



**BUSINESS FINANCE**

5163/01

Optional Module

October 2011

**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 that follow.**  
(This case study is fictitious.)

### **Red Dragon Paper Products Ltd.**

Red Dragon Paper Products Ltd is a medium-sized private limited company that makes a wide range of paper products. It was formed eight years ago by four friends who had been made redundant by the largest paper producer in the country. The four founders invested all of their redundancy payments in the business and since then they have all contributed further amounts of capital, which has allowed the business to grow. The company now has a 15% share of the domestic market and has recently entered the export market by distributing a selection of their products via a network of agents. The directors are looking for further growth, which they intend to finance by forming a public limited company. The directors are considering issuing shares by both prospectus and by private placing. 5

Although the marketing department of the company appears to be doing a good job, the accounting department has been criticised on a number of occasions. The latest occasion was when the company's auditor refused to sign off the year-end accounts as there were some issues concerning the financial statements. The auditor has also pointed out that there appeared to be a lack of knowledge of proper accounting procedures and the system of recording accounting entries was poor. He has therefore recommended that a company-wide training programme should be introduced to explain the basics of bookkeeping, record keeping, double entry accounting and other principles of accounting. He has also suggested that the company should consider introducing a computer-based accounting system as it would bring long term benefits to the company. 10 15

The production department of the company was acknowledged as being one of the most efficient in the industry. It has developed a number of new production techniques that meant that, even when production was running very close to budgeted targets, there are considerable margins of safety available. In addition, the department has developed new machinery and the production director has proposed that the company should consider taking out a patent on this equipment. He has also suggested that the current policy of depreciating the fixed assets via the straight-line method should be reviewed and replaced by a method that was more appropriate in a rapidly changing environment. 20 25

## Financial information

### Item A

The following figures have been extracted from the records of Red Dragon Paper Products Ltd at 30 September 2011

Leasehold Property	\$3 000 000 <sup>1</sup>
Creditors	\$120 000
Vehicles and Equipment (net book value)	\$53 000
Mortgage	\$400 000
Ordinary Shares at \$1 each	\$2 000 000
Bank Loan	\$100 000
Stock	\$80 000
Dividend Proposed	\$100 000
Cash	\$22 000
Overdraft	\$50 000
Provision for Taxation	\$80 000
Debtors	\$270 000
Profit and Loss Account	To provide balancing total
Accumulated Depreciation	\$7 000

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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) Explain **one** financial advantage and **one** disadvantage of distributing the company's products via a network of agents. [2 x 2 = 4]
- (b) Explain the differences between ordinary and preference shares. [2 x 2 = 4]
- (c) Explain the main purpose of the following:
- (i) Cash flow statements [2]
- (ii) Profit and loss accounts [2]
- (iii) Balance sheets [2]
- (d) Explain what is meant by the margin of safety. [3]
- (e) Identify and explain an alternative method of depreciating the fixed assets that would be more appropriate for the company. [3]
- [Total: 20]**
- 2 (a) Explain **both** the financial and legal formalities involved in forming a private limited company. [4 x 2 = 8]
- (b) Explain why the director of Red Dragon Paper Products Ltd wished to form a limited company **and** explain some of the problems that may arise if the company was formed. [3 x 2 = 6]
- (c) Explain what is involved in issuing shares by both prospectus and private placing. [6]
- [Total: 20]**
- 3 (a) Explain, using your own example, what is meant by the term double entry bookkeeping. [6]
- (b) List **four** examples of financial records and **four** books of account that the firm should be keeping. [8 x 1 = 8]
- (c) Identify and explain **two additional** accounting principles. [2 x 3 = 6]
- [Total: 20]**

- 4 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.

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

[20]

[Total: 20]

- 5 **Item A** includes figures for creditors, mortgage, dividend proposed, taxation and overdraft.

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

(b) Choose **five** stakeholder's and describe their reasons for examining items in financial accounts.

[5 x 2 = 10]

[Total: 20]

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