

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

BUSINESS FINANCE

5173/01

Core Module

October 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 **4** printed pages.



You must read the case study below and attempt all the tasks which follow

[The following case study is fictitious]

SIS

Sunder Iyer was feeling quite pleased with the results of his firm's second year of trading. He had set up the firm, Sunder Iyer Supplies (SIS), with \$20 000¹ he had received as an inheritance and he had introduced another \$5000 during the current trading year. Although he is not making large profits, and in fact during the first year his drawings matched the recorded profit, he believes that it will take at least three years to become fully established. His bank manager has been very supportive and was willing to reschedule the firm's loan when the firm experienced cash flow problems. 5

Sunder operates as a sole trader but on the advice of the bank manager he is now considering establishing a private limited company and is looking to his family and friends to become the main shareholders. 10

The firm supplies components to a major electrical goods manufacturer. Currently SIS produces 35% of the goods that it sells with the remaining 65% being bought in from other small suppliers. The gross profit margins on own-produced and bought-in supplies are very similar but Sunder hopes to increase profits on his own production by introducing more efficient up-to-date machinery.

Sunder had very little formal knowledge of the accounting process but he has recently enrolled on an accounting course at the local university. He now believes that he understands how double-entry bookkeeping works and why standard accounting principles need to be applied to produce accurate accounts. 15

A recent Government report points to a number of factors that are likely to influence the manufacturing sector in the near future: 20

- The National Government is planning to introduce new tighter rules regarding the production and publication of accounting records.
- The real incomes of the domestic population is forecast to fall in the near future due to higher taxation rates.
- New developments in CNC (Computer Numerically Controlled) manufacturing processes are likely to lead to lower components prices. 25
- There has been some evidence of a change in consumer preferences with a movement towards newer, more environmentally friendly products.

Sunder considers that most of these factors will bring benefit to his firm and he has produced a new business plan which he has submitted to the bank manager. Although the bank manager is in agreement with Sunder in most areas he has urged Sunder to be cautious. He has recommended that Sunder should pay particular attention to the management of working capital in the future and that he should consider introducing a system of depreciation for his fixed assets. 30

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

Financial Information**Item A**

Figures extracted from the records of SIS Ltd for the year ending 30 September 2005

	\$
Owner's Capital	25 000
Premises	50 000
Cash	4 000
Stock	17 000
Vehicles	13 000
Equipment	24 000
Creditors	9 000
Mortgage	37 000
Loan	35 000
Debtors	16 000
Net Profit	28 000
Drawings	10 000

Item B

Purchase Price of new equipment \$ 28 000

Expected useful life 5 years

Residual (scrap) value \$ 2000

You must attempt ALL of the following tasks

- 1 (a) Identify and explain **one** reason why Sunder chose to set up in business as a sole trader. [2]
- (b) Explain what is meant by the term 'cash-flow problems'. [3]
- (c) Explain what is meant by 'reschedule the firm's loan' and explain why the bank would allow this to happen. [5]
- (d) Explain why the 'gross profit margins' on the bought-in and own-produced components are similar. [4]
- (e) Explain what is meant by 'double-entry bookkeeping'. [4]
- [Total: 18]**
- 2 (a) Explain the legal and financial formalities that need to be followed in order to establish a limited company. [8]
- (b) Identify and explain **one** financial advantage and **one** financial disadvantage that would result from the process of incorporation. [4]
- (c) Distinguish between ordinary shares, preference shares and debentures as methods of raising capital for the limited company. [6]
- [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]
- (b) calculate the book value of the asset at the end of Year 3. [4]
- (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]
- [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]
- 5 Identify and explain **three** external (PEST) factors, from the case study, that could influence the future profitability of the firm. [Total: 12]
- 6 (a) Explain what is meant by the term 'working capital'. [2]
- (b) Using the information in the case study, calculate the firm's present level of working capital. [4]
- (c) Calculate **two** ratios that could be employed to analyse the working capital position of the firm. [6]
- (d) Explain **two** methods that could be employed to improve the working capital position of the firm. [6]
- [Total: 18]**

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