 1 Mark scheme

1 (a)

Current ratio	$\frac{900,000}{800,000}$	(1) (1)	1.125: 1
Liquid ratio (acid test)	$\frac{400,000}{800,000}$	(1) (1)	0.5: 1
Debtor days	$\frac{300,000}{3,000,000} \times 365$		37 days **(2)**
Creditor days	$\frac{100,000}{2,000,000} \times 365$		18 days **(2)**
EPS	$\frac{600,000}{400,000}$	(1) (1)	= £1.50
Dividend cover	$\frac{600,000}{300,000}$	(1) (1)	= 2 times **(1)**
Dividend yield	½ **(1)** x 75%	**(1)**	= 37.5% **(1)**

[16]

(b) Consider the level of stock holding with regard to liquidity.
Consider the use of just in time stock systems.
Improve the debtors collection period by offering incentives in the form of discounts.
(2 x 3 marks) **[6]**
Try and arrange a longer credit period with trade creditors.
Review dividend payment policy.
Introduction of new capital by issuing further shares. Authorised share capital allows a further £500,000 of share capital.
The company is non-geared and could consider borrowing with loans and debentures.
(2 x 3 marks) **[6]**

(c) Dividend cover shows that the dividend of £300,000 is covered twice by the profit after tax.
(2 marks) **[2]**

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jun 2005 Woodman Question 2

2 The following data were taken from the accounting records of Woodman Ltd for the year ended 31 March 2005.

(i) Tangible fixed assets at cost at 1 April 2004 were:

	£
Land and buildings (Land £400 000)	1 000 000
Motor vehicles	320 000
Office equipment	200 000

(ii) Depreciation at 1 April 2004:

Land and buildings	48 000
Motor vehicles	150 000
Office equipment	80 000

Woodman Ltd depreciates fixed assets as follows:

Buildings 1% per annum on cost using the straight line method.
Motor vehicles 20% per annum using the reducing balance method.
Office equipment 15% per annum on cost using the straight line method.

All fixed assets held at 31 March 2005 had been purchased since 2002.

A full year's depreciation is provided in the year of purchase but none in the year of sale. Land is not depreciated.

(iii) During the year ended 31 March 2005 the following assets were bought:

	£
Motor vehicles	30 000
Office equipment	15 000

(iv) During July 2004 a motor vehicle with an original cost of £20 000 was sold for £3 000 cash. The motor vehicle was purchased on 1 October 2001.

(v) During January 2005 office equipment was sold for £4 000 cash. A profit of £1 500 was made on the sale. Woodman Ltd had charged £3 600 for depreciation on this equipment.

(vi) On 1 January 2005 land was revalued at £600 000.

2505 Jun 2005 Woodman Question 2 continued

REQUIRED

(a) The Schedule of Fixed Assets for Woodman Ltd for the year ended 31 March 2005. [20]

(b) Profit is of interest to all users of final accounts. What other information from the final accounts of Woodman Ltd would be of interest to each of the following?

(i) Shareholders [2]

(ii) Banks [2]

(iii) Employees [2]

Total marks [26]

Analysis and Interpretation of Accounts

2505 Jun 2005 Woodman Question 2 Mark scheme

2 (a)

Woodman Ltd
Schedule of Fixed Assets for the year ended 31 March 2005

	Land & buildings		Motor vehicles		Office equipment	
Cost at 1 April	1 000 000		320 000		200 000	**(1) line**
Additions			30 000	**(1)**	15 000	**(1)**
Disposals			(20 000)	**(1)**	(6 100)	**(2)**
Revaluations	200 000	**(1)**				
Cost at 31 March	1 200 000		330 000		208 900	**(1) line**
Dep at 1 April	48 000		150 000		80 000	**(1)**
Disposals			(9 760)	**(2)**	(3 600)	**(1)**
Profit and loss	6 000	**(1)**	37 952	**(2)**	31 335	**(2)**
Dep at 31 March	54 000		178 192		107 735	**(1) line**
Book val at 31 Mar	1 146 000		151 808		101 165	**(2)(1of) line**

[20]

(b)

Shareholders – profits, dividends, and return on capital employed
Banks – cash flow, profits and gearing
Employees – sales, profits, cash flow and directors pay
(3 x 2 marks) **[6]**

Total marks [26]

Analysis and Interpretation of Accounts

2505 Jan 2005 Marshall Question 1

1 The following is a summary of the final accounts of Marshall Ltd for the year ended 31 December 2004.

Marshall Ltd

Profit and Loss Account for the year ended 31 December 2004

	£	£
Turnover		400 000
Cost of Sales		180 000
Gross Profit		220 000
Distribution Costs	60 000	
Administrative Expenses	90 000	150 000
Operating Profit		70 000
Corporation Tax		20 000
Profit after Tax		50 000
Profit and Loss b/d		50 000
		100 000
Proposed Ordinary Dividend	30 000	
Transfer to General Reserve	10 000	40 000
Retained Profit		60 000

Balance Sheet as at 31 December 2004

	£	£
Fixed Assets		300 000
Current Assets		
Stock	90 000	
Debtors	40 000	
Bank	30 000	
	160 000	
Creditors falling due in less than one year		
Creditors	70 000	
Dividends	30 000	
Corporation Tax	20 000	
	120 000	
Net Current Assets		40 000
Total Assets less Current Liabilities		340 000
Capital and Reserves		
£1 Ordinary Shares		250 000
General Reserve		30 000
Profit and Loss Account		60 000
		340 000

2505 Jan 2005 Marshall Question 1 continued

The current market value of one ordinary share is £3.

REQUIRED

(a) Calculate the following (where appropriate the calculation should be to 2 decimal places).

- **(i)** Return on Capital Employed [2]
- **(ii)** Gross Profit as a percentage of turnover [1]
- **(iii)** Net Profit as a percentage of turnover [1]
- **(iv)** Acid Test (Liquid ratio) [2]
- **(v)** Earnings Per Share [4]
- **(vi)** Dividend Yield [4]
- **(vii)** Price Earnings Ratio [3]

(b) Explain why the price earnings ratio would be useful to an investor. [4]

(c) The directors of Marshall Ltd are considering issuing 8% Debentures of £1 each to raise £200 000.

- **(i)** Assess how this would affect the gearing position of the company. [3]
- **(ii)** Discuss the implications for the ordinary shareholders. [6]

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jan 2005 Marshall Question 1 Mark scheme

1 (a)

(i)	ROCE	$\frac{70\,000}{340\,000}$	**(1)** **(1)**	= 20.59%	**[2]**
(ii)	Gross Profit as a % sales	$\frac{220\,000}{400\,000}$		= 55% **(1)**	**[1]**
(iii)	Net Profit as a % sales	$\frac{70\,000}{400\,000}$		= 17.5% **(1)**	[1]
(iv)	Acid Test	$\frac{70\,000}{120\,000}$	(1) (1)	= 0.58 : 1	**[2]**
(v)	Earnings Per Share	$\frac{50\,000}{250\,000}$	**(2)** **(1)**	= 20 pence **(1)**	**[4]**
(vi)	Dividend Yield	$\frac{30\,000}{250\,000}$	**(1)** **(1)**	X $\frac{1}{3}$ **(2)** = 4%	**[4]**
(vii)	P/E Ratio	$\frac{3}{0.20}$	**(1)** **(1)**	= 15 **(1)**	**[3]**

[17]

(b) The PE Ratio reflects the market value of the likely future growth in earnings. The higher the ratio the higher the future prospects are viewed by the market.
(2 x 2 marks)
(1 for point plus 1 for development) **[4]**

2505 Jan 2005 Marshall Question 1 Mark scheme continued

(c) **(i)** Would increase the gearing (1) to 59% (2).

(ii) The interest of £16000 would be an expense to the profit and loss account.
Shareholders will benefit if the extra capital is invested to increase the profit.
Shareholders could benefit from an increase in the earnings per share.
If profit is not increased the interest charges must still be paid.
Could reduce profitability and the return for the ordinary shareholder.

Increase risk for shareholder - borrowers take first slice of earnings and have priority over capital in winding up.
There is greater variability in profit available for dividends when earnings fluctuate.

(2 x 3 marks)
(1 for point plus 1 for development)

[6]

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jun 2004 Pyne and Newbould Question 2

2 Pyne Ltd and Newbould Ltd are two companies operating in clothes retailing. The following information relates to the two companies for the year ended 31 December 2003.

	Pyne Ltd £	Newbould Ltd £
Turnover	2 000 000	2 800 000
Cost of sales	900 000	1 400 000
Administrative expenses	300 000	700 000
Distribution costs	250 000	500 000
£1 issued ordinary shares	800 000	1 200 000
10% Debenture interest	40 000	60 000

REQUIRED

(a) Calculate for each company (answers to two decimal places where appropriate).

(i) Gross Profit as a % of turnover;

(ii) Net Profit (before interest) as a % of turnover;

(iii) Earnings per share;

(iv) Interest cover.

[16]

(b) Newbould Ltd is considering borrowing a further £800 000 to invest in new equipment.

(i) Explain the term *gearing*. [2]

(ii) Explain how this borrowing would affect gearing. [4]

(iii) Discuss the implications of high gearing for the company and for the ordinary shareholders. [8]

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jun 2004 Pyne and Newbould Question 2 Mark scheme

2 (a)

	Pyne Ltd	Newbould Ltd
(i) Gross profit as % turnover	55% **(1)**	50% **(1)**
(ii) Net profit (before interest) as % turnover	27.5% **(2)**	7.14% **(2)**
(iii) Earnings per share	$\frac{510,000}{800,000}$ = 63.75 pence **(2)**	$\frac{140,000}{1,200,000}$ = 11.67 pence **(2)**
(iv) Interest cover	$\frac{550,000}{40,000}$ = 13.75 times **(3)**	$\frac{200,000}{60,000}$ = 3.33 times **(3)**

[16]

(b) (i) Gearing is the relationship between debt capital and equity capital. Gearing shows debt capital as a % of total capital.

(2 x 1 mark) **[2]**

(ii) Borrowing would increase the loan capital of Newbould.
The gearing ratio of Newbould Ltd would increase. Present gearing ratio is 50%/33.33%.
Increase gearing ratio 116.67%/53.85%.

(2 x 2 marks) **[4]**

(iii) If profits are high then ordinary shareholder would benefit from high gearing.
Low interest rates with minimal effect on profits.
Higher geared companies will show increased earnings per share when the company performs well.
If profits are low and economy has high interest rates then shareholders in high geared companies would be disadvantaged.
Company required to meet interest rates and principal sum before paying dividends.
Could mean sale of surplus fixed assets.
May have difficulty in raising further finance from banks.

(4 x 3 marks)
(1 for point plus up to 2 for development) **[8]**

Total marks [30]

Analysis and Interpretation of Accounts

2505 Jun 2003 Davey and Bod Question 3

3 The following are extracts from the Balance Sheets of two companies as at 31 December 2002.

	Davey plc	Bod plc
	£	£
£1 Ordinary Shares	1 000 000	2 500 000
£1 10% Preference Shares	500 000	1 500 000
8% Debentures		400 000

Profits for the years ended 31 December 2002 before charging interest on debentures were:

Davy plc	Bod plc
£	£
350 000	682 000

The preference share dividends have been paid in full. Ignore taxation.

Additional information:	Davey plc	Bod plc
Market price per share	£2.50	£2.00
Declared dividend rate	20%	15%

REQUIRED

(a) Calculate for **each** company:

(i) earnings per share;

(ii) price/earnings ratio;

(iii) dividend yield. [18]

(b) **(i)** Explain the term *gearing*. [2]

(ii) Discuss the implications for an ordinary shareholder who has invested in a company with a high reliance on fixed interest long term borrowing. [6]

(iii) Assess the significance of the price earnings ratio to a potential investor in a company. [4]

Total marks [30]

2505 Jun 2003 Davey and Bod Question 3 Mark scheme

3 (a)

	Davey			Bod		
E.P.S	300,000 **(1)** / 1,000,000 **(1)**	=30 Pence	**(1)**	500,000 **(1)** / 2,500,000 **(1)**	=20 Pence	**(1)**
P/E Ratio	2.50 **(1)** / 0.30 **(1)**	=8.33 Years	**(1)**	2.00 **(1)** / 0.20 **(1)**	=10 Years	**(1)**
Dividend Yield	1.00 **(1)** / 2.50 **(1)**	x20%=8% **(1)**		1.00 **(1)** / 2.00 **(1)**	x15%=7.5% **(1)**	

[18]

(b) (i) Gearing is the relationship between debt capital and equity capital on the balance sheet of a company or Gearing Ratio.

$$\text{Gearing Ratio} = \frac{\text{Debt Capital}}{\text{Total Capital}}$$

[2]

(ii) When profits are high the ordinary shareholders in a high geared company will receive a higher return on earnings per share.
When profits are low the ordinary shareholders will receive a poor return.
High interest rates will effect high geared companies by reducing profitability.
Problems with liquidity in meeting payments of interest to providers of finance.
Reducing returns to equity holders.

(3 x 2 marks maximum 6)
(1 point plus 2 for development) **[6]**

(iii) The P/E ratio reflects the market view of the likely future growth in earnings.
The higher the ratio the more highly the future prospects are viewed by the market.

(2 x 3 marks maximum 4)
(1 point plus 2 for development) **[4]**

Total marks [30]

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

F004 Specimen Larch Question 2

2 The following data summarise some of the information relating to Larch plc for the year ended 31 December 2004.

(i) Tangible fixed assets at cost at 1 January 2004 were:

	£
Land and Buildings (Land £400 000)	900 000
Machinery	565 000
Office Equipment	170 000

(ii) Depreciation at 1 January 2004:

	£
Land and Buildings	120 000
Machinery	245 000
Office Equipment	86 000

The company depreciates its assets at the following rates per annum.

Buildings	2% per annum on cost
Machinery	10% on the reducing balance basis
Office Equipment	10% straight line on cost

A full year's depreciation is provided in the year of purchase, but none in the year of disposal. Land is not depreciated.

(iii) On 13 November 2004 land was revalued at £550 000.

(iv) During July 2004 office equipment originally purchased at a cost of £35 000, and with a written down value of £15 800 was sold at a profit of £1 200.

(v) Machinery purchased in August 2001 for £40 000 was sold for £25 000 during August 2004.

(vi) During the year the following assets were bought:

	£
Machinery	68 000
Office Equipment	18 000

(vii) With the exception of some office equipment, which was bought at a cost of £30 000 in 1992, all other office equipment has been purchased since 1997.

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

F004 Specimen Larch Question 2 continued

REQUIRED

(a) A Schedule of Fixed Assets for inclusion in the notes of the published accounts of Larch plc for the year ended 31 December 2004. [16]

(b) **(i)** Explain the correct treatment of the revaluation of land in the final accounts of a company. [3]

(ii) One of the directors wishes to use the revaluation reserve to pay dividends to the shareholders. Advise the Board of Directors of the suitability of this proposal. [6]

(c) FRS 15 Tangible Fixed Assets is an accounting standard in respect of fixed assets.

(i) Identify **three** purposes of accounting standards. [3]

(ii) Outline how FRS 15 meets **one** of those purposes. [2]

Total marks [30]

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

F004 Specimen Larch Question 2 Mark scheme

Question					Marks
2(a)	Schedule of Fixed Assets				
		Land & Buildings	Machinery	Office Equipment	
	Balance 1 January 2004	900 000	565 000	170 000 [1 for line]	
	Revaluation	150 000 [1]			
	Disposals	-	(40 000) [1]	(35 000) [1]	
	Additions	-	68 000 [1]	18 000 [1]	
		1 050 000	593 000	153 000	
	Depreciation:				
	Provision 1 January 2004	120 000	245 000	86 000 [1 for line]	
	Disposals	-	(10 840) [2]	(19 200) [2]	
	Charge for year	10 000	35 884 [2]	12 300 [2]	
		130 000	270 044	79 100	
	Balance Sheet	**920 000**	**322 956**	**73 900**	
				[1 of for line]	**[16]**
2(b)(i)	The fixed asset of Land and Buildings would be increased by £150 000 (debit). A revaluation reserve of £150 000 would be created (credit). *1 mark for **each** part of double entry and 1 mark for use of revaluation reserve.*				[3]

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

F004 Specimen Larch Question 2 Mark scheme continued

2(b)(ii)	The revaluation reserve is a capital reserve, created through activities outside normal trading. In this case it is created by fixed asset revaluation. Capital reserves are unrealised and undistributable. The Board of Directors should be made aware that the suggestion to pay dividends from the revaluation reserve is unsuitable for the following reasons: • it is prohibited by company law to pay dividends or make other distributions from undistributable reserves/unrealised funds; • it is imprudent to pay dividends from a fund which anticipates profits on the sale of an asset; a drop in the underlying asset value by the time of disposal may mean that a profit may not be realised; • it is unethical to pay dividends to shareholders before the profit is realised because they could be misled into thinking that the company is performing better than it may actually be. *Max 2 marks for analysing the significance of a capital reserve and max 4 marks for evaluating the suitability of the suggestion.*	**[6]**
2(c)(i)	Three purposes of accounting standards are: • to provide rules for disclosure (e.g Cash Flow Statements); • to indicate how information should be presented in the final accounts (e.g. corporation tax); • to provide rules for the measurement of assets and liabilities.	**[3]**
2(c)(ii)	FRS 15 provides guidance on the principles and measurement/valuation of fixed assets and depreciation	**[2]**
	Total marks	**[30]**

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

2505 Jan 2007 Agrawel Question 2

2 The following data was taken from the accounting records of Agrawel Ltd for the year ended 31 December 2006.

(i) Tangible fixed assets at cost 1 January 2006 were:

	£
Land and buildings (Land £250 000)	400 000
Motor vehicles	180 000
Office equipment	70 000

(ii) Depreciation at 1 January 2006:

Land and buildings	30 000
Motor vehicles	90 000
Office equipment	20 000

Agrawel Ltd depreciates fixed assets as follows:

Buildings 2% per annum on cost using the straight line method.
Motor vehicles 20% per annum using the reducing balance method.
Office equipment 10% per annum on cost using the straight line method.
A full year's depreciation is charged in the year of purchase and none in the year of sale.
Land is not depreciated.

(iii) On 12 January 2006, the land was revalued at £400 000.

(iv) During May 2006, office equipment originally purchased at a cost of £2 000, with a written down value of £500, was sold for a profit of £150.

(v) A motor vehicle purchased on 1 July 2004 for £15 000 was sold for £2 500 during November 2006.

(vi) During the year the following assets were bought:

Motor vehicles	£34 000
Office equipment	£12 000

2505 Jan 2007 Agrawel Question 2 continued

REQUIRED

(a) A Schedule of Fixed Assets for the year ended 31 December 2006. [20]

(b) Agrawel Ltd is considering a new product for launch in 2008 and this will require a substantial investment in research and development. Discuss how research and development expenditure should be treated in the final accounts of Agrawel Ltd. [6]

(c) Other than the issue of shares, discuss ways in which Agrawel Ltd could finance an investment in research and development. [8]

Total marks [34]

The Role of Accounting Standards: The Purposes of Accounting Standards & Standards

2505 Jan 2007 Agrawel Question 2 Mark scheme

2 **(a)** Agrawel Ltd
Schedule of Fixed Assets for the year ended 31 December 2006

	Land and buildings	Motor vehicles	Office equipment
Cost at 1 January	400 000	180 000	70 000 **(1)**
Additions		34 000 **(1)**	120 000 **(1)**
Disposals		(15 000) **(1)**	(2 000) **(1)**
Revaluation **(1)**	150 000 **(1)**		
Cost at 31 Dec	550 000	199 000	80 000 **(1)**
Depreciation 1 Jan	30 000	90 000	20 000 **(1)**
Disposals		(5 400) **(2)**	(1 500) **(1)**
Profit and loss	3 000 **(2)**	22 880 **(2)**	8 000 **(1)**
Depreciation 31 Dec	33 000	107 480	26 500 **(1)**
Book value 31 Dec	517 000	91 520	53 500 **(2)**

[20]

(b) A distinction must be made between the types of research and development.
Pure and applied research must be written off to the profit and loss as an expense.
A development cost can be capitalized and shown as a fixed asset.

(3 x 2 marks) **[6]**
(1 for point plus 1 for development)

Preference shares and the different types of preference share depending on the risk. Shares could be cumulative, non-cumulative.
A secured loan or debenture charged on the assets of the company.
Agrawel has land and buildings worth £550 000 after the revaluation and this could be used for a long term loan or mortgage.
Leasing agreements if the investment required new machinery. A leasing agreement could be in the form of a finance lease or operating lease.
A short term borrowing facility from the bank by agreeing an overdraft limit.
Agrawel should investigate the possibility of obtaining a grant for the new investment. It could qualify for a regional, national or a European grant.

(4 x 2 marks) **[8]**
(1 for point plus 1 for development)

Total marks [34]