

Limited companies

Read online at pastopic.com/cambridge/accounting-0452/notes/limited-companies

Last checked 1 October 2026

Read first: [Sole traders](#)

© 2026 Pastopic. Free for personal study. Please share the link, not the file.

What you need to know

By the end of this topic you should be able to:

1. **Explain the advantages and disadvantages of operating as a limited company**, a business owned by shareholders and run by directors.
2. **Understand what limited liability means**: a shareholder can lose no more than the amount they agreed to pay for their shares.
3. **Understand what equity means**: the total funds provided by the shareholders, equal to the company's assets less its liabilities.
4. **Understand the capital structure of a limited company**: preference share capital, ordinary share capital, the general reserve and retained earnings.
5. **Understand and tell apart issued, called-up and paid-up share capital**.
6. **Understand and tell apart share capital (preference and ordinary shares) and loan capital (debentures)**, including the difference between redeemable and non-redeemable preference shares.
7. **Prepare the income statement, the statement of changes in equity and the statement of financial position** of a limited company.
8. **Make the same year-end adjustments as for a sole trader** (accrued and prepaid expenses and income, depreciation, irrecoverable debts and the provision for doubtful debts).

You do **not** need cumulative or non-cumulative preference shares, rights issues, share premium or the capital redemption reserve.

Understand it

What a limited company is

A **limited company** is a business that is a separate legal person from its owners. It is owned by **shareholders** (also called **members**), who buy **shares** in it, and it is run by **directors**, whom the shareholders elect. In a small company the shareholders and the directors are often the same people.

There are two kinds:

- A **private limited company** (its name ends "Limited" or "Ltd") **cannot offer its shares to the public**; shares are usually held by family, friends or the people who run it, and they can only be sold with the other shareholders' agreement.
- A **public limited company** (its name ends "plc") **can offer its shares to the public**, for example on a stock exchange, and **must publish its financial statements** for anyone to read. A private company's statements are not published for the public in the same way.

Advantages of operating as a limited company (compared with a sole trader or a partnership)

- **Limited liability**: the shareholders' personal possessions are safe if the company fails (see below). This makes people more willing to invest.
- **Separate legal identity**: the company owns its assets, signs contracts, owes its debts and can sue or be sued in its own name. Legal action for the company's debts is taken against the company, not against the individual shareholders.
- **Continuity of existence**: the company carries on when a shareholder dies, retires or sells their shares.
- **Easier to raise finance**: it can raise large amounts by issuing shares to many people (a plc to the public), and lenders are often more willing to lend to a company; it can also issue **debentures**.
- **Shareholders need not run the business**: they can invest without taking part, and expert directors can be appointed.

Disadvantages

- **Difficult and costly to set up**: many legal formalities, forms and fees. It is the hardest business type to establish.
- **More rules to follow** once it is running: company law, annual financial statements, meetings with shareholders. A plc must publish its statements, so there is **less privacy**.
- **The profit is shared** between all the shareholders as dividends.
- **The original owners may lose control** if new shareholders buy a large share of the voting (ordinary) shares, and decisions take longer when many people have a say.
- **Directors' fees and salaries** add to the costs.

Limited liability

If a sole trader's business cannot pay its debts, the owner must pay them personally, even by selling their house: that is **unlimited liability**. A shareholder in a limited company has **limited liability**: they can lose **no more than the amount they agreed to pay for their shares**. Their personal possessions cannot be taken to pay the company's debts.

For example, Rosa agreed to buy 5 000 shares of \$1 each and has so far paid \$0.60 a share, \$3 000. If the company fails owing far more than it owns, Rosa can be asked for the \$2 000 still unpaid on her shares, and she loses the \$3 000 already paid: \$5 000 at most. Her car and savings are safe.

Limited liability belongs to the **shareholders**, not to the directors, employees or lenders. Debenture holders are lenders to the company, so they are never liable for its debts.

Equity and the capital structure

Equity is the **total funds provided by the shareholders** (the owners). It is what would belong to them if every asset were sold at its book value and every liability paid:

$$\text{equity} = \text{assets} - \text{liabilities}$$

A company's equity is made up of:

Part of equity	What it is
Ordinary share capital	Money the shareholders paid for their ordinary shares (number of shares × nominal value, such as 400 000 shares of \$0.50 = \$200 000).
Preference share capital (non-redeemable)	Money paid for preference shares the company will never buy back.
General reserve	Profits the directors have set aside (transferred out of retained earnings) to keep in the business, usually for future growth. It is not cash.
Retained earnings	Profits of this and earlier years that have not been paid out as dividends or transferred to the general reserve.

Share capital is money **put in** by shareholders; the general reserve and retained earnings are profits **kept back**. Together they are the equity. Debentures, bank loans, dividends paid and goodwill are **never** part of equity.

Capital employed is all the long-term finance used by the company: equity plus non-current liabilities (such as debentures and long-term bank loans). It also equals total assets less current liabilities.

$$\text{capital employed} = \text{equity} + \text{non-current liabilities} = \text{total assets} - \text{current liabilities}$$

Ordinary shares, preference shares and debentures

A company can raise long-term finance by selling **shares** (share capital) or by borrowing through **debentures** (loan capital).

	Ordinary shares	Preference shares	Debentures
Holders are	owners (members)	owners (members)	lenders , not members
Return	a dividend , not fixed: the directors decide it, and it depends on profit	a dividend at a fixed rate (such as 5% of their value)	interest at a fixed rate
Paid	last: only after preference dividends, and only if there are profits	before any ordinary dividend, only if there are profits	every year, even if there is a loss ; it is an expense in the income statement
Voting	one vote per share at the shareholders' meetings	usually no vote	no vote

	Ordinary shares	Preference shares	Debentures
If the company is wound up	repaid last	repaid before ordinary shareholders	repaid before all shareholders; often secured on the company's non-current assets
Repaid	not repaid while the company exists	not repaid, unless redeemable	repaid on a set date
In the SFP	equity	equity (non-redeemable) or non-current liability (redeemable)	non-current liability

Both preference shares and debentures give a fixed rate of return, carry no vote and are part of capital employed. The key difference: preference shareholders are owners who get a **dividend** from profits, debenture holders are lenders who get **interest** whether or not there is a profit.

Redeemable and non-redeemable preference shares. **Redeemable** preference shares will be bought back (repaid) by the company on a set date, so they behave like a loan: they are shown as a **non-current liability**, and their fixed dividend is taken off before the profit for the year is reached. **Non-redeemable** preference shares are never repaid, so they are part of **equity**, and their dividend is a dividend paid in the statement of changes in equity.

Issued, called-up and paid-up share capital

A company does not always ask for the full price of its shares at once. It may ask for part now and the rest later.

- **Issued share capital:** the full value of the shares given out (issued) to shareholders.
- **Called-up share capital:** the part of the issued share capital that the company has **asked (called on)** shareholders to pay so far.
- **Paid-up share capital:** the part of the called-up capital that shareholders **have actually paid**.

So issued $\geq$ called-up $\geq$ paid-up. When everything has been called and paid, the three are equal ("issued and fully paid").

For example, a company issues 300 000 ordinary shares of \$1 each and asks for 70% now. By the end of the month, holders of 280 000 shares have paid.

- Issued = $300\,000 \times 1 = 300\,000$
- Called-up = $300\,000 \times 70\% = 210\,000$
- Paid-up = $280\,000 \times 0.70 = 196\,000$ (holders of 20 000 shares still owe \$14 000)

Dividends and the general reserve

A **dividend** is the part of the profit paid out to shareholders. It is **not an expense**: it is a share of profit given to the owners, so it never appears in the income statement. It comes out of **retained earnings**, and so the dividend policy directly changes retained earnings.

- An **interim dividend** is paid **during** the year.
- A **final dividend** is agreed after the year ends and paid in the **next** year. So in any year the statement of changes in equity usually shows **last year's final dividend** and **this year's interim dividend**, both paid in this year.
- A final dividend that is only **proposed** at the year end has **not** been paid, and is **not** recorded in the income statement, the statement of changes in equity or the statement of financial position for that year. It is recorded next year, when it is paid.

A dividend can be given in three ways:

- as an amount: a dividend of \$12 000;
- per share: \$0.03 per share on 400 000 shares = 12 000;
- as a percentage of the issued ordinary share capital: 6% of \$200 000 = 12 000.

A **transfer to the general reserve** just moves profit from one part of equity to another: retained earnings fall and the general reserve rises by the same amount, so **total equity does not change**. Equity increases from a profit for the year and from issuing shares; it falls from a loss and from dividends paid.

The three financial statements

A limited company prepares:

1. **The income statement**, exactly as for a sole trader, with the same adjustments, to find the **profit for the year**. A company's own costs differ in two ways:
 - **Directors' fees and salaries** are expenses (directors are employees of the company).
 - **Debenture interest** for the full year is an expense (a finance cost), taken off **profit from operations** to give the profit for the year, even if some of it has not yet been paid. Interest on a long-term bank loan is treated the same way.
2. **The statement of changes in equity (SOCE)**. It replaces the capital account of a sole trader. It shows how each part of equity changed during the year: one column each for ordinary share capital, general reserve and retained earnings, and a total column.
3. **The statement of financial position (SFP)**, with an **equity** section instead of a capital section.

Here is how the profit flows through them, using Tamarind Print Limited, whose year ended 31 December 2025. It has 6% debentures of \$80 000.

Income statement	
profit from operations	57 600
– debenture interest (6% × 80 000)	4 800
= profit for the year	52 800

↓

Statement of changes in equity	
share capital: 200 000 + 50 000 share issue	250 000
general reserve: 30 000 + 9 000 transfer	39 000
retained earnings: 41 500 + 52 800 profit	
– 26 000 dividends paid – 9 000 transfer	59 300

↓

Statement of financial position	
equity (250 000 + 39 000 + 59 300)	348 300
non-current liabilities: 6% debentures	80 000
capital employed	428 300

During 2025, Tamarind Print Limited paid the final dividend for 2024 of \$14 000 (in March) and an interim dividend of \$0.03 per share on its 400 000 ordinary shares of \$0.50 (in August), \$12 000. On 1 October it issued 100 000 more ordinary shares of \$0.50 each, fully paid. On 31 December it transferred \$9 000 to the general reserve and proposed a final dividend of \$16 000 for 2025.

Tamarind Print Limited: Statement of changes in equity for the year ended 31 December 2025

Details	Ordinary share capital \$	General reserve \$	Retained earnings \$	Total \$
On 1 January 2025	200 000	30 000	41 500	271 500
Profit for the year			52 800	52 800
Dividend paid (final, 2024)			(14 000)	(14 000)
Dividend paid (interim)			(12 000)	(12 000)
Issue of ordinary shares	50 000			50 000
Transfer to general reserve		9 000	(9 000)	–
On 31 December 2025	250 000	39 000	59 300	348 300

Things to notice:

- Profit and dividends go **only** in the retained earnings column (and the total). Nothing is taken from or added to share capital except a **share issue**.
- The transfer is a plus in the general reserve and a minus in retained earnings; the total column shows "–", as total equity doesn't change.
- The proposed final dividend of \$16 000 is **not** in the statement: it hasn't been paid.
- Every column adds down, and the four closing figures across add to the total: 250 000 + 39 000 + 59 300 = 348 300. Use this as a check.

The closing balances are copied into the equity section of the SFP:

Equity and liabilities	\$	\$
Equity		
Ordinary share capital		250 000
General reserve		39 000
Retained earnings		59 300
		348 300
Non-current liabilities		
6% Debentures		80 000

Capital employed = 348 300 + 80 000 = 428 300.

The statement of financial position

The SFP of a company is laid out like a sole trader's, with these sections:

- **Non-current assets:** each one at cost, less accumulated depreciation (the provision for depreciation), giving net book value; land is usually not depreciated. Totals for all three columns.
- **Current assets:** inventory; trade receivables **less the provision for doubtful debts**, shown as a net figure; other receivables (prepaid expenses, income due); bank; cash. Then **total assets**.
- **Equity:** ordinary share capital; non-redeemable preference share capital; general reserve; retained earnings. Total.
- **Non-current liabilities** (due after more than 12 months): debentures; long-term bank loans; redeemable preference shares.
- **Current liabilities** (due within 12 months): trade payables; other payables (expenses owing, **debenture interest owing**, income received in advance); bank overdraft.
- **Total equity and liabilities**, which must equal total assets.

Items that are **never** in the SFP: profit for the year (it is already inside retained earnings), dividends paid, debenture interest paid, a proposed final dividend, and the provisions as liabilities.

Year-end adjustments

The income statement uses the same adjustments as a sole trader's, and each one also changes a figure in the SFP. Examples for a year ended 31 December 2025:

- **Expense owing (accrued):** add it to the expense; it is an other payable. Electricity paid \$5 620 with \$480 owing: expense 5 620 + 480 = 6 100.
- **Expense paid in advance (prepaid):** take off the part that belongs to next year; it is an other receivable. Insurance of \$3 600 paid on 1 October 2025 for 12 months: 3 months belong to this year, so the expense is $3\,600 \times \frac{3}{12} = 900$ and \$2 700 is prepaid.

- **Income due (accrued):** add it to the income; it is an other receivable. **Income received in advance:** take it off the income; it is an other payable. Rent receivable of \$7 200 received, of which \$1 200 is for next year: income $7\,200 - 1\,200 = 6\,000$. Revenue received in advance is treated the same way.
- **Straight-line depreciation:** a percentage of **cost**. Vehicles costing \$64 000 at 20%: $64\,000 \times 20\% = 12\,800$ each year.
- **Reducing-balance depreciation:** a percentage of **net book value**. Machinery costing \$50 000 with \$18 000 accumulated depreciation, at 25%: $(50\,000 - 18\,000) \times 25\% = 8\,000$. Add the year's charge to the accumulated depreciation in the SFP.
- **Irrecoverable debts:** an expense, taken off trade receivables. A debt of \$460 written off: receivables \$15 460 become \$15 000.
- **Provision for doubtful debts:** worked out on the receivables left after write-offs; only the **change** goes in the income statement. At 5% of \$15 000 the provision is \$750. If it was \$900, the **decrease** of \$150 is added to gross profit as income; if it was \$600, the **increase** of \$150 is an expense. The SFP shows $15\,000 - 750 = 14\,250$.
- **Debenture interest owing:** charge the full year. 6% debentures of \$80 000 cost \$4 800 a year; if only \$2 400 has been paid, the expense is still \$4 800, and \$2 400 is an other payable.

Every adjustment changes the profit for the year, and so the retained earnings. If retained earnings were worked out before an adjustment was made, correct them by the same amount: extra income or a prepaid expense **raises** them, an extra expense **lowers** them.

A company has no drawings, so "goods taken for own use" does not arise; shareholders are paid only through dividends.

Key facts and formulas

There is no formula list in the IGCSE Accounting exam, so everything here must be learnt.

Formula	Status
Equity = share capital + general reserve + retained earnings = assets – liabilities	Learn it
Capital employed = equity + non-current liabilities = total assets – current liabilities	Learn it
Share capital = number of shares × nominal value per share	Learn it
Called-up capital = issued capital × proportion called	Learn it
Paid-up capital = shares paid for × amount called per share	Learn it
Closing retained earnings = opening + profit for the year – dividends paid – transfer to general reserve	Learn it

Formula	Status
Closing general reserve = opening + transfer	Learn it
Closing total equity = opening + profit – dividends paid + shares issued (transfers don't change it)	Learn it
Dividend = rate per share × number of shares, or percentage × issued ordinary share capital	Learn it
Debenture interest = debentures × rate (a full year's, whether paid or not)	Learn it
Profit for the year = profit from operations – debenture (and loan) interest	Learn it
Order: income statement → statement of changes in equity → statement of financial position	Learn it

How to do it

We have 77 tagged questions for this topic from 2021 to 2025 (52 different, as many appear on two or three paper variants): 63 one-mark multiple-choice questions from Paper 1 and 14 twenty-mark Paper 2 questions. Each Paper 2 question mixes several types, so the counts add up to 109.

Question type	Questions
Calculate equity, retained earnings, a dividend or capital employed	22
Prepare the statement of changes in equity	14
Limited liability, advantages and disadvantages (multiple choice)	12
Advise the directors	11
What is in equity	9
Shares or debentures: their features	8
State or explain a company term	8
Which statement an item goes in	7
Prepare the income statement of a company	7
Prepare the statement of financial position	6
Issued, called-up and paid-up share capital	5

1. Calculate equity, retained earnings, a dividend or capital employed (22 questions)

All multiple choice. Write the one equation that links the figures, then solve it for the missing one.

1. **Retained earnings:** closing = opening + profit – dividends paid – transfer to general reserve.
2. **Total equity at the end:** opening total + profit – dividends paid + new shares issued. A transfer to the general reserve changes nothing.
3. **Equity from a list:** add share capital (ordinary and non-redeemable preference), general reserve and retained earnings. Leave out debentures and loans.
4. **Capital employed:** equity + debentures + long-term loans.

For example, opening equity \$182 400, profit \$21 650, dividends paid \$9 800, transfer to general reserve \$4 000, shares issued \$20 000: closing equity = $182\,400 + 21\,650 - 9\,800 + 20\,000 = 214\,250$.

Variations you will meet:

- **Missing dividend:** rearrange rule 1. Opening retained earnings \$64 300, profit \$37 200, transfer \$12 000, closing \$58 900: dividends = $64\,300 + 37\,200 - 12\,000 - 58\,900 = 30\,600$.
- **Missing profit:** closing equity – opening equity + dividends paid (with no share issue). A transfer to the general reserve is a distractor.
- **Missing retained earnings from the SFP:** use assets = equity + liabilities. Non-current assets + net current assets = share capital + reserves + non-current liabilities, so retained earnings are the figure that balances.
- **"By how much did equity increase?":** profit – dividends + shares issued; the opening share capital is not part of the increase.
- **A final dividend as a percentage:** the profit left after the transfer and the interim dividend, divided by the issued ordinary share capital. Profit \$48 000, transfer \$8 000, interim dividend \$12 000, share capital \$200 000: $(48\,000 - 8\,000 - 12\,000) \div 200\,000 = 14\%$.
- **A proposed dividend** at the year end is ignored: only dividends **paid** reduce retained earnings.
- **Correcting retained earnings** after missed adjustments: income accrued and expenses prepaid add; expenses accrued and income in advance subtract. Draft retained earnings \$20 450 with rent receivable due \$300 and wages owing \$820: $20\,450 + 300 - 820 = 19\,930$.

2. Prepare the statement of changes in equity (14 questions)

Paper 2, 3–7 marks. Use the layout in "Understand it".

1. **Heading:** "[Company] Statement of changes in equity for the year ended [date]", and the four column headings.
2. **Opening row,** dated "On [first day of the year]", with each balance and the total.
3. **Profit for the year** in retained earnings and total. Use the profit **after** debenture interest (and after the dividend on **redeemable** preference shares, if the question gives profit before it: 5% on \$60 000 of redeemable preference shares means taking \$3 000 off).
4. **Each dividend paid** on its own row, described fully ("Dividend paid (final)", "Dividend paid (interim)"), in brackets in retained earnings and total. Work out per-share or percentage dividends first.
5. **Issue of shares,** if any, in share capital and total.
6. **Transfer to general reserve:** plus in general reserve, bracketed in retained earnings, "-" in total.

7. **Closing row**, "On [last day of the year]": add down every column, then check the columns add across.

Variations you will meet:

- **Retained earnings column only** (or "calculate the retained earnings"): the same rows, just one column: opening, profit for the year, dividends paid, transfer, closing.
- **A dividend given per share**: \$0.02 per share on 450 000 shares = 9 000. Count only the shares in issue on the day it was paid.
- **A dividend agreed or proposed at the year end**: leave it out, whatever its size.
- **Profit from an income statement you have just prepared**: use your own figure; the mark follows through.

3. Limited liability, advantages and disadvantages (multiple choice) (12 questions)

1. **Limited liability** means a shareholder's loss is limited to the amount they **agreed to pay for their shares**. Not "their personal assets", not "the debentures they hold", not "no liability at all".
2. **Who has it**: shareholders (members). Not directors, employees or lenders.
3. **Sole traders and partners** have unlimited liability: they must pay business debts from personal assets. Debenture holders are never liable for the company's debts.
4. **Advantages for shareholders**: separate legal identity, personal assets protected, continuity. **Not** advantages: loans being easy, dividends having to be paid, or financial statements being quicker or easier to prepare (a company has more to prepare).
5. **Hardest to set up** and most legal formalities: the limited company.
6. **When a company fails**, shareholders lose the money they paid for their shares; they don't pay a share of the debts.

4. Advise the directors (11 questions)

Paper 2, 5 marks: two or more points **for**, two or more **against**, each one mark (at most 4), and a clear **recommendation** for one mark. Tie each point to the story (the amount, the interest rate, the existing loans, who the shareholders are).

Issue debentures (a loan)

- For: debenture holders **don't vote**, so the shareholders **keep control** and their stake is not reduced; **interest is fixed**, so it can be budgeted, and a low rate may cost less than the dividends shareholders would expect; funds may be **quicker and easier** to raise; once repaid, there is **no further liability**; the company may have few loans at present.
- Against: **interest must be paid every year, even if there is a loss**, and it **reduces profit**; they are a **liability that must be repaid**, so funds must be available on the repayment date; they are **repaid before shareholders** if the company is wound up and are often **secured on the non-current assets**; the company may already have debentures or loans to repay; the issue may not raise enough.

Issue ordinary shares

- For: **no interest** and **no repayment**, so cash is not tied up; **no security** is needed; the **directors decide the dividend**, which can be low or nil in a bad year; share capital is permanent, long-term finance, suited to buying non-current assets.
- Against: new shareholders get **votes**, so existing shareholders' **control may be diluted**; shareholders **expect a dividend**, and profit is shared among more people; an issue **may take longer** and **may not raise the full amount**.

Take a long-term bank loan

- For: may be obtained **more quickly** than a share issue; no loss of control; the liability ends once repaid.
- Against: **interest** is charged, even in a loss-making year; **repayments** are required and funds must be available when due; the bank will want **security**; the bank may refuse if the company already has large long-term liabilities.

Use a bank overdraft (usually a poor way to pay for non-current assets)

- For: quick and flexible; interest only while overdrawn; the liability ends when it is cleared.
- Against: the bank can **demand repayment at very short notice**; overdraft interest is usually high and continues until cleared; it may be hard to repay; non-current assets should be financed by **long-term** finance (shares, debentures, loans).

A spending decision (such as doubling the advertising budget or buying new equipment)

- For: may **increase sales** and attract **more customers**; may **reduce high inventory**; benefits may last **into future years**; if the extra gross profit is more than the extra cost, **profit for the year rises**.
- Against: the company **may not afford it**, or may have to **borrow and pay interest**; there is **no guarantee** sales will rise; the extra expense **reduces profit** and could cause a **loss**.

Converting a sole trader or partnership into a limited company: for, limited liability, separate legal identity and continuity, and easier to raise finance; against, formation costs and formalities, more regulation, and loss of control and sharing dividends if **new** shareholders join. If the owners will be the **only** shareholders, say that control and dividends are not a problem.

End with "I recommend that the directors should ... because ...", naming the option.

5. What is in equity (9 questions)

All multiple choice.

- **In equity** ("capital and reserves", "shareholders' equity"): ordinary share capital, non-redeemable preference share capital, general reserve, retained earnings.
- **Not in equity**: debentures and long-term bank loans (non-current liabilities), redeemable preference shares, dividends, goodwill (an asset).
- **Meaning of equity**: the total funds provided by the shareholders. Not borrowing, not dividends, not interest.

- **What increases total equity:** a profit for the year, an issue of shares. **Not:** a loan (a liability), a transfer to general reserve (moves within equity).
- **What the dividend policy affects directly:** retained earnings.

6. Shares or debentures: their features (8 questions)

All multiple choice. Use the comparison table in "Understand it".

- **Debentures:** loan capital, a fixed rate of **interest**, **no** voting rights, interest paid whether or not there is a profit, repaid on a set date (not only when the company is wound up), not part of equity.
- **Fixed rate of return:** preference shareholders and debenture holders; not ordinary shareholders.
- **Both preference shares and debentures:** fixed rate of return, no voting rights, included in capital employed.
- Ordinary dividends are paid **after** debenture interest, never before.

7. State or explain a company term (8 questions)

Paper 2, 1–2 marks each. Learn a short, precise answer for each:

- **Equity:** the total funds provided by the owners (shareholders) of the company; or the difference between its assets and its liabilities.
- **One difference between a public and a private limited company:** a public company may offer its shares to the public, a private company cannot; or a public company must publish its financial statements, a private company does not.
- **Issued and called-up share capital:** issued is the share capital given out to shareholders; called-up is the part of it the company has asked shareholders to pay. Paid-up is the part actually received.
- **Two benefits (advantages) of operating as a limited company:** limited liability; separate legal identity; continuity of existence; easier access to extra capital and loans.
- **Two differences between ordinary and preference shares:** preference shares get a fixed rate of dividend, ordinary shares a variable one; preference dividends are paid before ordinary dividends; on winding up, preference shareholders are repaid before ordinary shareholders; ordinary shares carry voting rights, preference shares usually don't. Say "dividend", never "interest", and say what is paid first (the dividend, or the repayment on winding up).
- **Where debentures go in the SFP:** non-current liabilities.
- **Why a company has no inventory:** it provides a service rather than selling goods, or its customers supply their own materials, so it has nothing to hold for resale.
- **Why a company needs no provision for doubtful debts:** its trade receivables are very small (for example, less than a week's revenue); there have been no irrecoverable debts; some customers pay in advance.
- **Why there is little cash despite a profit:** profit is not cash. Cash may have gone on dividends paid, buying non-current assets, a rise in inventory, repaying loans or paying trade payables and overdrafts, or customers may be slow to pay. Debenture interest and expenses are already inside the profit, so they are

not reasons.

8. Which statement an item goes in (7 questions)

All multiple choice.

Item	Income statement	SOCE	SFP
Profit for the year	last line	yes (retained earnings)	inside retained earnings
Debenture interest (full year, paid and owing)	yes (expense)	no	owing part: current liability
Directors' salaries	yes (expense)	no	no
Dividends paid (interim, and last year's final)	no	yes	no
Proposed final dividend at the year end	no	no	no
Transfer to general reserve	no	yes	new balance of the reserve
Issue of shares	no	yes	new share capital
Debentures issued	no	no	non-current liability

The only item in **both** the income statement and the SOCE is the **profit for the year**.

9. Prepare the income statement of a company (7 questions)

Paper 2, 6–9 marks. It is prepared exactly as for a sole trader, working every adjustment in "Year-end adjustments" beside its line, then:

1. **Revenue** (less any revenue received in advance), less **cost of sales** (opening inventory + purchases – closing inventory), gives **gross profit**. A service company has no trading section.
2. **Less expenses**, including **directors' salaries**, depreciation and any increase in the provision for doubtful debts; add any other income and any decrease in the provision.
3. **Profit from operations**, less the **full year's debenture interest** (paid plus owing), gives the **profit for the year**.
4. **No dividends**, no transfer to the general reserve: they belong in the SOCE.

10. Prepare the statement of financial position (6 questions)

Paper 2, 6–9 marks.

1. Heading: "[Company] Statement of financial position at [date]".

2. **Non-current assets** with cost, accumulated depreciation (updated for this year) and net book value, and totals; or at book value if that's all you are given.
3. **Current assets**: inventory (closing), trade receivables **less** provision for doubtful debts, other receivables, bank, cash; total; then **total assets**.
4. **Equity**: share capital, general reserve (**updated** for this year's transfer), retained earnings (**closing**, from your SOCE); total.
5. **Non-current liabilities**: debentures and long-term loans (and redeemable preference shares); total.
6. **Current liabilities**: trade payables, other payables (accrued expenses and debenture interest owing), bank overdraft; total.
7. **Total equity and liabilities**, equal to total assets.

For an **equity section only** (an "extract"), list share capital, general reserve and retained earnings in that order, and total them. Redeemable preference shares are **not** in it.

11. Issued, called-up and paid-up share capital (5 questions)

All multiple choice.

1. **Issued** = number of shares issued $\times$ nominal value.
2. **Called-up** = issued $\times$ the fraction asked for so far.
3. **Paid-up** = shares whose holders have paid $\times$ the amount called per share.
4. Definitions: called-up is "the share capital for which payment has been **requested**"; paid-up is "the amount **received**"; issued is "the value of shares actually issued". "Shares that could be issued" or "issued plus not yet issued" is none of them.

For example, 160 000 shares of \$2 with 50% called and holders of 150 000 shares paid: issued \$320 000, called-up \$160 000, paid-up $150\,000 \times 1 = 150\,000$.

Worked examples

Example 1

At the start of the year, Heron Glass Limited had total equity of \$182 400, including retained earnings of \$27 400. During the year it made a profit for the year of \$21 650, paid dividends of \$9 800, transferred \$4 000 to the general reserve and issued new ordinary shares for \$20 000, fully paid.

What was the total equity at the end of the year? **[1]**

A \$194 250 B \$210 250 C \$214 250 D \$224 050

Total equity = $182\,400 + 21\,650 - 9\,800 + 20\,000 = 214\,250$. **C (1)**

The transfer moves profit into the general reserve and leaves the total unchanged, and the opening retained earnings are already inside the \$182 400. A leaves out the share issue; B also takes off the transfer; D forgets the dividends.

Example 2

Wren Valley Limited's financial year ends on 30 September. On 1 October 2024 the company had:

- 500 000 ordinary shares of \$0.40 each, issued and fully paid;
- 120 000 4% redeemable preference shares of \$1 each;
- a general reserve of \$45 000 and retained earnings of \$28 600.

During the year ended 30 September 2025:

- the final ordinary dividend of \$11 500 for the year ended 30 September 2024 was paid on 15 December 2024;
- an interim ordinary dividend of \$0.02 per share was paid on 30 April 2025;
- the profit for the year, before the preference dividend, was \$61 400.

On 30 September 2025 the directors transferred \$15 000 to the general reserve and proposed a final ordinary dividend of 5%.

(a) Prepare the statement of changes in equity for the year ended 30 September 2025. [7]

(b) Prepare an extract from the statement of financial position at 30 September 2025 showing the equity section only. [2]

(c) Explain why the proposed final dividend does not appear in your answer to (a). [2]

(a) Workings: ordinary share capital $500\,000 \times 0.40 = 200\,000$; interim dividend $500\,000 \times 0.02 = 10\,000$; preference dividend $120\,000 \times 4\% = 4\,800$, so the profit for the year is $61\,400 - 4\,800 = 56\,600$. The redeemable preference shares are a non-current liability, so they have no column.

Wren Valley Limited: Statement of changes in equity for the year ended 30 September 2025

Details	Ordinary share capital \$	General reserve \$	Retained earnings \$	Total \$
On 1 October 2024	200 000	45 000	28 600	273 600 (1)
Profit for the year			56 600	56 600 (2)
Dividend paid (final)			(11 500)	(11 500) (1)
Dividend paid (interim)			(10 000)	(10 000) (1)
Transfer to general reserve		15 000	(15 000)	– (1)

Details	Ordinary share capital \$	General reserve \$	Retained earnings \$	Total \$
On 30 September 2025	200 000	60 000	48 700	308 700 (1)OF

The profit row earns two marks only after taking off the preference dividend; \$61 400 would earn one.

(b)

Wren Valley Limited: Statement of financial position (extract) at 30 September 2025

Equity	\$
Ordinary share capital	200 000
General reserve	60 000
Retained earnings	48 700
	308 700 (1)OF

(1) for all three items in the right order. The \$120 000 of redeemable preference shares go under non-current liabilities, not here.

(c) The dividend has only been proposed; it has not been paid, and the company does not owe it until the shareholders approve it. (1) It will be shown in next year's statement of changes in equity, when it is paid (\$10 000, that is $200\,000 \times 5\%$). (1)

Example 3

The trial balance of Marlin Hardware Limited at 31 March 2026 was:

	Debit \$	Credit \$
Revenue		264 000
Purchases	158 400	
Inventory at 1 April 2025	21 300	
Wages	38 650	
Directors' salaries	24 000	
Rent	13 200	
Insurance	4 080	
General expenses	6 915	
Debenture interest paid	1 500	
Premises at cost	180 000	

	Debit \$	Credit \$
Fixtures at cost	48 000	
Provision for depreciation of fixtures		14 400
Trade receivables	26 500	
Provision for doubtful debts		580
Bank	7 285	
Trade payables		18 740
8% Debentures (repayable 2031)		37 500
Ordinary share capital		150 000
General reserve		20 000
Retained earnings at 1 April 2025		33 610
Dividends paid	9 000	
	538 830	538 830

Additional information:

1. Inventory at 31 March 2026 was valued at \$23 700.
2. Insurance includes \$840 for the three months to 30 June 2026.
3. Wages of \$1 350 were owing at 31 March 2026.
4. Fixtures are depreciated at 15% per annum on cost (straight line). Premises are not depreciated.
5. The provision for doubtful debts is to be 3% of trade receivables.
6. The debenture interest for the year has not all been paid.
7. \$6 000 is to be transferred to the general reserve. No dividends were outstanding.

(a) Prepare the income statement for the year ended 31 March 2026. [9]

(b) Calculate the retained earnings at 31 March 2026. [3]

(c) Prepare the statement of financial position at 31 March 2026. [9]

(a) Workings: insurance $4\ 080 - 840 = 3\ 240$; wages $38\ 650 + 1\ 350 = 40\ 000$; depreciation $48\ 000 \times 15\% = 7\ 200$; new provision $26\ 500 \times 3\% = 795$, an increase of $795 - 580 = 215$; debenture interest $37\ 500 \times 8\% = 3\ 000$, of which \$1 500 is owing.

Marlin Hardware Limited: Income statement for the year ended 31 March 2026

	\$	\$
Revenue		264 000
Less Cost of sales		

	\$	\$
Inventory at 1 April 2025	21 300	
Purchases	158 400	
	179 700	
Less Inventory at 31 March 2026	23 700	156 000 (1)
Gross profit		108 000 (1)OF
Less Expenses		
Wages (38 650 + 1 350)	40 000 (1)	
Directors' salaries	24 000	
Rent	13 200	
General expenses	6 915 (1)	
Insurance (4 080 – 840)	3 240 (1)	
Depreciation of fixtures (48 000 × 15%)	7 200 (1)	
Increase in provision for doubtful debts (795 – 580)	215 (1)	94 770
Profit from operations		13 230
Less Debenture interest (37 500 × 8%)		3 000 (1)
Profit for the year		10 230 (1)OF

(b)

Retained earnings	\$
At 1 April 2025	33 610
Profit for the year	10 230 (1)OF
	43 840
Less Dividends paid	(9 000)
Less Transfer to general reserve	(6 000) (1)
At 31 March 2026	28 840 (1)OF

(c)

Marlin Hardware Limited: Statement of financial position at 31 March 2026

	Cost \$	Accumulated depreciation \$	Net book value \$
Non-current assets			
Premises	180 000	–	180 000

	Cost \$	Accumulated depreciation \$	Net book value \$
Fixtures	48 000	21 600	26 400 (1)OF
	228 000	21 600	206 400 (1)OF
Current assets			
Inventory			23 700
Trade receivables		26 500	
Less Provision for doubtful debts		795	25 705 (1)
Other receivables (insurance prepaid)			840
Bank			7 285
			57 530 (1)OF
Total assets			263 930
Equity			
Ordinary share capital			150 000
General reserve (20 000 + 6 000)			26 000 (1)
Retained earnings			28 840 (1)OF
			204 840
Non-current liabilities			
8% Debentures (repayable 2031)			37 500 (1)
Current liabilities			
Trade payables		18 740	
Other payables (1 350 + 1 500)		2 850 (1)	21 590 (1)OF
Total equity and liabilities			263 930

Accumulated depreciation is $14\,400 + 7\,200 = 21\,600$. The debenture interest owing (\$1 500) sits with the wages owing in other payables; the dividends paid and the profit for the year are already inside retained earnings.

Example 4

Sandbar Kayaks Limited is a private limited company. Its three directors own all its shares. They need \$90 000 to build a new workshop and are choosing between issuing 5% debentures and issuing more ordinary shares to new investors. The company already has 7% debentures of \$60 000, repayable in 2028.

(a) State **one** difference between a private limited company and a public limited company. [1]

(b) Explain the difference between called-up and paid-up share capital. [2]

(c) Advise the directors whether they should issue debentures or ordinary shares. Justify your answer. [5]

(a) A public limited company can offer its shares to the public; a private limited company cannot. (1)

(b) Called-up share capital is the part of the issued share capital that the company has asked its shareholders to pay. (1) Paid-up share capital is the part of the called-up capital that the shareholders have actually paid. (1)

(c)

Debentures:

- Debenture holders have no votes, so the three directors would keep full control of the company. (1)
- Interest of \$4 500 a year ($90\,000 \times 5\%$) must be paid even in a year of losses, on top of the \$4 200 already paid on the 7% debentures. (1)
- The debentures would have to be repaid, and the company must find \$60 000 in 2028 already. (1)

Ordinary shares:

- There would be no interest and no repayment, and the directors could pay a small dividend or none in a poor year. (1)
- The new shareholders would have votes, so the directors could lose control if the investors bought a large part of the shares. (1)

Recommendation: the directors should issue ordinary shares, because the company already has debentures to repay and adding more fixed interest and repayments would be risky; they should sell only enough shares to keep a majority of the votes. (1)

Any four of these points earn the 4 marks available for points, and the recommendation earns the fifth; either choice earns it if it follows from the points made.

Common mistakes

- **Vague narratives in the SOCE.** "Profit", "Dividend" and "General reserve" lose marks: write "Profit for the year", "Dividend paid (interim)", "Transfer to general reserve", and date the opening and closing rows.
- **Wrong direction or wrong column.** Profit and dividends go in retained earnings, not in share capital; a transfer is plus in the general reserve and minus in retained earnings. Check that the columns add down and across.
- **Extra items in the SOCE**, such as debentures or a proposed dividend. Only share issues, profit, dividends paid and transfers belong there.
- **Leaving out debenture interest**, or charging only the amount paid. The full year's interest is an expense, and any unpaid part is an other payable.
- **Putting dividends in the income statement.** Dividends are a share of profit for the owners, not an expense.

- **Misplacing items in the SFP:** a bank overdraft as a non-current liability, debentures as a current liability, the provision for doubtful debts as a liability instead of a deduction from trade receivables, or debenture interest paid, dividends paid and the profit for the year as separate lines. Also forgetting to update the general reserve for the transfer, or leaving out retained earnings.
- **Leaving out section totals** in the SFP (non-current assets, current assets, equity, each group of liabilities).
- **Not being able to define equity.** Learn it: the total funds provided by the shareholders, or assets less liabilities.
- **Mixing up dividends and interest.** Shareholders (ordinary and preference) receive dividends; debenture holders receive interest. "Preference shares are paid first" needs finishing: the **dividend** is paid first, and they are **repaid** first on winding up.
- **One-sided advice.** Examiners see answers that discuss only debentures, or discuss whether to expand at all instead of how to pay for it, or give no recommendation. Give points on both options (or for and against) and end with a clear choice. A company does not lose control when shares are issued; its **existing shareholders** may.
- **Advice that ignores the story:** selling shares to the public or losing control when the owners will be the only shareholders.
- **Profit and cash.** "Paying expenses" or "debenture interest" doesn't explain low cash, as they are already in the profit; dividends, new non-current assets, more inventory, loan repayments and slow-paying customers do.
- **Abbreviations** such as "GR" or "NP": use the full words.

How to get the marks

- **Headings:** the company name, the statement, and "for the year ended [date]" (income statement, SOCE) or "at [date]" (SFP).
- **Workings in brackets** beside each adjusted figure: "Insurance (4 080 — 840)". A working can earn the mark even if a slip spoils the total.
- **Own-figure marks (OF):** the SOCE's profit comes from your income statement, the SFP's retained earnings from your SOCE. Always finish every statement, even after an earlier error.
- **SOCE:** every row described in full, opening and closing dates, brackets for deductions, a total column; the closing row usually earns its own mark.
- **SFP:** correct section headings (Non-current assets, Current assets, Equity, Non-current liabilities, Current liabilities), a total for each section, total assets equal to total equity and liabilities.
- **"State"** needs one short, precise point (such as "non-current liabilities"). **"Explain"** needs the point and what it means or why, usually for two marks.
- **"Advise ... Justify your answer":** two points for each side (or each option) tied to the figures in the question, then "I recommend ..." with a reason. Five marks: four for points, one for the recommendation.
- **"Two differences" or "two benefits":** two separate ideas, each stated fully; don't give the same point twice in different words.

- **Multiple choice:** write the linking equation first (retained earnings, equity, capital employed) and ignore distractors such as transfers, proposed dividends and debentures.

Quick check

1. Plover Limited issued 240 000 ordinary shares of \$0.50 each and has called 80% of their value. Holders of 225 000 shares have paid everything called. Calculate the issued, called-up and paid-up share capital.
2. A company's retained earnings were \$52 700 at the start of the year and \$49 350 at the end. The profit for the year was \$31 900 and \$7 500 was transferred to the general reserve. Calculate the dividends paid during the year.
3. Say where each item appears in a company's SFP (equity, non-current liabilities, current liabilities, or not at all): (i) general reserve, (ii) 7% debentures repayable in 2032, (iii) non-redeemable preference share capital, (iv) redeemable preference share capital, (v) interim dividend paid, (vi) debenture interest owing, (vii) a final dividend proposed at the year end.
4. A company has ordinary share capital \$180 000, general reserve \$22 000, retained earnings \$15 500, 6% debentures \$40 000, a bank loan repayable in five years \$25 000 and a bank overdraft \$3 000. Calculate its equity and its capital employed.
5. A company's issued share capital is 600 000 ordinary shares of \$0.25 each. Its profit for the year was \$39 000. It transferred \$6 000 to the general reserve and paid an interim dividend of \$9 000. The rest of the profit is to be paid as a final dividend. What percentage final dividend will the shareholders receive?

Answers

1. Issued = $240\,000 \times 0.50 = \$120\,000$. Called-up = $120\,000 \times 80\% = \$96\,000$ (\$0.40 a share). Paid-up = $225\,000 \times 0.40 = \$90\,000$.
2. $52\,700 + 31\,900 - 7\,500 - 49\,350 = \$27\,750$.
3. (i) Equity. (ii) Non-current liabilities. (iii) Equity. (iv) Non-current liabilities. (v) Not at all: it is in the SOCE, and has already reduced retained earnings. (vi) Current liabilities (other payables). (vii) Not at all: it hasn't been paid.
4. Equity = $180\,000 + 22\,000 + 15\,500 = \$217\,500$. Capital employed = $217\,500 + 40\,000 + 25\,000 = \$282\,500$ (the overdraft is a current liability, so it is left out).
5. Share capital = $600\,000 \times 0.25 = 150\,000$. Profit left = $39\,000 - 6\,000 - 9\,000 = 24\,000$, and $24\,000 \div 150\,000 = 16\%$.

Past questions to try

- **0452/23/O/N/23 Q5**: an income statement from a trial balance for a service company, the statement of changes in equity, and advice on debentures or shares.
- **0452/21/M/J/23 Q5**: retained earnings, a statement of financial position with debentures and a bank loan, why profit is not cash, and shares or a bank loan.
- **0452/23/O/N/22 Q4**: a statement of changes in equity with a per-share interim dividend, and a choice between debentures and shares.
- **0452/13/O/N/21 Q22**: finding the dividend paid from retained earnings.