



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

BUSINESS FINANCE

5163/01

Optional Module

October 2008

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 **4** printed pages.



You must read the case study and attempt ALL the tasks which follow.

(The case study is fictitious.)

A-2-Z BUILDING SUPPLIES LTD

Ricky Poon has recently taken up the position of Finance Director of A-2-Z Building Supplies Ltd. Although the company has been trading for ten years, there has been a significant decline in the last two years and the Board decided that it was necessary to bring in some new people to develop new strategies for the company. Ricky is a fully trained management accountant and he is hoping that this training will allow him to develop a finance strategy for the company. 5

Ricky has already met with the management team of the company and he has identified a number of weaknesses in the accounting system:

- 1 The departments do not have a formal cash budgeting system. This has led to overspending and contributed to the liquidity problems that the company has been experiencing. 10
- 2 There has been no monitoring of the working capital position of the company. As a result the company has not been operating efficiently.
- 3 The company has a strange pricing policy for its products, with some prices set according to a gross profit margin and others according to a percentage mark up.

Ricky has already prepared a report to the Board recommending changes in all of these areas. 15

A-2-Z Building Supplies Ltd currently has three sites from which it provides building materials to the building trade and the general public. About 70% of its sales are to the building trade, but recent changes in government building regulations have meant that there has been little growth in sales. By contrast, the sales to the general public have been growing steadily and Ricky has proposed that the company should concentrate its marketing effort on this sector for the next few years. This would involve a radical restructuring of the company's distribution facilities and the establishment of an on-line ordering service. Although some of the funds could be raised by closing one of the distribution sites, it is likely that the company will have to raise additional funds. Ricky has made a number of suggestions to the Board about how the additional capital could be obtained. 20

The company recently entered into a franchise agreement with a major supplier of high quality building products, but this has not been very successful. The latest market forecasts indicate that there should be some growth, but Ricky is concerned that this may adversely affect the sales of the traditional products. 25

The company's distribution vehicles are quite old and, due to lack of a formal depreciation process, it is unlikely that they can all be replaced. Ricky has suggested that the company should consider leasing as a method of replacing the vehicles. Another alternative is that they could sub-contract the haulage (the transport of goods) to a specialist transportation firm. 30

Financial Information

Item A Cash Budget Totals

		\$ ¹
Opening cash balance	01 January 2008	30 000
Purchases - Materials	January - March	44 000 per month
	April - June	72 000 per month
Overheads		15 000 per month
Purchases - Equipment	May	52 000
	June	18 000
Additional Insurance Premium	March – May	2 500 per month
Estimated Sales Revenue	January	50 000
	February	40 000
	March	65 000
	April	90 000
	May	150 000
	June	100 000

Item B Balance Sheet Totals as at 31 October 2008

	\$ ¹
Leasehold property	2 500 000
Debtors	145 000
Debentures	200 000
Working capital	57 000
Provision for taxation	27 000
Cash	35 000
Accumulated depreciation	60 000
Creditors	118 000
Vehicles at cost	150 000
Dividend proposed	30 000
Overdraft	10 000
Mortgage	575 000
Ordinary shares	1 200 000
Bank loan	235 000
Stock	Balance not available
Profit and loss account	To provide the balancing item
Share premium account	10% of share value

Note: The figure given for the working capital is considered to be accurate.

Item C Equipment purchase

Purchase price of new vehicles	\$70 000
Expected useful life of vehicles	5 years
Expected residual value of vehicles	\$10 000

For an additional payment of \$2 000 per year, the vehicles' life could be extended to 8 years, and the new residual value would be \$12 000.

¹ Figures quoted in \$US

You must attempt ALL of the following tasks.

- 1 (a) Explain, using your own worked examples, how a percentage mark up is different from a gross profit margin. [6]
- (b) Explain how Ricky's duties as a finance director will differ from his job as a management accountant. [4]
- (c) Explain **one** advantage and **one** disadvantage to A-2-Z Building Supplies Ltd of entering into a franchise agreement. [2 x 2 = 4]
- (d) Explain **one** advantage and **one** disadvantage to A-2-Z Building Supplies Ltd of leasing new equipment. [2 x 2 = 4]
- (e) Explain **one** disadvantage of sub-contracting the transport of the materials. [2]
- [Total: 20]**
- 2 (a) Explain why it is important for a business to monitor the level of working capital. [8]
- (b) Using the information in **Item A**, produce a six-month cash budget for A-2-Z Building Supplies Ltd. [12]
- [Total: 20]**
- 3 (a) Identify and explain **one** advantage and **one** disadvantage of closing the distribution site. [2 x 2 = 4]
- (b) (i) Identify **four** sources of finance that the company could use to fund the new marketing strategy. [4]
- (ii) Explain **one** advantage of using **each** of these sources. [4 x 2 = 8]
- (c) State, with reasons, which source of funds you consider to be most appropriate for A-2-Z Building Supplies Ltd to use. [4]
- [Total: 20]**
- 4 (a) Explain what is meant by the balance sheet equation. [4]
- (b) Using the information in **Item B**, construct a balance sheet to show the financial position of A-2-Z Building Supplies Ltd at 31 October 2008. [16]
- [Total: 20]**
- 5 (a) Explain why the company should employ a formal process of depreciating its fixed assets. [6]
- (b) Use the information contained in **Item C** and the straight-line method of depreciation to calculate the annual depreciation allowance that should be applied to the new vehicles. [6]
- (c) Calculate the book value of the vehicles at the end of Year 3. [2]
- (d) Explain why the company should consider making the additional annual payments with regard to the vehicles. [6]
- [Total: 20]**

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