



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

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BUSINESS FINANCE

5173/01

Optional Module

May 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 **6** printed pages and **2** blank pages



You must read the case study below and attempt ALL of the tasks that follow.

(This case study is fictitious.)

Chang Engineering Ltd.

Chang Engineering Ltd is a small engineering company that makes components for the construction industry. The company was formed ten years ago by four members of the same family and an external investor. The external investor left the company five years ago and the family members bought out her share of the company and they now have complete control of the business. All of them have executive positions within the company and they all draw salaries from the business. 5

During the first five years the company grew rapidly, as the construction industry was booming, but in the last five years the company has seen its turnover and its profits falling. Despite this, the owners are optimistic about the future and they are planning to expand the business by diversifying into producing components for the automobile industry. The associated costs and revenues for this proposal are shown in **Item A**. Michael Chang, the Finance Director, has suggested that the company raises the required capital by offering debentures to interested parties, as he believes that this will be the cheapest method of raising the finance. However, the other family members are not in agreement with his suggestion and have asked him to come up with some alternative sources. 10 15

The company has established a good reputation for reliability and value for money products and it is keen to ensure that this is maintained. The company has sound accounting policies, based upon recognised accounting principles and the company's auditor has always been complimentary about the way that they have produced the year-end financial statements. He has also praised them for the attention to detail that they have given to minimising costs, through measures such as standard costing and the analysis of variances. The only recommendation that the auditor has made in recent times was that the company should consider introducing marginal cost pricing for its products, but as yet the company has not moved to adopt this proposal. 20

A recent report by the Engineering Federation, of which the company is a member, suggested that members should become more transparent with regard to information about their business dealings, by providing more information to potential interested parties. In addition, they have suggested that in the modern trading environment it is essential for companies to make greater investments in staff training. Although this may involve initial increases in costs, the Federation suggests that there will be considerable savings in the long term. The company's Human Resources Director has promised to look into this matter and will produce a report for the next Board Meeting. 25 30

Financial Information

Item A

Machine A

Purchase Price		\$400 000 ¹
Maximum output per day		1200 units
Unit sales price		\$4.00
Variable costs		
	Labour costs per day	\$400
	Maintenance costs per unit	\$0.25
	Material costs per unit	\$2.50

Machine B

Purchase Price		\$600 000
Maximum output per day		1800 units
Unit sales price		\$4.50
Variable costs		
	Labour costs per day	\$500
	Maintenance costs per unit	\$0.25
	Material costs per unit	\$2.00

Further information

- 1 You should assume that **each** of the machines will operate at **full** capacity and that **all** output can be sold.
- 2 Machine A can be run for 5 days per week for a maximum of 48 weeks per year.
- 3 Machine B can be run for 6 days per week for a maximum of 40 weeks per year.

¹ Quoted in US dollars

Item B**Standard Cost Information****Material Costs**

To manufacture 1 unit of output it is estimated that it would take 8 kilograms of materials at a cost of \$15 per kilogram.

In the last production time period the firm produced 1000 units of output, using 11 000 kilograms of materials at a cost of \$160 000.

Labour Costs

To manufacture 1 unit of output it is estimated that it would take 3 hours of labour input at a cost of \$10 per hour.

During the last production period, 1000 units of output were produced using 3200 hours of labour input at a cost of \$29 500.

Item C

Extracts from the financial statements for Chang Engineering Ltd as at 30 April 2011.

	\$000s
Issued fully paid up shares @ \$2 each	1200
Net current assets	84
Capital employed	1934
Stock	42
Provisions	11
Current liabilities	61
Net profit	215
Turnover	1350
Equipment at cost	300
Prepayments	5
Debtors	22
10% debenture stock	200
Market value of shares	3000

You must attempt ALL of the following tasks.

Where appropriate use information from the case study to support your answer.

- 1 (a) (i) Explain what is meant by an external investor. [2]
 (ii) Explain **one** advantage and **one** disadvantage of raising finance via external investors. [2 x 2 = 4]
- (b) (i) Explain what is meant by a debenture. [2]
 (ii) Explain why raising finance by issuing debentures might be cheaper than other sources of finance. [2]
 (iii) Suggest **two** sources of finance, other than debentures and external investors, that the company could have used. Explain **one** advantage of **each** of these alternative sources. [2 x 3 = 6]
- (c) Explain **two** possible financial implications of making greater investments in staff training. [2 x 2 = 4]
 [Total: 20]
- 2 (a) Using the information in the **Item A**, calculate the number of weeks to the nearest whole number, that will be required for **each** of the machines to break-even. [2 x 8 = 16]
 (b) Calculate the yearly contribution for **each** of the machines. [2 x 2 = 4]
 [Total: 20]
- 3 (a) Explain what is meant by standard cost. [2]
 (b) Use the information contained in **Item B** to calculate:
 (i) the direct material price variance; [3]
 (ii) the direct material usage variance; [3]
 (iii) the direct material total variance. [3]
 (c) Use the information contained in **Item B** to calculate:
 (i) the direct labour rate variance; [3]
 (ii) the direct labour efficiency variance; [3]
 (iii) the direct labour total variance. [3]
 [Total: 20]

- 4 (a) (i) Identify **two internal** users who will have an interest in the financial records and accounts of the firm. Explain why they will have an interest. [2 x 2 = 4]
- (ii) Identify **two external** users who will have an interest in the financial records and accounts of the firm. Explain why they will have an interest. [2 x 2 = 4]
- (b) Select and calculate an appropriate financial ratio for each of the **internal** users and **external** users identified in 4(a) above.
You should use the information contained in Item C to calculate the ratios. [4 x 3 = 12]
[Total: 20]
- 5 For published accounts to be useful they must be accurate and produced according to recognised accounting principles.
- (a) Identify **three** recognised accounting principles. [3 x 1 = 3]
- (b) Using your own examples, explain how **each** of the principles that you have identified contributes towards the production of accurate accounts. [3 x 4 = 12]
- (c) Explain why it is necessary to have accounts independently checked by an auditor. [5]
[Total: 20]

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