



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

BUSINESS FINANCE

5163/01

Optional Module

May 2013

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 **6** printed pages and **2** blank page.



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

(This case study is fictitious.)

Case study: A1 Security Ltd

A1 Security Ltd is a private limited company that has been trading for two years. The company was formed by two friends, Olga and Vladimir, who had met at an international conference on corporate security. Both had carried out research into fibre optic technology and were world leaders in this field. Vladimir had developed many new security products and held patents on a number of them. Both Olga and Vladimir had been in business as sole traders before they formed the company, but neither had been particularly successful. They hoped that, by working together, they would have more success. 5

A1 Security Ltd provides security systems for corporate clients. This includes physical security such as alarm systems and computer protection systems. The systems for each client are unique and are developed after an initial survey has been undertaken. The maintenance of these systems has been sub-contracted to two other firms because Vladimir believed that it would be more cost effective. Olga, however, did not agree as she felt that it was likely to reduce revenues and ultimately to reduce the level of profit. 10

Recently the company was approached by the head of a government department, who is interested in upgrading the security within that department. Olga and Vladimir are enthusiastic about the possible extra work but they realise that taking on such a large contract will put a strain on their resources. They approached their accountant for some advice and she suggested that they should look for additional financing by becoming a public limited company. Both Olga and Vladimir, who are the majority shareholders of their company, think that this will be a huge step and they have called a meeting of the Board to discuss the proposal. 15 20

Olga is responsible for the financial affairs of the company as she briefly studied accountancy whilst at university. She does, however, admit that her knowledge is limited to understanding some of the principles of the accounting process. Olga is aware of the historic cost and prudence principles but not the other recognised principles. She has produced a Balance Sheet (Statement of Financial Position) for the company but she is unsure whether it is accurate. When she showed her draft Balance Sheet (Statement of Financial Position) to the company's accountant she was told that it has a number of errors that will have to be corrected. The accountant suggested that Olga should attend a basic accountancy course as she needs to appreciate what is meant by the balance sheet equation and the reasons why adjustments are sometimes necessary before the final Balance Sheet (Statement of Financial Position) can be produced. 25 30

Vladimir is more practical with financial affairs. He is good at working out costs and he has introduced a system for monitoring the variable costs of the company's activities. He is also keen on monitoring the cash flow of the company by producing three-month cash budgets. He has recently suggested that the company should introduce discounted cash flow techniques for appraising their investments as he believes that this will be more reliable. 35

Financial Information

Item A

Estimated cash receipts and expenditure for A1 Security Ltd August to October 2013

Cash Receipts			
Security Surveys		Security Installations	
August	4	August	2
September	6	September	1
October	3	October	3

Each survey costs the client \$15 000¹. A1 Security Ltd will receive 50% of the payment for a survey in the month that it is carried out and 50% in the following month. No surveys are planned for July.

For each security system that A1 Security Ltd installs it will receive \$30 000. It will receive 75% of this money in the month that the installation takes place and the remaining 25% in the following month. No security installations are planned for July.

Cash Payments		
	Wages	Materials
August	\$20 000	\$30 000
September	\$40 000	\$20 000
October	\$50 000	\$50 000

Other payments

Purchase of new equipment	September	\$15 000
Insurance premium to be paid	October	\$15 000
Payments to be made against a loan of \$5 000 per month		
Opening cash balance	August 1	\$40 000

¹ Quoted in US dollars

Item B**Draft Balance Sheet for A1 Security Ltd as at 31 January 2013**

	\$000	\$000
Land and Buildings	4800	
Equipment at Cost	<u>9600</u>	
		14400
Stock/Inventories	800	
Fixtures	1200	
Debtors/Trade Receivables	720	
Cash	<u>120</u>	
	2840	
Accumulated Depreciation	1800	
Creditors/Trade Payables	480	
Current Tax Payable	200	
Proposed Dividend	240	
Overdraft	<u>100</u>	
	2820	
Working Capital		<u>20</u>
		<u>14420</u>
Financed by		
Ordinary Shares 1600@ \$4	8 000	
Preference Shares 400@ \$8	3 200	
10% Debenture issued 31 Jun 2011	2 000	
Profit & Loss Account	<u>1 220</u>	
	<u>14 420</u>	

It was reported that the ordinary shares had been sold at a 25% premium.

This is not an accurate version of the Balance Sheet

You must attempt ALL of the following tasks.

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

- 1 (a) (i) Explain what is meant by a patent. [2]
- (ii) Explain how a patent is treated in the accounts of a business. [2]
- (b) Explain **one** advantage and **one** disadvantage of sub-contracting the maintenance of the security systems. [2 x 2 = 4]
- (c) Explain, with an example, what is meant by a variable cost. [3]
- (d) Explain what is meant by discounted cash flow techniques and give **one** example of such a technique. [4]
- (e) The accountant has recommended that the company should raise additional finance by becoming a public limited company.
- (i) Identify **two** other sources of long term capital that A1 Security Ltd could use to finance its expansion plans. [2]
- (ii) State, with a reason, which of the sources, in (i) above, you would recommend to A1 Security Ltd. [3]
- [Total: 20]**

2 Using the information in **Item A**:

- (a) Produce a three-month cash budget for A1 Security Ltd for the period August to October 2013. [12]
- (b) Explain **two** advantages and **two** disadvantages of keeping large reserves of cash. [4 x 2 = 8]
- [Total: 20]**

3 Olga stated that she understood the accounting principles of historic cost and prudence.

- (a) Explain what is meant by **both** historic cost and prudence. [2 x 2 = 4]
- (b) List **four** additional accounting principles that Olga should be aware of. [4 x 1 = 4]
- (c) Explain how **each** of these additional principles contributes towards the production of accurate accounts. [4 x 3 = 12]
- [Total: 20]**

4 Using the information in **Item B**:

(a) Produce a revised Balance Sheet (Statement of Financial Position) for A1 Security Ltd that represents a 'true and fair view' of the financial affairs of the company. [12]

(b) Explain what is meant by the balance sheet equation. [4]

(c) Identify **four** financial documents (records) that A1 Security will use in their business. [4 x 1 = 4]

[Total: 20]

5 (a) Explain **two** advantages and **two** disadvantages of operating as a sole trader. [4 x 2 = 8]

(b) Explain **both** the legal and the financial implications of **becoming** a public limited company [2 x 4 = 8]

(c) Explain **one** financial advantage and **one** financial disadvantage of **operating** as a public limited company. [2 x 2 = 4]

[Total: 20]

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