



UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma in Business
Standard Level

BUSINESS FINANCE

5163/01

Optional Module

May 2010

2 hours plus 15 minutes' reading time

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

Write your Centre number, candidate number and name on all the work you hand in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Attempt **all** tasks.

Start each task on a new piece of paper.

Please leave a margin on the right and left hand side of each new page.

At the end of the examination, fasten all your work securely together, in the correct order.

The number of marks is given in brackets [] at the end of each question or part question.

This document consists of **5** printed pages and **3** blank pages.



You must read the case study below and attempt ALL the tasks which follow.
(This case study is fictitious.)

Xie Hong Enterprises Ltd

Xie Hong Enterprises Ltd is a private limited company that operates in South East Asia providing computer support services for both corporate and private clients. The company was set up three years ago and it has seen growth in each of these years. The Chief Executive Officer (CEO), Xie Hong, is very proud of the achievements of the company and he is keen to maintain both the growth rate and the reputation of the company. Together with the Finance Director, he has developed some ambitious expansion plans which will involve raising a large amount of additional capital. 5

Currently, the company has 200 private clients and 40 corporate clients. The private clients require service on an irregular basis, only when they are experiencing problems. They are charged a fixed fee for a callout and they are then offered a discount on this fee if they need further visits from the engineers. If they require any replacement hardware or software, this is provided at cost price plus a 25% mark up. The current callout fee is set at \$40¹ with a 10% discount for subsequent visits. If it is necessary to take equipment away for repair, the company will lend the client a replacement for a fixed daily fee, which is currently \$10 per day. Invoices for private clients are produced on a monthly basis and the company allows a 5% discount if the invoice is settled within seven days. 10 15

The services offered to the corporate clients are quite different. Most of the corporate clients have their own computer maintenance departments and therefore they maintain their own systems. The main services offered to these clients are website design and maintenance and website training. The clients are charged a fee of \$5 000 for establishing a website, a fee of \$600 per month for maintaining the website and a negotiated fee of \$40-\$50 per trainee attending the training. These rates have been fixed for the last two years, and the Finance Director has suggested that they should be reviewed as the costs of the company have risen during this time. 20

At the recent Annual General Meeting the expansion plans for the company were presented and approved by the Board of Directors, although some directors had reservations about some aspects of the plans. The purchase of the machinery was approved but the Board, on the recommendation of the Finance Director, decided that the company should switch to the reducing balance method of depreciating assets, rather than the present straight line method. The Board also approved a 10% increase in all fees charged to corporate clients, and a change in the pricing policy for the sales of hardware and software to the private clients. The profit should now be calculated as a gross profit margin rather than a percentage mark up. 25 30

The CEO was unhappy with these proposals as he believed that the company would be facing more competition in the future and could therefore lose sales to competitors. He was, however, happy that the Board had approved the proposal to raise the additional finance required for the expansion through a mixture of additional ordinary shares, preference shares and debentures. A different proposal to raise the capital by converting to a public limited company was defeated at the Board meeting because it would create too many problems. 35

Since the Board meeting, the CEO has implemented the necessary changes for the expansion of the company. He has just received the latest market intelligence report from the trade association. This indicates that there are a number of external factors that are likely to have an impact on the company. Some of these will have a positive effect and some a negative effect. The factors identified were: 40

¹Figures in \$US

- The government is considering increasing the domestic interest rates in an effort to reduce the rising inflation rate in the economy.
- A new government initiative to provide everyone over the age of 12 with basic computing skills will be introduced. This will be financed by a 1% increase in the rate of tax on business profits. 45
- A new operating system for PCs will be launched in two years' time and it is expected that this system would be widely adopted by the corporate sector.
- The government is proposing to introduce new legislation concerning maternity benefits for young mothers. These changes would allow extra payments to the mothers who would then return to work earlier as their childcare costs would be fully covered. The aim of this proposal is to increase the proportion of younger people in the workforce as it is believed that they are more likely to cope with the increasing pace of technological developments. 50

The CEO has studied the report and has decided to call an emergency Board Meeting as he believes that there are serious implications for the future profitability of the company. 55

Financial Information

Item A

Extracts from the accounts of Xie Hong Enterprises Ltd for the year ending 31 march 2010

	\$
Turnover	1 250 000
Gross Profit	900 000
Non-operating income	?
Profit after taxation	284 000
Interest payable	15 000
Corporation tax	?
Retained profit carried forward	256 400
Expenses	600 000
Profit on ordinary activities before taxation	355 000
Cost of sales	?
Dividends	28 400
Operating profit	300 000

Where figures are not given you should derive the figures as you construct the profit and loss account.

Item B

Machine 1

Initial purchase cost: \$450 000
 Expected useful life: 8 years
 Estimated residual value: \$30 000

Machine 2

Initial purchase cost: \$800 000
 Expected useful life: 12 years
 Estimated residual value: \$80 000

The Finance Director is recommending a discount rate of 40% for the reducing balance method of depreciation.

You must attempt ALL of the following tasks.

Where appropriate use information from the case study to support your answer.

- 1 (a) (i) Explain the differences between percentage mark up and percentage gross profit margin. [4]
- (ii) Calculate the selling price if goods cost \$240 to buy and the mark up is 25%. [3]
- (iii) Calculate the percentage gross profit margin associated with the selling price calculated in (ii) above. [3]
- (b) Explain **one** financial advantage and **one** financial disadvantage of forming a private limited company. [4]
- (c) During one month, a private client received an initial visit, four subsequent visits and borrowed a computer for six days. Calculate the amount payable to the company if the client settles their bill within the seven day period. [6]
- [Total: 20]**
- 2 (a) Using the information contained in **Item A**, produce a Profit and Loss Account for Xie Hong Enterprises Ltd as at 31 March 2010. [12]
- (b) Describe **two** likely business expenses that the company has. [4]
- (c) Explain how there could be a conflict between pursuing growth and maintaining a good reputation. [4]
- [Total: 20]**
- 3 (a) Distinguish clearly between ordinary shares, preference shares and debentures as methods of raising additional capital. [3 x 3 = 9]
- (b) Discuss the advantages to the company of raising the additional capital through a mixture of ordinary shares, preference shares and debentures. [5]
- (c) Explain **two** possible problems of converting to a public limited company. [2 x 3 = 6]
- [Total: 20]**
- 4 (a) Using the information contained in **Item B**, calculate:
- (i) The annual depreciation for machine 1, using the straight line method of depreciation. [4]
- (ii) The annual depreciation for machine 2, using the straight line method of depreciation. [4]
- (iii) The depreciation allowance for machine 1 during year 2, if the company decided to use the reducing balance method of depreciating the fixed assets. [4]
- (iv) The depreciation allowance for machine 2 during year 2, if the company decided to use the reducing balance method of depreciating the fixed assets. [4]
- (b) Explain **two** reasons why the company should consider introducing the reducing balance method of depreciating the fixed assets. [2 x 2 = 4]
- [Total: 20]**

Question 5 is on the next page.

- 5 The case study mentions **four** external or PEST factors that are likely to have an impact on the future profitability of the company.

For the PEST factors mentioned describe a positive **and** a negative effect that **each** factor may have on the profitability of the company.

[4 x 5]

[Total: 20]

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