



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

BUSINESS FINANCE

5173/01

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 **4** printed pages.



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

(The case study is fictitious.)

Eastern Marketing Ltd

Paul Chang has recently taken over control of the family business from his uncle who has now retired. The company has been supplying fresh vegetables to the restaurant trade for many years and has established a good reputation for reliability. Two years ago the company successfully bought out its closest rival, and this is shown by the goodwill figure in the balance sheet. At the beginning of the current year the company registered a patent for a machine that is capable of vacuum packing fresh vegetables and Paul hopes to be able to market the patent through licensing agreements. 5

Although Paul knows a great deal about the distribution business, he has a very limited knowledge of the formal accounting process and has made a number of mistakes when attempting to produce a balance sheet, a profit and loss statement and the cash flow statement. He can, however, keep the records quite well and has maintained the prime books and even produced an accurate trial balance. The company's accountant has suggested that Paul's problems stem from the fact that he does not understand the principles of accounting and has recommended that Paul should attend a basic accountancy course. He has also suggested that Paul should introduce some immediate control procedures through a system of standard costing and variance analysis. 10 15

Paul has some ambitious plans for expanding the business but the accountant and most members of the board are urging caution. This is partly due to the problems with the accounting process but also the external environment is changing rapidly. The PEST factors that are most likely to have an impact on the business are:

- The provincial government is recommending that all accounts should include references to depreciation that is based on the reducing balance method. It is introducing additional inspections to ensure that the process is completed within three years. Also there will be greater controls of waste management for commercial premises in the near future. 20
- The national government is considering raising the interest rate on new lending and limiting the amount of credit available at any one time. 25
- A government campaign to promote healthier eating in order to improve general health standards has been a great success and more people are searching for the healthier food alternatives.
- New developments in technology are making food preparation much easier and cheaper and a number of new machines have been entering the marketplace. 30

Despite the possible problems posed by the PEST factors above, Paul is determined to press ahead with his plans. He wants to open a new distribution centre closer to the provincial capital as he believes that this will reduce the variable costs of the distribution process. He is also considering establishing a distribution system via a website as he believes that this reduces the break-even output. In order to implement his plans he will need to raise a large amount of capital. Paul has suggested that a scrip issue and offering convertible loan stock are the most efficient sources. All machinery and equipment associated with the expansion proposal is to be appraised using discounted cash flow techniques. The company's accountant has been given the job of producing plans with full costings which will be submitted to the next board meeting. 35

Financial Information

Item A

The company has adopted the policy of depreciating the fixed assets using the straight-line method.
 Historic costs of the fixed assets: \$650 000¹
 Expected useful life: 8 years
 Predicted residual value: \$90 000

Item B

Balance Sheet of Eastern Marketing Ltd as at 30th April 2010 (The balance sheet contains errors and omissions.)

	\$	\$	\$
Fixed assets			
Premises		1 040 000	
Equipment at cost	950 000		
Accumulated depreciation	190 000	760 000	
Goodwill		250 000	
Patent		150 000	
			2 200 000
Current assets			
Creditors	98 000		
Prepayments	30 000		
Stock	140 000		
Cash	28 000	296 000	
Current liabilities			
Debtors	75 000		
Provision for taxation	18 500		
Provision for dividend	27 000		
Overdraft	32 000	152 500	
Working capital			143 500
Net assets			2 343 500
Debtentures		500 000	
Investments		350 000	1 493 000
Financed by			
Ordinary shares 800,000@\$1		800 000	
Profit and loss account		693 500	1 493 500

Notes

- 1 The firm's accountant has indicated that the correct figure for the profit and loss account is \$777 500.
- 2 The \$1 ordinary shares had been sold at a premium of 40%.

¹ figures in \$US

You must attempt ALL of the following tasks.

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

- 1 (a) Explain what is meant by goodwill, and give **one** reason why it is included in the fixed assets of the company. [3]
- (b) Explain what is meant by variable cost. [2]
- (c) Explain what is meant by break-even output, and how the operation of the website sales might reduce the break-even point. [5]
- (d) Explain what is meant by a scrip issue. [3]
- (e) Explain what is meant by convertible loan stock. [3]
- (f) Explain what is meant by discounted cash flow techniques, and give **one** example. [4]
[Total: 20]
- 2 (a) Explain what is meant by the books of prime entry and explain what role they play in the accounting process. [2 x 3 = 6]
- (b) Explain what is meant by the trial balance and explain what role it plays in the accounting process. [2 x 3 = 6]
- (c) Explain what is meant by a cash flow statement and explain how it is related to the books of prime entry and the trial balance. [2 x 4 = 8]
[Total: 20]
- 3 (a) Explain why a business should consider depreciating its fixed assets and explain how such a policy is in line with the principles of accounting. [2 x 4 = 8]
- (b) Explain the circumstances in which the reducing balance method of depreciation would be preferred to the straight line method of depreciation. [6]
- (c) Use the information in **Item A** to calculate the book value of the assets at the end of year 3. [6]
[Total: 20]
- 4 The information given by Paul in **Item B**, the balance sheet, is incorrect.
- (a) Describe and explain the errors or omissions in the balance sheet. [8]
- (b) Produce an amended balance sheet. [12]
[Total: 20]
- 5 (a) Explain how **each** of the PEST factors mentioned in the case study could affect the future profitability of the company. [4 x 3 = 12]
- (b) Explain what is meant by standard costing and explain how this can be combined with variance analysis to bring about greater control over the finances of the company. [2 x 4 = 8]
[Total: 20]

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