

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

BUSINESS FINANCE

5173/01

Core Module

May 2005

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

The time allocated for this examination includes 15 minutes reading time.
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 the tasks which follow

[The following case study is fictitious]

EmW (East meets West) Ltd

Ronald Chan has just been appointed as the head of the accounts department of EmW Ltd. He is a trained accountant and has been in public practice as an auditor for several years. He is aware that most of the directors of the company have very little knowledge of accounting and he is keen to introduce a training programme to explain to them the principles of the accounting process. He has also proposed to the managing director, Lucy Lui, that the firm should introduce more advanced management practices when they are allocating overheads, valuing stock and appraising investment opportunities. 5

Lucy Lui is a talented fashion designer who established EmW Ltd four years ago. She borrowed money from her family and from the bank to set up the company and she decided at the outset to operate as an incorporated business. She has taken out copyright on her trade name and logo and she believes that this has contributed a great deal to her success. 10

EmW manufactures traditional eastern clothing and textiles, mainly for the export trade but there has been some growth in the home market in recent times due to rising income levels. The firm produces three different ranges of products: women's clothing, men's clothing and household textiles. 15

EmW sells most of its exported products through a network of agents, but the company is proposing to establish a chain of retail outlets at major international airports which they will operate on a franchise basis.

Lucy and Ronald have discussed the future plans for the firm on several occasions and both agree that they will need to invest in new equipment to cope with any increase in output. They are happy that the current workforce of 80 people (60 in manufacturing, 20 in sales and administration) will be able to deal with any expansion and both agree that there is no need to increase the size of their premises. They have discussed how they might raise the additional capital and have decided that they will seek a loan from a venture capitalist rather than approaching the existing shareholders. 20

Item A

Extracts from the balance sheet and profit and loss account of EmW Ltd.

	\$000s ¹
Capital Employed	1856
10% Debenture Stock	200
Issued Fully paid Ord. Shares	1000
Net Current Assets	75
Net Profit	210
Turnover	1300
Current Liabilities	60
Stock	37
Equipment (at cost)	300
Accumulated Depreciation	75
Provisions	11
Prepayments	4

¹ The dollar referred to in this text is the US Dollar [US\$]

Item B

Manufacturing Fixed Overhead Costs \$250,000

Product	Floor Space sq.m	Number of employees
Women's clothing	3 000	25
Men's clothing	2 500	20
Household textiles	3 500	15

Item C

Stock Valuation Men's Clothing Section

Opening Stock June 1st 200 units @ \$12

Date	Units Purchased	Units Issued
June 8	200 @ \$12	-
9	-	300
16	300 @ \$12.50	-
17	-	200
19	400 @ \$13	-
21	-	500
25	250 @ \$14	-
28	-	300

Item D

Purchase of new equipment.

Proposal A

Purchase Price \$500,000

Expected useful life 5 years

Year	Expected Returns \$	Running Costs \$
1	300 000	30 000
2	320 000	30 000
3	325 000	32 000
4	275 000	35 000
5	250 000	40 000

Proposal B

Purchase Price \$850,000

Expected useful life 7 years

Year	Expected Returns \$	Running Costs \$
1	450 000	75 000
2	500 000	75 000
3	500 000	75 000
4	550 000	80 000
5	600 000	80 000
6	600 000	90 000
7	500 000	110 000

You must attempt ALL of the following tasks

- 1 (a) Explain what is meant by the term 'copyright' and explain how it will contribute towards the profits of the business. [4]
- (b) Explain how Ronald's new job as Head of the Accounts department will be different from his previous job as an auditor. [4]
- (c) Identify **one** reason why EmW employs agents to distribute its products. [2]
- (d) Explain what is meant by the term 'venture capitalist' and give **one** reason why EmW might approach a venture capitalist to raise additional finance. [4]
- (e) Identify **one** financial reason why Lucy chose to set up in business as an incorporated organisation. [2]
- [Total: 16]**
- 2 (a) Calculate the allocation of fixed overheads to **each** of the firm's products by employing the following criteria:
- (i) Floor space [6]
- (ii) Number of employees [6]
- (b) Identify and explain **two** reasons why the firm should employ this cost-centred approach to the allocation of its overheads. [6]
- [Total: 18]**
- 3 (a) Identify **two** internal and **two** external users who will have an interest in the financial records and accounts of the firm, and explain why they would have an interest. [8]
- (b) For **each** of the users identified, select and calculate an appropriate financial ratio that will be useful to them. [8]
- [Total: 16]**
- 4 Using the information provided in **Item C**, calculate the closing stock figure by employing:
- (a) the FIFO method of stock valuation [8]
- (b) the LIFO method of stock valuation [8]
- [Total: 16]**
- 5 (a) Identify and explain **three** accounting principles that would need to be used to produce accurate accounts. [12]
- (b) From the evidence available in the case study, explain how the firm is applying **two** of these principles to produce accounts that represent a 'true and fair view'. [4]
- [Total: 16]**
- 6 (a) Calculate the Accounting Rate of Return (ARR) % for **each** of the proposals shown in **Item D**. [12]
- (b) Calculate the payback period for **each** of the proposals. [6]
- [Total: 18]**

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