

UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma Advanced Level

MARK SCHEME for the May 2010 question paper
for the guidance of teachers

CAMBRIDGE INTERNATIONAL DIPLOMA IN BUSINESS

5173 Business Finance, maximum mark 100

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- 1 (a) Explain what is meant by 'goodwill' and give *one* reason why it is included within the fixed assets of the company. [3]

Allow 2 marks for a definition that includes reference to estimated value of sales that will be associated with acquiring a known client base and an extra mark for mention of an intangible asset with a short lifespan.

- (b) Explain what is meant by 'variable cost'. [2]

Allow 2 marks if the answer refers to costs that will vary with the level of output/sales e.g. labour or material costs.

- (c) Explain what is meant by 'break-even output' and how the operation of the website sales might reduce the break-even point. [5]

Allow up to 3 marks for a complete definition of break-even – the point at which total revenue equals total costs and therefore the business is making neither a loss nor a profit.

Allow 2 further marks if the answer contains a valid reason for reduction of break-even e.g. reduction in variable costs reduces the break-even point.

- (d) Explain what is meant by a 'scrip issue'. [3]

Allow 3 marks if the answer makes reference to the issuing of 'free' shares to existing shareholders by capitalising the retained profits, thus making them part of the permanent capital of the business.

- (e) Explain what is meant by 'convertible loan stock'. [3]

Allow 3 marks if the answer makes reference to the issue of additional debentures that have the option of being converted into share capital when they fall due for redemption.

- (f) Explain what is meant by 'discounted cash flow techniques' and give *one* example of such a technique. [4]

Allow 3 marks if the answer makes reference to techniques that take account of the time value of money by discounting future income streams to give the present value of this income. Allow 1 further mark if the answer mentions net present value or internal rate of return.

[Total: 20]

- 2 (a) Explain what is meant by the books of prime entry and explain what role they play in the accounting process. [2 × 3 = 6]

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) etc. Allow 3 additional marks for explaining the purpose of prime entry books – it allows the summarising of large amounts of data and effective comparison with previous trading periods.

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- (b) Explain what is meant by the trial balance and explain what role it plays in the accounting process. [2 × 3 = 6]

Allow up to 3 marks for a complete explanation of what is meant by the trial balance – the statement that is drawn up from the books of prime entry and shows the summary totals from these records.

Allow the additional 3 marks if the purpose 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 correct.

- (c) Explain what is meant by a cash flow statement and explain how it is related to both the books of prime entry and the trial balance. [2 × 4 = 8]

For a simple explanation of the cash flow statement as a document that records the inflow and outflow of cash as a result of trading activities allow 3 marks. For recognition that it is a year-end statement allow 1 further mark. For identifying that it is based upon the entries that have been made in the prime books and that it in itself the accuracy is related to the initial entries and therefore is the end result of the accounting process. Allow up to 4 marks depending on the quality of the explanation.

[Total: 20]

- 3 (a) Explain why a business should consider depreciating its fixed assets and explain how such a policy is in line with the principles of accounting. [2 × 4 = 8]

Allow up to 2 marks for a well explained reason for depreciating assets e.g. to reflect their true value, to provide for the replacement of assets in the future, etc.

Allow up to 2 marks for any well explained answer that links the process of depreciation with recognised principles e.g. depreciated asset values reflect a prudential approach, historic costs have to be amended to reflect current values, going concern concept applies as the assets are seen to be continually used, etc.

- (b) Explain the circumstances in which the reducing balance method of depreciation would be preferred to the straight line method of depreciation. [6]

Allow up to 3 marks for any well explained reason for adopting the reducing balance method e.g. a better reflection of the net realisable value of the assets as the depreciation allowance is higher in the first few years – therefore fits in with the principle of prudence, a better method to reflect the value of assets that have a short working life e.g. computer equipment that becomes obsolete very quickly.

- (c) Use the information in *Item A* to calculate the book value of the assets at the end of year 3. [6]

Allow 2 marks for an answer that provides explicit evidence of the process necessary to complete the calculation.

Allow the remaining 4 marks for successfully extracting the required information and completion of the calculation.

For suggested solution see Appendix 1.

[Total: 20]

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4 Use the information in *Item B* to:

- (a) Describe and explain the errors or omissions in the balance sheet. [8]**

Allow up to 2 marks for any error/omission identified with an explanation – the principal errors include – debtors entered as a liability, creditors entered as an asset, investments not entered in assets, no share premium included. There will be errors in the subtotals as a result – these should attract marks in part (b).

- (b) Produce an amended balance sheet that represents a true and fair view of the financial position of the company. [12]**

Level 1	Candidate demonstrates weak knowledge of the structure of a balance sheet and makes many errors/omissions in the use of data.	(1–3 marks)
Level 2	Candidate shows better knowledge of process required but still many errors in the use of data.	(4–6 marks)
Level 3	Structure of balance sheet is almost complete and fewer errors in the use of data.	(7–9 marks)
Level 4	Structure of balance sheet is complete – errors are absent and subheading and subtotals are correctly entered.	(10–12 marks)

[Total: 20]

- 5 (a) Explain how *each* of the PEST factors mentioned in the case study could affect the future profitability of the company. [4 × 3 = 12]**

Allow up to 2 marks for each PEST factor extracted from the case study that is explained. Allow a further 2 marks per factor if the answer explains how the factor is likely to affect the revenues and/or costs of the business and therefore have an influence on the level of profit.

- (b) Explain what is meant by 'standard costing' and explain how this can be combined with variance analysis to bring about greater control over the finances of the company. [2 × 4 = 8]**

Allow up to 4 marks for a well explained discussion of the nature of standard costing and a further 4 marks if the answer explains how variance analysis is used to provide explanations for any variations from the estimated values contained in the standard costs. The answer should refer to the ability to use this information to reduce the uncertainty and therefore control the costs more effectively.

[Total: 20]

Appendix 1

Historic costs of the fixed assets \$650 000

Expected useful life 8 years

Predicted residual value \$90 000

$$\begin{aligned} \text{Annual depreciation allowance} &= \frac{\text{Historic cost} - \text{Residual value}}{\text{Useful life}} \\ &= \frac{\$650\,000 - \$90\,000}{8} = \$70\,000 \end{aligned}$$

$$\begin{aligned} \text{Book value} &= \text{Historic cost} - \text{Accumulated depreciation} \\ &= \$650\,000 - (\$70\,000 \times 3) = \$440\,000 \end{aligned}$$

Appendix 2

Balance sheet for Eastern Marketing Ltd. as at 30 April 2010

	\$	\$	\$
Fixed assets			
Premises		1 040 000	
Equipment at cost	950 000		
Accumulated depreciation	190 000	760 000	
Goodwill		250 000	
Patent		150 000	
			2 200 000
Investments			350 000
Current assets			
Debtors	75 000		
Prepayments	30 000		
Stock	140 000		
Cash	28 000	273 000	
Current liabilities			
Creditors	98 000		
Provision for taxation	18 500		
Provision for dividend	27 000		
Overdraft	32 000	175 500	
Working capital			97 500
Net assets			2 647 500
Debentures		500 000	
			2 147 500
Financed by			
Ordinary shares 800,000 @ \$1		800 000	
Share premium		320 000	
Profit and loss account		1 027 500	2 147 500