

UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma Standard Level

MARK SCHEME for the October 2011 question paper
for the guidance of teachers

CAMBRIDGE INTERNATIONAL DIPLOMA IN BUSINESS
5163 Business Finance, maximum mark 100

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- 1 (a) Explain one financial advantage and one disadvantage of distributing the company's products via a network of agents. [2 x 2 = 4]

Allow 2 marks for a relevant and well explained financial advantage and 2 marks for a relevant and well explained financial disadvantage.

e.g. Advantages – cost saving etc.

Disadvantages – share of the profits etc.

- (b) Explain the differences between ordinary and preference shares. [2 x 2 = 4]

Ordinary shares – voting capital (equity) usually 1 share = 1 vote; paid dividends from profits but amount of dividend is likely to vary according to amount of profit made

Preference shares – no voting rights; usually paid a fixed % rate of dividend regardless of amount of profit made

- (c) Explain the main purpose of the following:

(i) Cash flow statements

(ii) Profit and loss accounts

(iii) Balance Sheets. [3 x 2 = 6]

Cash Flow statements – to show cash inflows and outflows; to predict future shortfalls of cash; to plan for future expenditure

Profit and Loss Account – to calculate gross and net profit; to determine tax liability; to compare income with costs; to measure improvement over different years

Balance Sheet – to show the value of the business; to show liquidity position; to list details of assets and liabilities

- (d) Explain what is meant by the margin of safety. [3]

Allow 1 mark for a vague definition e.g. there is some spare capacity.

Allow the full 3 marks if the answer refers to the difference between the actual or budgeted output and the break-even level of output.

- (e) Identify and explain an alternative method of depreciating the fixed assets that would be more appropriate for the company. [3]

Allow 1 mark for identifying an alternative method e.g. the reducing balance method.

Allow a further 2 marks if the answer refers to higher levels of depreciation in the early life of an asset, which is more appropriate when technology is changing quickly and assets are becoming obsolete more quickly.

[Total: 20]

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- 2 (a) Explain **both** the financial and legal formalities involved in forming a private limited company. [4 x 2 = 8]

Allow up to 4 marks for both financial and legal formalities. If only financial or legal formalities are discussed allow a maximum of 4 marks.

For each relevant financial/legal formality that is well explained allow 2 marks.

Financial formalities could include setting limit for authorised capital, directors paying in full for their shareholdings, appointment of external auditor etc.

Legal formalities could include complying with company law, registering company with full documentation etc.

Markers should be prepared to allow marks where there appears to be an overlap between the legal and financial formalities.

- (b) Explain why the directors of Red Dragon Paper Products Ltd wished to form a public limited company **and** explain some of the problems that may arise if the company was formed. [3 x 2 = 6]

Allow up to 3 marks for any reasonable explanation of why the directors wished to form the company and up to 3 marks for any well explained problems that may result from its formation.

Reasons might include easier to raise large amount of capital, cheaper to raise capital, existing owners can still retain control, higher public profile of the business etc.

Problems could include loss of privacy, greater risk of being taken over etc.

- (c) Explain what is involved in issuing shares by both prospectus and private placing. [6]

Allow up to 3 marks for a complete explanation of each method.

Prospectus involves producing a formal document that describes the company and invites interested parties to apply for shares at a fixed price.

Private placing is associated with an external party operating on behalf of the company. This individual will approach prospective investors and negotiate variable prices for the shares depending on the volume of their investment. Often involves offering a discount on share price.

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- 3 (a) Explain, using your own example, what is meant by the term double entry bookkeeping. [6]

Allow up to 3 marks for a complete definition of the concept – transactions recorded twice, positive and negative aspects, credit and debit entries.

Allow the additional 3 marks if the response includes clear and relevant worked example.

- (b) List four examples of financial records and four books of account that the firm should be keeping. [8 x 1 = 8]

Allow 1 mark per record and 1 mark per book – e.g. invoice, credit note, debit note/sales day book, journal, ledger etc.

- (c) Identify and explain two additional accounting principles. [2 x 3 = 6]

Allow up to 3 marks for each principle identified and explained.

Principles include realisation, matching, money terms, going concern etc.

[Total: 20]

- 4 (a) Using the information in Item A, produce a balance sheet to show the financial position of Red Dragon Paper Products Ltd as at 30 September 2011. [20]

(Note: there are 8 marks available for a correct format for the balance sheet and up to 12 marks for correct figures)

Allow up to 8 marks for a correct and complete balance sheet format – this must include the title and all sub-totals should be identified.

Allow 1–4 marks for a balance sheet that has an appropriate format but there are errors or omissions.

Allow 5–8 marks for a balance sheet that has an appropriate format and there are fewer errors or omissions.

The remaining 12 marks are to be awarded for being able to extract the relevant data and for classifying correctly and arriving at an overall balance for the statement.

Level 1 The candidate has extracted the data and has classified some of the data correctly but there are likely to be errors /or missing sub-total figures. It is unlikely that the statement balances /or the balance figure is incorrect. 1–4 marks

Level 2 As Level 1 but there are fewer errors associated with the classification of the data and fewer errors in the provision of sub-totals. The correct overall balance is not provided possibly because of the incorrect calculation of the profit figure. 5–8 marks

Level 3 As Level 2 but the process is complete and the sub-totals and the overall balance is achieved by correctly calculating the profit figure. 9–12 marks

For suggested solution see Appendix 1.

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5 Item A includes figures for Creditors, Mortgage, Dividends, Taxation, and Overdraft.

- (a) For each item listed suggest two stakeholders that would be interested in that figure.**
[5 x 2 = 10]

Allow 1 mark for each suitable stakeholder identified:

- Creditors – suppliers, customers, managers
- Mortgage – bank managers, other lenders, managers
- Dividends – shareholders, directors, employees
- Taxation – taxation authorities, managers
- Overdraft – bank managers, employees, managers

- (b) Choose five stakeholders and describe their reasons for examining items in financial accounts.**
[5 x 2 = 10]

Allow 2 marks for suitable description of each stakeholder's reasons:

Creditors; suppliers to check if company keeping up with payments, customers to see if they can withhold payment, managers to monitor efficiency

Mortgage – bank managers to check on repayments or security, other lenders to consider if firm is a secure risk, managers to monitor liabilities and repayments

Dividends – shareholders to evaluate amount paid, directors to determine amount paid, employees to compare with wage increases

Taxation – taxation authorities to check calculation and collect payment, managers to ensure payments made

Overdraft – bank managers to ensure money repaid, employees to consider job security, managers to arrange repayment

[Total: 20]

Appendix 1

Balance Sheet of Red Dragon Paper Products Ltd as at 30 September 2011

	\$	\$	\$
Fixed Assets			
Property		3 000 000	
Vehicles and Equipment (at cost)	60 000		
Less Depreciation	7 000	53 000	3 053 000
Current Assets			
Stock	80 000		
Debtors	270 000		
Cash	22 000		
		372 000	
Current Liabilities			
Taxation	80 000		
Creditors	120 000		
Dividend	10 000		
Overdraft	50 000		
		350 000	
			22 000
less			3 075 000
Mortgage	400 000		
Bank Loan	100 000		
		500 000	
			2 575 000
Financed by			
Ordinary Shares		2 000 000	
Profit and Loss Account		575 000	
			2 575 000