



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

**BUSINESS FINANCE**

5163/01

Optional Module

October 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 **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.)

### **Ling Trading**

Charles Ling has been in business as a sole trader for five years. He began selling electrical goods from a market stall, but as his business grew he decided to rent a retail outlet in the town centre. Although this has resulted in higher selling expenses, the increase in turnover has meant that his net profits have risen for each of the last three years. Charles is now looking to expand the business by opening a second shop in the neighbouring town and he is also considering manufacturing some of the electrical components that he sells. He approached his bank about taking out a loan to finance his expansion plans and is also considering leasing some machinery to manufacture the components. 5

Although Charles is a successful businessman, he knows very little about the formal accounting process. He realised this recently when his nephew, who is taking a business degree at the local university, asked him some questions about his business affairs. Charles was able to explain what double-entry accounting involved, but he was unaware of any of the other accounting principles that his nephew mentioned. In addition, he was unaware of what was meant by prime entry books or why he should be producing a trial balance. In his defence Charles argued that all of his accounts were dealt with by a friend, who was a qualified financial accountant. 10 15

Two weeks after he had applied for the bank loan Charles received a reply from the bank. The bank manager refused the loan because Charles had not provided sufficient information, in particular an up-to-date profit and loss account or a break-even analysis for the manufacturing proposal. Also, the bank manager suggested that Charles should consider the possibility of forming a private limited company as an alternative method of raising the finance. Although Charles was disappointed by the news, he decided to look into all these issues and he approached his nephew for some help. 20

Charles's nephew agreed to help out his uncle and he produced a report that included a number of recommendations:

- The business should be restructured as a limited company with Charles as the sole director. 25
- The business should introduce a formal double-entry accounting system with a permanent employee responsible for maintaining the accounts.
- The business needs to closely monitor the level of working capital to maintain its liquidity and the business should produce a cash flow statement. 30
- Charles should consider entering into a hire purchase agreement rather than leasing the machinery for the manufacturing proposal.
- Charles should consider applying for a trademark for all of the products that he manufactures.

In addition to his report, Charles's nephew produced a break-even analysis for the manufacturing proposal and an up-to-date profit and loss account. He also submitted a new loan application to the bank. Charles was impressed with his nephew's efforts, although he was unsure what all of them meant. However, he did agree to consider them very carefully and he has agreed to meet his nephew once the bank has replied to the new loan application. 35

## Financial Information

### Item A

Leasing of machinery for manufacturing components	\$200.00 per day <sup>1</sup>
Maximum output	300 units per day
Raw material costs	\$0.50 per unit
Fuel costs	\$0.04 per unit
Labour costs	\$0.12 per unit

Assume that the machinery will be run at full capacity and that all output can be sold for \$1.70 per unit. You should treat the leasing of the machinery as a fixed cost.

### Item B

Trading figures for Ling Trading up to 30 September 2013

Opening Stock (Inventories)	\$120 000
Turnover	\$400 000
Closing Stock (Inventories)	\$140 000
Vehicle Expenses	\$12 000
Telephone Expenses	\$4 000
Printing and Stationery	\$12 000
Purchases	\$280 000
Rent and Rates	\$36 000
Electricity	\$8 000
Insurance	\$2 000
Depreciation-Vehicles	\$8 000
Depreciation- Fixtures and Fittings	\$3 600

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<sup>1</sup> 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 the relationship between increased selling expenses, increased turnover and increased net profits. [4]
- (ii) Explain, with an example, what is meant by double-entry accounting. [4]
- (b) (i) Explain what is meant by working capital. [2]
- (ii) Explain why it is important for a business to maintain its liquidity. [4]
- (c) (i) Explain **one** advantage of a hire purchase agreement. [2]
- (ii) Explain what is meant by a trademark and explain how a trademark is treated in the accounts of a business. [4]

**[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]
- (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]
- (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]

**[Total: 20]**

- 3 (a) Explain the possible legal effects if Charles formed a limited company. [8]
- (b) Explain **two** financial advantages and **two** financial disadvantages of forming a limited company. [4 x 2 = 8]
- (c) Explain **two** duties that Charles would have as a director of a limited company. [2 x 2 = 4]

**[Total: 20]**

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

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

Calculate the following showing your working and formulae:

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

[Total: 20]

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

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

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

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

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

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

[Total: 20]





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