

CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma Standard Level

MARK SCHEME for the October 2013 series

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

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October 2013 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

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- 1 (a) (i) Explain the relationship between increased selling expenses, increased turnover and increased net profits. [4]

To achieve a full award the candidate should explain that the increase in total net profit has been caused by the increase in sales revenue despite the increases in expenses. Net profit per unit might actually have fallen and it is also possible that the sales price per unit has been increased to cover the increase in expenses.

Allow 1 mark for each element of the above discussion.

- (ii) Explain, with an example, what is meant by double-entry accounting. [4]

Allow 2 marks for an answer that explains that double-entry accounting involves making two entries for each transaction – one a credit entry and one a debit entry.

Allow a further 2 marks for any valid example that illustrates this process.

- (b) (i) Explain what is meant by working capital. [2]

Allow 1 mark for a vague statement that it is money required for day-to-day expenses.

Allow up to 2 marks for a well explained answer that states that it is the surplus of current assets over current liabilities. An answer that provides the correct formula for working capital, $WC = CA - CL$, should be awarded 2 marks.

- (ii) Explain why it is important for a business to maintain its liquidity. [4]

Allow 2 marks for each sensible suggestion provided by the candidate to a maximum of 4 marks.

It will ensure that creditors can be paid and this will mean that they will continue to supply goods or services. It will mean that the business can deal with any unforeseen difficulties. It will demonstrate to outsiders that the firm is being run in a sensible manner and this will encourage them to have dealings with the business etc.

- (c) (i) Explain one advantage of a hire purchase agreement. [2]

Allow 2 marks for an answer that is complete.

A hire purchase agreement involves the business paying an initial deposit and then a series of regular payments. The right of title to the goods is only transferred by the vendor after the final instalment has been paid.

- (ii) Explain what is meant by a trademark and explain how a trademark is treated in the accounts of a business. [4]

Allow 2 marks for any well explained definition of a trademark and a further 2 marks if the answer explains how it is dealt with in the accounts.

A trademark is a chosen name that a business has attached to its goods/services. It is a registered name and no other business has the right to sell goods/services under that name. It often means that the business can sell its goods/services at a premium.

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A trademark is treated as an intangible fixed asset and it will be entered into the business's balance sheet.

[Total: 20]

2 Using the information contained in Item A:

- (a) Calculate the break-even level of output in units to the nearest whole number for the proposal. [8]**

Level 1 The candidate provides an answer that shows that they understand some of the process required to calculate break-even output but they do not provide a formula and the calculation contains errors/omissions. (1–3 marks)

Level 2 As Level 1 but the candidate clearly understands the process and has provided a relevant formula and workings. The figures have been correctly extracted from the case study and at the top end they arrive at an accurate solution. (4–8 marks)

For suggested solution see Appendix 1.

- (b) Explain what would happen if the business was to operate at:**

(i) 10 units below the break-even output [2]

(ii) 10 units above the break-even output [2]

For (i) and (ii):

Allow 1 mark if the candidate makes a vague statement e.g. the business is not covering fixed costs etc.

Allow 2 marks if the candidate correctly states that the business will be making losses or profits.

- (c) Explain what is likely to happen to the break-even point if the selling price increases by 20% and the variable costs increase by 30%.
(Your answer can be supported by calculations) [8]**

Level 1 The answer is very vague and is likely to discuss changes in the level of profit rather than the break-even point. (1–4 marks)

Level 2 The answer is much more focused and analyses the changes in terms of a changing level of contribution per item sold and suggests a correct overall alteration in the break-even level. (5–8 marks)

If a candidate simply provides a revised break-even figure but there is no explanation or discussion of the changes allow a maximum of 4 marks.

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3 (a) Explain the possible legal effects if Charles formed a limited company. [8]

Need to comply with legislation.
 Need to produce audited accounts.
 Issuing of shares to raise capital.
 Disclosure of records and accounts.

Candidates should also introduce concept of limited liability.

For each of the above identified allow 1 mark and allow 1 further mark for development.
 Allow credit as above for any other relevant suggestions.

(b) Explain two financial advantages and two financial disadvantages of forming a limited company. [4 × 2 = 8]

For each advantage/disadvantage identified allow 1 mark and a further 1 mark for explanation.

Advantages: Ability to raise large amounts of capital, no need to pay out dividends if profits are not made, enhanced credit rating with outside financial institutions etc.

Disadvantages: Need to share profits with shareholders, initial expenses involved in registering the company, need to pay to have the company's accounts audited etc.

(c) Explain two duties that Charles would have as a director of a limited company. [2 × 2 = 4]

Safeguard shareholders' investment
 Ensure company operates within legal guidelines
 Formulating policy
 Ensure production of annual accounts/reports.

For each duty allow 1 mark and up to 1 further mark for quality of explanation.
 Allow credit as above for any other relevant suggestions.

[Total: 20]

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4 Using the information contained in Item B:

(a) Construct a Profit and Loss Account (Income statement) for Ling Trading. [12]

Candidates need to process the data to produce an accurate statement that identifies both the gross profit and the net profit.

Level 1 Some data used – calculations of profit figures not made. (1–4 marks)

Level 2 Most data entered correctly – profit figures still incorrect. (5–8 marks)

Level 3 All data correctly entered and profit figures correctly calculated. (9–12 marks)

See Appendix 2 for suggested solution.

Calculate the following showing your working and formulae:

(b) (i) Calculate the percentage mark-up that Charles achieved on cost of sales. [4]

Allow 2 marks for providing the correct formula for calculating % mark-up.

Allow 2 additional marks for correct extraction of data from the P&L and correct calculation of the mark-up.

See Appendix 3 for suggested solution.

(ii) Calculate the percentage gross profit margin that Charles achieved on sales. [4]

Allow 2 marks for providing the correct formula for calculating % GPM.

Allow 2 additional marks for correct extraction of data from the P&L and correct calculation of the GPM.

See Appendix 4 for suggested solution.

[Total: 20]

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5 (a) (i) Explain with an example, what is meant by the books of prime entry. [3]

Allow up to 2 marks for an explanation that refers to the entering of financial data in books that summarise the financial transactions that have been evidenced by the financial records and documents.

Examples may be given – e.g. day books, ledgers – allow 1 extra mark for this.

(ii) Explain what role they play in the accounting process. [3]

Allow 3 marks for explaining the role of prime entry books- it allows the summarising of large amounts of data and effective comparison with previous trading periods.

(b) (i) Explain what is meant by the trial balance. [3]

Allow up to 3 marks for a complete explanation of what is meant by the trial balance – the statement that is drawn up using the data from the books of prime entry and shows the summary totals from these records. It will be represented as a summary list of credit and debit balances and the totals for these should balance. If the candidate provides a valid example allow up to 3 marks as long as there is some explanation provided.

(ii) Explain what role it plays in the accounting process. [3]

Allow 3 marks if the role is well described, i.e. to provide a running total of the financial position and to provide an initial check to ensure that the original entries have been correctly entered into the accounts and that no mistakes have been made as data has been transferred.

(c) (i) Explain what is meant by a cash flow statement. [4]

For an explanation of the cash flow statement as a document that records the total inflow and outflow of cash as a result of all trading activities, ensuring that there have been no errors or omissions, allow 3 marks.

For recognition that it is a year-end statement, allow 1 further mark.

(ii) Explain how it is related to both the books of prime entry and the trial balance. [4]

For identifying that it is based on the entries that have been made in the prime books and therefore the accuracy of the cash flow statement is related to the initial entries that were made. The trial balance should have shown up any errors or mistakes but it is only an interim statement whereas the cash flow statement does the same job but at the end of the trading period.

Allow up to 4 marks depending on the quality of the explanation.

[Total: 20]

Appendix 1

2 (a) Contribution = sales – variable costs

$$\$1.70 - \$ (0.50 + 0.04 + 0.12) = \$1.04$$

$$\text{Break-even} = \frac{\text{fixed costs}}{\text{contribution}} = \frac{\$ 200}{\$ 1.04} = 192.3 = 192 \text{ or } 193 \text{ units}$$

Appendix 2

4 (a) Profit and Loss Account for Ling Trading to 31 October 2013

	\$	\$
Turnover		400 000
Opening stock (Inventories)	120 000	
Purchases	280 000	
		400 000
less Closing stock (Inventories)	140 000	
		260 000
Gross profit		140 000
less		
Vehicle expenses	12 000	
Telephone	4 000	
Printing and stationery	12 000	
Rent and rates	36 000	
Electricity	8 000	
Insurance	2 000	
Depreciation – vehicles	8 000	
Depreciation – fixtures and fittings	3 600	
Total expenses		85 600
Net profit		54 400

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Appendix 3

$$\begin{aligned} 4 \quad (b) \quad (i) \quad \% \text{ mark-up} &= \frac{\text{gross profit}}{\text{cost of sales}} \times 100 \\ &= \frac{140\,000}{260\,000} \times 100 = 54\% \end{aligned}$$

Appendix 4

$$\begin{aligned} 4 \quad (b) \quad (ii) \quad \% \text{ Gross Profit Margin} &= \frac{\text{gross profit}}{\text{turnover}} \times 100 \\ &= \frac{140\,000}{400\,000} \times 100 = 35\% \end{aligned}$$