

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

BUSINESS FINANCE

5173/01

Optional Module

October 2006

**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 **4** printed pages.



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

[The following case study is fictitious.]

Ace Flights

Aditya Chandran is a happy man. He has just emerged from a meeting with his bank manager, who has agreed to lend 25% of the required capital for Aditya's business proposal. Although this still leaves Aditya with the problem of raising the rest of the finance, he is confident that he can raise at least enough money to make a start.

Aditya's idea is to turn his hobby (hot air ballooning) into a commercial enterprise. He intends to offer pleasure flights for the general public and also to provide special services e.g. marriage services in the air! In addition, he has applied to the regional government for a grant to carry out aerial surveys and aerial photography. The grant has been approved, subject to Aditya being able to prove that he can complete the survey on time. Aditya believes that he can meet the requirements of the government as he can undertake the surveying during the week, whereas the pleasure flights are more likely to be booked for the weekends. 5 10

Aditya has undertaken some market research and he believes that it will take several months for the pleasure flights to become established. He is hoping that he can survive on the grant funds and the monthly expenses payments from the government. In the long term, Aditya knows that he needs both sections of the business to succeed in order to avoid becoming insolvent. He is also aware that he will need to manage the working capital very carefully. 15

Aditya has a limited knowledge of accounting but he has been attending a basic training course and he now believes that he understands the process of double entry bookkeeping. Aditya hopes to be able to keep his own books but he is aware that he needs a greater understanding of all of the principles of the standard accounting model before he will be able to complete this task. 20

Aditya is unsure about the legal form that his business should take. His bank manager has suggested that he should consider either a limited partnership or a limited company, but Aditya wants to be a sole trader.

Financial Information

Estimated costs and revenues for Ace Flights – Pleasure flights proposal

Standard quality balloon – Alternative 1

Fixed costs

| | \$ |
|--|--------|
| Purchase price of standard quality hot air balloon | 30 000 |
| Purchase of recovery vehicle | 10 000 |
| Annual aviation license fee | 5 000 |
| Annual insurance premium | 5 700 |

Operating costs (per flight)

| | |
|---------------------------|-----|
| Fuel | 100 |
| Wages | 100 |
| Recovery vehicle expenses | 75 |

Revenue

Per flight: \$600 in total
 Maximum of 6 flights per weekend
 Maximum of 40 weekends flying per year

The balloon has a useful life of 3 years and a residual value of zero.

Deluxe quality balloon – Alternative 2

Fixed costs

| | \$ |
|--|--------|
| Purchase price of deluxe quality hot air balloon | 50 000 |
| Purchase of recovery vehicle | 10 000 |
| Annual aviation license fee | 5 000 |
| Annual insurance premium | 5 700 |

Operating costs (per flight)

| | |
|---------------------------|-----|
| Fuel | 150 |
| Wages | 100 |
| Recovery vehicle expenses | 75 |

Revenue

Per flight: \$750 in total
 Maximum of 6 flights per weekend
 Maximum of 40 weekends flying per year

The balloon has a useful life of 5 years and a residual value of zero.

Aditya has decided not to allow for depreciation allowances on the recovery vehicle.

You must attempt ALL of the following tasks

- 1 (a) Explain the difference between a grant and a loan. [2]
- (b) Identify and explain **one** advantage and **one** disadvantage of obtaining finance by means of a government grant. [4]
- (c) (i) Explain what is meant by the term insolvent. [2]
- (ii) Describe **one** consequence of a firm becoming insolvent. [2]
- (d) (i) Explain what is meant by the term working capital. [2]
- (ii) Identify and explain **two** ways in which Aditya could ensure that he will have sufficient working capital. [4]
- (e) Use the straight line method of depreciation to calculate the book value of the standard balloon at the end of year 2. [4]
- [Total: 20]**
- 2 (a) Explain, using your own examples, what is meant by the term double entry bookkeeping. [8]
- (b) Identify and explain **three** principles of accounting that Aditya needs to apply in order to produce accurate accounts. [3x4=12]
- [Total: 20]**
- 3 (a) Calculate the number of weeks, to the nearest whole number, that will be required for **both** the standard balloon and the deluxe balloon to break-even. You may assume that the weekly maximum of six flights will be achieved. [16]
- (b) Calculate the weekly contribution for **each** of the balloons. [4]
- [Total: 20]**
- 4 (a) Using the information in the case study, calculate the A.R.R. percentage (Accounting Rate of Return) to the nearest whole number, for **both** the standard balloon **and** the deluxe balloon. You should assume that the purchase of the balloon also requires the purchase of the recovery vehicle. [16]
- (b) Identify and explain **one** other method of investment appraisal that could be used to assess the financial viability of the project. [4]
- [Total: 20]**
- 5 (a) Describe the legal and financial differences between a sole trader, a limited partnership and a limited company. [12]
- (b) State, with reasons, which of the forms of organisation in (a) above you would recommend for Aditya's business. [8]
- [Total: 20]**

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