

UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Diploma Advanced Level

MARK SCHEME for the October 2005 question paper

CAMBRIDGE INTERNATIONAL DIPLOMA IN BUSINESS

5173 Business Finance, maximum mark 100

This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which Examiners were initially instructed to award marks. They do not indicate the details of the discussions that took place at an Examiners' meeting before marking began. Any substantial changes to the mark scheme that arose from these discussions will be recorded in the published *Report on the Examination*.

All Examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes must be read in conjunction with the question papers and the *Report on the Examination*.

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Page 1	Mark Scheme	Syllabus
	CAMBRIDGE INTERNATIONAL DIPLOMA – OCTOBER 2005	5173

- 1 (a) **Identify and explain one reason why Sunder chose to set up in business as a sole trader.** [2]
 Allow 1 mark for identifying a relevant reason and a further mark for explanation. e.g. less formalities involved - cheaper to start - retain all profits - greater incentives.
- (b) **Explain what is meant by the term ‘cash flow problems’.** [3]
 Allow 1 mark for a vague statement about insufficient cash.
 To achieve a full award the response should link the shortage of cash to the level of trading and make reference to current assets/liabilities and/or debtors/creditors.
- (c) **Explain what is meant by ‘reschedule the firm’s loan’ and explain why the bank would allow this to happen.** [5]
 Allow up to 2 marks for explaining the process of rescheduling - loan payments being adjusted to alleviate cash flow problems - lower payments and/or longer repayment period. Allow up to 3 marks for explaining why the bank would reschedule - allow the firm to continue in business - keep their custom - no alternative if the firm was forced to close - bank can adjust the repayments to create more profits for the bank in the future.
- (d) **Explain why the ‘gross profit margins’ on the bought-in and own-produced components are similar.** [4]
 Allow up to 2 marks for a response that explains the term profit margin - the profit made on sales expressed as a percentage of the sales figure.
 Allow 2 additional marks for any reasonable explanation of similarities in margins - similar production facilities in the industry - SIS keeping own prices down to enter the market - competitive market limits ability to increase margins.
- (e) **Explain what is meant by ‘double entry bookkeeping’.** [4]
 Allow up to 2 marks for a vague statement regarding making two entries for any transaction. To achieve a full award the candidate should refer to dual recording and mention positive and negative aspects of the entry/credit and debit entries possibly with a worked example.
- [Total 18]**
- 2 (a) **Explain the legal and financial formalities that need to be followed in order to establish a limited company.** [8]
 Allow up to 4 marks for legal formalities and 4 marks for financial formalities. If candidate only refers to legal or financial maximum of 4 marks.
 Allow up to 2 marks per well explained point.
 Legal - registration procedures, need to comply with company legislation etc.
 Financial - required to sell/purchase quota of shares, appointment of Auditors etc.
- (b) **Identify and explain one financial advantage and one financial disadvantage that would result from the process of incorporation.** [4]
 Allow 1 mark for listing relevant advantage/disadvantage.
 Allow 1 additional mark for explanation of the points listed.
 Advantage - Access to more capital, enhanced financial status, possible to obtain cheaper loans etc.
 Disadvantage - legal costs of formation, need to pay out dividend in the future etc.
- (c) **Distinguish between ordinary shares, preference shares and debentures as methods of raising capital for the limited company.** [6]
 Allow 1 mark for defining each type of raising finance.

Page 2	Mark Scheme	Syllabus
	CAMBRIDGE INTERNATIONAL DIPLOMA – OCTOBER 2005	5173

To achieve the second mark for each category the candidate should draw comparisons between the sources of finance. **[Total 18]**

3 Using the information in Item B and employing the straight line method of depreciation:

- (a) calculate the annual depreciation allowance that should be applied by the firm. [6]**

Level 1 The candidate demonstrates some knowledge of the process required but the calculations are incomplete and/or contain errors. **[1-3marks]**

Level 2 The candidate applies the process well to the task and produces accurate results. **[4-6 marks]**

- (b) calculate the book value of the asset at the end of Year 3. [4]**

Level 1 The candidate provides evidence of knowing how to complete the task but the process is incomplete and/or contains errors. **[1-2 marks]**

Level 2 The process is well applied to the task and produces accurate results. **[2-4 marks]**

- (c) identify one alternative method of depreciation that could be employed by the firm, and explain when this method would be more suitable than the straight line method. [6]**

It is most likely that the candidates will identify the reducing balance method of depreciation although allow credit if they select the sum of digits method.

Allow up to 3 marks for listing the method and any explanation of how the method is applied. To achieve a full award the candidate must provide an explanation of why the alternative method is more suitable - e.g. it would allow for increased depreciation allowances in the early years for assets that tend to lose their value quickly e.g. computers, vehicles. Max. 3 marks for explanation.

For suggested solution to (a) and (b) see Appendix 1.

[Total 16]

4 Using the information provided in the case study and Item A, produce in an appropriate format, a balance sheet for the firm as at 30 September 2005. [Total 18]

Level 1 The candidate provides limited evidence of understanding the nature of the balance sheet and fails to extract information correctly. The structure of the balance sheet is incomplete and there are likely to be several errors in the calculations. **[1-6 marks]**

Level 2 As above but the structure is clearly better understood and the candidate has made fewer errors in extracting/classifying the data. It is likely that not all of the subtotals are correct/included. **[7-12 marks]**

Level 3 As Level 2 but errors are fewer and the format/structure is complete with correctly calculated totals. **[13-18 marks]**

Page 3	Mark Scheme	Syllabus
	CAMBRIDGE INTERNATIONAL DIPLOMA – OCTOBER 2005	5173

- 5 Identify and explain three external (PEST) factors, from the case study, that could influence the future profitability of the firm. [Total 12]
 Allow 1 mark for each factor identified.
 Allow up to 3 additional marks for a reasoned explanation of how each factor could influence the future level of profits. To achieve a full award the response must link the factor to changes in costs and/or revenues and then by implication the level of profit.
- 6 (a) Explain what is meant by the term working capital. [2]
 1 mark available for a vague definition e.g. day to day finances.
 To achieve 2 marks the response must refer to net current assets - the formula for calculating W.C. is sufficient for 2 marks.
- (b) Using the information in the case study, calculate the firm's present level of working capital. [4]
 Allow up to 2 marks if the candidate clearly knows the method required to calculate W.C. but they have made errors in their calculations.
 Allow the additional 2 marks if the data has been extracted correctly and the calculation is complete and correct.
- (c) Calculate two ratios that could be employed to analyse the working capital position of the firm. [6]
 Allow 1 mark per ratio identified - current ratio and acid test ratio.
 Allow an additional 2 marks if the calculations have been completed successfully.
- (d) Explain two methods that could be employed to improve the working capital position of the firm. [6]
 Allow up to 2 marks for stating that it is necessary to bring about changes in either the level of current assets and/or the level of current liabilities.
 Allow up to 2 additional marks if the methods chosen are appropriate and are explained in terms of their effects on the levels of current assets/liabilities.
- [TOTAL 18]

Page 4	Mark Scheme	Syllabus
	CAMBRIDGE INTERNATIONAL DIPLOMA – OCTOBER 2005	5173

Appendix 1

$$\begin{aligned}
 \text{(a) Annual depreciation Allowance} &= \frac{\text{Initial Purchase Price} - \text{Residual Value}}{\text{Useful Life in years}} \\
 &= \frac{\$28,000 - \$2,000}{5} = \$5,200
 \end{aligned}$$

$$\begin{aligned}
 \text{Book value} &= \text{Initial purchase price} - \text{Accumulated Depreciation} \\
 &= \$28,000 - (\$5,200 \times 3) = \$12,400
 \end{aligned}$$

Appendix 2

	\$	\$	\$
Fixed Assets			
Premises		50,000	
Vehicles		13,000	
Equipment		24,000	
			87,000
Current Assets			
Stock	17,000		
Debtors	16,000		
Cash	4,000		
		37,000	
Current Liabilities			
Creditors	9,000		
Loan	35,000		
		44,000	
Net Current Assets			(7,000)
Net Assets Employed			80,000
Mortgage		37,000	
			43,000
Capital Account			
Owners Capital			25,000
Net Profit		28,000	
Drawings		10,000	43,000