

UNIVERSITY OF CAMBRIDGE LOCAL EXAMINATIONS SYNDICATE
CAMBRIDGE CAREER AWARD – STANDARD LEVEL

BUSINESS

5163/1

Business Finance
Core module

OCTOBER 2002

Additional materials:
Answer paper

TIME 2 hours plus 15 minutes reading time

INSTRUCTIONS TO CANDIDATES

Write your name, Centre number and candidate number in the spaces provided on the answer paper/booklet.

Attempt all tasks.

Write your answers on the separate answer paper provided.

If you use more than one sheet of paper, fasten the sheets together.

INFORMATION FOR CANDIDATES

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

You may use a calculator.

This question paper consists of 4 printed pages.

[Turn over

You must read the case study below and attempt all the tasks that follow.

(The case study is fictitious)

Case Study – Activate Ltd

Bob and Brian, the two friends who had established Activate Ltd, had first met 20 years ago when they were both physical training instructors in the army. They had both been in business before, without much success. In fact Brian had at one time been declared bankrupt, but this time they were both determined that they were going to be successful. They had both attended business start-up training courses and were confident in their ability to handle the financial affairs of their business. 5

They had formed Activate Ltd as a private limited company five years ago. It provided adventure holidays within the UK for young people aged between 25 and 30 years old. They had deliberately borrowed as little as possible, and this appeared to have been a wise decision as the general level of interest rates had risen over the last three years. 10

Bob, who had prepared the financial accounts for the business, had recently submitted this year's accounts to the auditor, but the auditor had been unwilling to sign them. Despite this setback, Bob and Brian were happy with the year's end results and were confident about the future. Indeed Brian, who dealt with most of the marketing of the company, had been involved in discussions with a major package holiday company regarding expanding Activate's business to include overseas destinations. A major multinational company which was interested in developing management training courses with Activate had also contacted him. 15

Bob and Brian had done some preliminary costings for these proposals and had been investigating various sources of finance for the necessary expansion of their activities. They approached the firm's auditor, who had amended the accounts (see Table 1), for further advice. He made two main recommendations: 20

- they should consider 'going public'
- they would need to implement much tighter controls on their working capital than had been the case in the past

Table 1

Extracts from Activate Ltd Balance Sheet and Profit & Loss Statement

	\$
Property	110,000
Stock	3,400
Creditors	2,500
Debtors	4,100
Vehicles (net)	26,500
Dividend	2,400
Cash	450
Mortgage	20,000
Loan	5,000
Ord shares	65,000
Rent	12,000
Profit & Loss Account	to provide balancing item
Sales	450,000
Accumulated Depreciation	3,500
Overdraft	980
Drawings	30,000

Table 2

<p>Expected Revenue for the next six months \$000's July 50, Aug 50, Sept 60, Oct 35, Nov 40, Dec 30</p>
<p>Expected Costs are: wages \$32,000 per month rent \$12,000 per annum insurance \$8,400 per annum advertising \$1,200 per month fuel, power \$1,600 per month In addition, the company would need to purchase new equipment costing \$11,000 – paid in two 50% instalments (Aug & Sept), and replacement vehicles costing \$24,000 – paid in three instalments (50% and 2 x 25%) (Sept, Oct & Nov) and refurbishment of property \$28,000 to be paid in November</p>

Table 3

<p>Current Turnover = \$450,000 Current Gross Profit Margin = 12% Expected increase in turnover = 22% Current Net Profit = 85% of Gross Profit Figure Expected Gross Profit Margin maintained at 12 % Expected Net Profit (due to set up costs) = 70% of Gross Profit Figure</p>

You must attempt all of the following tasks.

- 1 (a) (i) Explain what is meant by the term 'bankrupt' as used in the case study. (line 3) [2]
 (ii) Identify the consequences that being declared bankrupt would have on someone who was engaged in business. [2]
- (b) (i) Explain how the owners could have borrowed to finance their enterprise. [2]
 (ii) Explain why the owners might have chosen to keep the borrowing of the company low. [2]
- (c) (i) Explain the role of the auditor in the accounting process. [2]
 (ii) Explain why the auditor might have chosen not to sign the accounts of the business. [2]
- (d) Explain what is meant by the term 'multinational company' as used in the case study. (line 16) [2]
- (e) (i) Explain what is meant by the term 'going public' as used in the case study. (line 22) [2]
 (ii) Explain **two** methods that could be employed to go public. [4]
[Total: 20]
- 2 Using the information contained in Table 2, prepare a cash budget for the six-month period July to December. [12]
- 3 List and explain the possible advantages and disadvantages if Activate Ltd became a public limited company. [10]
- 4 List and explain **two** accounting concepts that are required to produce accurate accounts. [8]
- 5 (a) Explain what is meant by the term 'working capital'. (line 23) [2]
 (b) Describe the methods that could be employed to ensure that there is effective control of working capital. [10]
[Total: 12]
- 6 (a) Using the information in Table 1, construct a balance sheet to show the position of Activate Ltd as at 30 June 2002. [14]
 (b) Use this balance sheet to comment on the financial position of Activate Ltd. [4]
[Total: 18]
- 7 Using the information contained in Table 3 calculate the change in both gross and net profit that would occur if the new proposals were implemented. [8]
- 8 Select **three** sources of finance that could be used by Activate Ltd to expand its operations. Describe the effects that each source would have upon the capital structure and the future profitability of the firm. [12]