



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

BUSINESS FINANCE

5163/01

Optional Module

May 2012

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 of the tasks which follow.

(This case study is fictitious.)

S & A Catering Supplies

Sunil and Anil are the two owners of S&A Catering Supplies, a small business that produces and distributes containers to the catering industry. The business was established two years ago and it currently employs 20 people in a single factory unit. The business is structured as a limited partnership, with Sunil as the general partner and Anil as a sleeping partner. They chose this structure as there were fewer formalities involved in the formation of the business and they both had enough capital to invest to ensure that the business could begin production. 5

The business has made reasonable profits in both years of operation and this has allowed some expansion to take place. However, the partners have agreed that if they wish to expand further, they may have to consider looking for additional finance from outside of the business. Sunil has had discussions with the firm's bank manager and he has pointed out that some of their expansion plans could be financed by restructuring their assets and increasing the level of liquidity within their finances rather than increasing the capital base. At the same time, he has pointed out that continued growth may mean that they have to consider restructuring the business as an incorporated organisation. Although this would involve some initial expenses, the banker has suggested that there will be some long term financial advantages from being an incorporated organisation. Both Sunil and Anil are uncertain about this proposal but they have agreed to consider it. 10 15

One thing that the partners need to do immediately is to increase their knowledge of the accounting process. Although both of them have an idea of how to calculate the level of profits, they understand very little else about how accounts are constructed. At the moment they employ a financial accountant to produce the accounts for the business and he has suggested that both partners should attend the local college to gain some insight into the accounting process. He has produced a list of topics that they both need to understand. This list includes the concept of the money cycle and the role of profit within a business organisation; the distinction between tangible assets and intangible assets; and the activities associated with both financial accounting and management accounting. The accountant believes that if they gained such knowledge, they would be more likely to remain successful in the future. 20 25

The accountant has also suggested that the partners should introduce a formal process of appraising any future investments. At the moment there is no such process and there have been instances when equipment has not been used for considerable periods of time. He has pointed out that the methods of appraising investments are relatively straightforward and he has recommended that they begin by using the payback method. Both partners have agreed to do this. 30

Financial Information

Item A

The business has recently purchased a new machine for producing meat containers. The machine has a maximum output of 10 000 units per week. The partners have decided not to run the machine at full capacity because the running costs tend to rise as the output rises and they do not have sufficient orders to justify a full capacity run.

The production manager has produced the following figures for two different levels of output.

If the machine is operating at 60% capacity the cost of producing a single unit is \$4.50¹.

If the machine is operating at 80% capacity the cost of producing a single unit is \$4.80.

The sales and distribution costs differ depending on the level of output.

At 60% capacity the sales and distribution costs are \$0.60 per unit, and at 80% capacity the sales and distribution costs are \$0.50 per unit.

The current sales level matches the 60% capacity level, but the sales team has suggested that they could reach the 80% level. The current sales price is \$7.50, but the sales team has stated that in order to guarantee selling all output from an 80% capacity run the sales price would have to be reduced by 10%.

When undertaking any calculations, you should ignore the purchase price of the machine and any allowances for depreciation that may be decided on by the business.

Item B

Machine A has an initial cost of \$600 000 and a useful life of 5 years. It will have a residual value of \$50 000. The net income from the machine has been estimated at \$150 000 per year.

Machine B has an initial cost of \$800 000 and has a useful life of 8 years. It will have a residual value of \$100 000. The net income from the machine has been estimated at \$180 000 per year.

¹ Quoted in US dollars

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 the process of incorporation. [3]
- (ii) Identify the likely expenses associated with the process of incorporation. [3]
- (iii) Explain **two** possible long term financial advantages of becoming an incorporated organisation. [2 x 2 = 4]
- (b) (i) Explain why the running costs per unit might increase if the business runs the machine at 80% capacity. [3]
- (ii) Explain why the sales and distribution costs per unit might decrease if the business runs the machine at 80% capacity [3]
- (c) Explain **one** advantage and **one** disadvantage that is associated with Anil's status as a sleeping partner. [2 x 2 = 4]
- [Total: 20]**
- 2 (a) Explain what is meant by the money cycle. [6]
- (b) Explain the role that profit plays within the money cycle. [4]
- (c) Using the information in **Item A**, calculate the weekly net profit that would be achieved at;
- (i) 60% capacity level [5]
- (ii) 80% capacity level [5]
- [Total: 20]**
- 3 (a) Using your own examples, explain the differences between tangible assets and intangible assets. [10]
- (b) Using your own examples, explain the difference between financing that increases the capital base and financing that increases the level of liquidity. [10]
- [Total: 20]**

- 4 Financial accounting is associated with recording information, summarising information and presenting information.
- (a) Explain, using your own examples, what is meant by
- (i) recording information [4]
 - (ii) summarising information [4]
 - (iii) presenting information [4]
- (b) Explain **four** differences between the work of a management accountant and the work of a financial accountant. [4 x 2 = 8]
- [Total: 20]**
- 5 (a) (i) Explain what is involved in a formal process of appraising any future investment opportunities. [6]
- (ii) Explain **two** possible benefits from adopting a formal system of investment appraisal [2 x 2 = 4]
- (b) Using the information in **Item B**, calculate the payback period, in years, for:
- (i) Machine A [5]
 - (ii) Machine B [5]
- [Total: 20]**

BLANK PAGE

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

University of Cambridge International Examinations is part of the Cambridge Assessment Group. Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.