



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

BUSINESS FINANCE

5173/01

Optional Module

October 2012

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 **5** printed pages and **3** blank pages.



You must read the case study below and attempt ALL of the tasks which follow.
(This case study is fictitious.)

A2Z Manufacturing Ltd

The Board members of A2Z Manufacturing Ltd were reasonably pleased with the year-end results for the company. The gross profit figure had increased as predicted despite the fact that the level of turnover had not risen as expected. However, there was some concern that the net profit figure was rather disappointing. The Finance Director had indicated that trading conditions had been difficult, but there were signs that the economic climate was improving and this should lead to better results in the future. 5

The company was established five years ago and it had achieved a 20% share of the domestic electrical components market. The company began life manufacturing computer components for the telecommunications industry under a licence from a major multinational company. Soon after becoming established in the market, they began to develop their own range of products for the export market, and two years ago they borrowed additional capital from the bank. Although they still produced the computer components, the bulk of their turnover now came from selling their own-brand products via a network of agents. Some board members had suggested that the company should stop manufacturing the computer components, but the Chief Executive Officer (CEO) pointed out that the components still made a positive contribution, even though they did not make a profit. 10 15

The company's external auditor had raised a number of concerns regarding the year-end statements that had been submitted to the Annual General Meeting. These include the following:

- There appeared to be some inconsistencies in the way that the company's accounts department was applying adjustments to the figures for the fixed assets, debtors and stocks totals. 20
- The company did not appear to have a consistent policy of calculating depreciation allowances.
- The company had not carried out any analysis of their results and the auditor has suggested that in the future the company should introduce ratio analysis for all aspects of the company's operations. 25

The CEO, who had very limited knowledge of formal accounting procedures, had asked the Finance Director to investigate these issues and to submit proposals to the next Board meeting. The CEO had also asked the Finance Director to submit a report regarding methods of raising additional capital, which would be required to finance the expansion plans that had been approved at the last Board meeting. In particular, he had asked for a report recommending the most suitable method of raising finance. The options available to the company were a prospectus, a bonus issue or a rights issue. This report would also be submitted to the next Board meeting. 30

Financial information**Item 1****Machine A**

Initial Purchase Price	\$600 000 ¹
Residual Value	10% of purchase price
Useful life	6 years
Maximum output per month	10 000 units
Sales price per unit	\$12
Variable cost per unit	\$8
Fixed overhead costs per unit per month	\$1.50

Machine B

Initial Purchase Price	\$800 000
Residual Value	15% of purchase price
Useful life	8 years
Maximum output per month	15 000 units
Sales price per unit	\$10
Variable cost per unit	\$7
Fixed overhead costs per unit per month	\$1.25

¹ Quoted in US dollars

You must attempt ALL of the following tasks.

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

- 1 (a) (i) Explain why gross profit had risen as predicted, while turnover had not. [3]
 (ii) Explain why the figure for net profit was disappointing, even though the gross profit figure was encouraging. [3]
- (b) (i) Explain what is meant by producing under a licence. [2]
 (ii) Explain what is meant by a multinational company. [3]
- (c) Explain how **one** external (PEST) factor, mentioned in the case study, could affect the company. [3]
- (d) Explain the purpose of **two** end of year statements that will be submitted to the Annual General Meeting. [2 x 3 = 6]
[Total: 20]
- 2 It is common in the accounting process to make adjustments to the accounts in respect of fixed assets, debtors and stocks.
- (a) Explain why it is considered necessary to make such adjustments detailing which accounting principles are being used when the adjustments are made. [8]
- (b) Using the information in **Item 1**, calculate
- (i) the annual depreciation allowance for Machine A, using the straight-line method [4]
 (ii) the annual depreciation allowance for Machine B, using the straight-line method [4]
 (iii) the accumulated depreciation for **both** machines after three years [4]
[Total: 20]
- 3 (a) Distinguish between a prospectus, a bonus issue and a rights issue as methods of raising share capital. [3 x 4 = 12]
- (b) Explain **two** advantages and **two** disadvantages of raising finance through issuing debentures. [4 x 2 = 8]
[Total: 20]

- 4 (a) Distinguish between contribution and profit. [8]
- (b) Using the information in the case study, calculate
- (i) the monthly contribution from Machine A [3]
 - (ii) the monthly contribution from Machine B [3]
 - (iii) the annual profit from **both** machines, assuming that they will operate for 10 months of the year. [6]

[Total: 20]

- 5 Ratio analysis is often used by accountants to measure the performance of a business.
- (a) Explain what is meant by a ratio, and describe with examples **three** types of ratios that will be used by accountants. [10]
- (b) Explain the possible limitations of ratio analysis. [10]

[Total: 20]

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