

CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge International Diploma Advanced Level

MARK SCHEME for the October 2013 series

CAMBRIDGE INTERNATIONAL DIPLOMA IN BUSINESS
5173 (Business Finance), maximum mark 100

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October 2013 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

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- 1 (a) Explain why in some situations it might be cheaper to operate with an overdraft facility rather than a loan agreement. [2]

Allow **up to 2 marks** for any relevant discussion e.g. interest payments are only payable for the days that the overdraft is being used rather than the regular payments that have to be made with a loan agreement.

- (b) Explain how both overtime payments and bonus payments would help the business to meet its production targets. [2 × 2 = 4]

Allow **up to 2 marks** for any relevant discussion for **each** of the methods.

Examples:

Overtime payments involve paying the workers an additional payment for each hour that they work beyond their normal work time and this extra payment can act as an incentive to produce more.

A bonus scheme allows for an additional payment for each unit that is produced as long as the production target is met. Again this is an incentive for the workforce.

- (c) Explain why there could be conflict between making maximum profits and achieving growth. [6]

Allow **up to 3 marks** for explaining what is involved in making maximum profits e.g. profit is achieved when there is a surplus of revenue over costs and therefore the business must strive to increase its revenues and to minimise its costs.

Allow **1 mark** for stating that growth is concerned with increasing the scale of operations and **a further 2 marks** if the answer states that in order to do so it will be necessary to make investments and this will increase the costs of operation which might lead to a decline in the level of profits.

If the answer simply states that maximising profits is a short term objective whereas growth is a long term objective allow **2 marks**.

- (d) Explain what is meant by budgetary control and variance analysis. [2 × 2 = 4]

Allow **up to 2 marks** for each complete definition.

Budgetary control involves setting targets which have to be achieved and then reviewing the actual results using the targets as a yardstick.

Variance analysis involves reviewing the actual results and comparing them with standard target values that had been set earlier.

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- (e) Explain what is meant by limited liability and *ultra vires* audit. [2 × 2 = 4]

Allow up to 2 marks for each complete definition.

Limited liability refers to the liability of individuals for the debts of a business organisation. If the business is incorporated the individual is only liable for debts to the extent of the amount that he/she invested in the business.

Ultra vires audit refers to monitoring the results of an incorporated business to ensure that the directors have fulfilled their responsibilities to ensure that the organisation has been run according to the recognised guidelines and that no individual has exceeded their powers during the process.

[Total: 20]

- 2 (a) Using the information contained in Item A, produce in an appropriate format, a Balance Sheet (Statement of Financial position) for R K Fashions as at 30 September 2013. [12]

Allow marks according to the following criteria.

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 (1–4 marks)

Level 2 As Level 1 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 (5–8 marks)

Level 3 As Level 2 but errors are fewer and the format/structure is complete with correctly calculated totals at the top end (9–12 marks)

For suggested solution see Appendix 1

- (b) (i) Identify two internal users and two external users who would find the information in the balance sheet useful. [4 × 1 = 4]

Allow 1 mark for each user – internal – workers, managers, owners etc.

external – government, media, prospective investors etc.

- (ii) For each of the users you identified in (b)(i) above, identify one ratio that they would find useful when analysing a balance sheet. [4 × 1 = 4]

Allow 1 mark for each ratio that is appropriate e.g. ROCE, current ratio, debtors collection period etc.

[Total: 20]

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- 3 (a) Explain both the legal and financial formalities that need to be followed in order to establish a limited company. [2 × 4 = 8]**

Allow **up to 4 marks** for legal formalities and **4 marks** for financial formalities

If candidate only refers to legal or financial allow a **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 directors, appointment of auditors etc.

- (b) (i) Explain one financial advantage and one financial disadvantage that would result from establishing a limited company. [2 × 2 = 4]**

Allow **1 mark** for listing relevant advantage/disadvantage

Allow **1 additional mark** for explanation of the points listed

Advantages – access to more capital, enhanced financial status, possible to obtain cheaper loans etc.

Disadvantages – high legal costs of formation, need to pay out dividend in the future etc.

- (ii) Explain one financial advantage of operating as a sole trader. [2]**

Allow **2 marks** for any relevant well explained advantage e.g. the sole trader receives all of the profits from the business, there might be tax advantages with lower rates of taxation for individuals etc.

- (c) Distinguish ordinary shares, preference shares and debentures as methods of raising capital for a limited company. [3 × 2 = 6]**

Allow **up to 2 marks** for each of the methods of raising finance.

Allow **1 mark** for explaining the characteristics of each method of raising finance e.g. ordinary shares have high voting rights but receive dividends after all other claimants

To achieve **the second mark** for each category the candidate should draw comparisons between the sources of finance e.g. the payments made to debenture holders are certain as the interest rates are fixed at the time of issue and they may be lower than payments made to shareholders.

[Total: 20]

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- 4 (a) Explain, with two examples, what is meant by overhead costs. [4]

Allow up to 2 marks for the explanation of overheads and 1 mark for each valid example.

An indirect cost or overhead is a cost that is associated with the production process but it cannot be traced directly or in full to a particular product. Indirect expenses are costs that are not directly charged to the production of a particular product e.g. rent and rates, fuel and power. Other examples would include insurance costs, cleaning materials.

- (b) Using the information in Item B, calculate the allocation of fixed overheads to each of the firm's products by using the following criteria:

- (i) Floor space [6]

Allow marks according to the following criteria.

Level 1 Candidate provides an answer that demonstrates some knowledge of the process required but there are errors/omissions in the calculations (1–3 marks)

Level 2 Candidate provides clear evidence of the required process and shows that they can extract the data and correctly complete the calculations (4–6 marks)

For suggested solution see Appendix 2

- (ii) Number of employees [6]

Allow marks according to the following criteria.

Level 1 Candidate provides an answer that demonstrates some knowledge of the process required but there are errors/omissions in the calculations (1–3 marks)

Level 2 Candidate provides clear evidence of the required process and shows that they can extract the data and correctly complete the calculations (4–6 marks)

For suggested solution see Appendix 2

- (c) Explain two reasons why the firm should employ this cost-centred approach to the allocation of its overheads. [2 × 2 = 4]

Allow up to 2 marks for any well explained reason e.g. it will ensure that the total overheads of the business will be covered, it will allow closer and fairer control of the costs of production, it will promote better decision making, especially in terms of make or buy decisions etc.

[Total: 20]

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- 5 (a) Explain two reasons why it is necessary to depreciate fixed (non-current) assets. [2 × 2 = 4]

Allow **up to 2 marks** for any relevant well explained reason e.g. fixed assets such as machinery or vehicles will tend to lose value with age and therefore their book value should reflect this, allowing for depreciation will ensure that finance is available to replace worn out assets etc.

- (b) Explain two methods which could be used for calculating depreciation of fixed (non-current) assets. [2 × 3 = 6]

Allow **1 mark** for listing a method e.g. straight-line, reducing balance, sum of digits and a **further 2 marks** for explaining how the method works e.g. the straight-line method works by allocating a fixed depreciation allowance each year to arrive at the book value.

If the candidate chooses to produce a formula and a worked example to illustrate how the method works allow marks as appropriate to the above.

- (c) Explain two factors that could be taken into account when deciding which method will be used to depreciate the fixed (non-current) assets. [2 × 2 = 4]

Allow **up to 2 marks** for any well explained relevant discussion e.g. fixed assets that are likely to lose a lot of value quickly should use the reducing balance or sum of digit method rather than the straight-line method, as these methods have higher initial depreciation allowances. Fixed assets which hold their value e.g. property will be better suited by the straight-line method.

- (d) Explain how depreciation is treated in the year-end financial statements. [6]

Allow **1 mark** for identifying each year-end statement i.e. balance sheet, profit and loss account and cash flow statement and **a further 1 mark** if the answer shows how the depreciation allowances will be treated e.g. in the balance sheet the allowance will be subtracted from the historic cost of the asset, in the P&L Account the allowance will be treated as an expense and in the cash flow statement the allowance will be added back in as a positive cash input.

[Total: 20]

Appendix 1

Balance Sheet (Statement of Financial position) for R K Fashions as at 31 September 2013.

	\$	\$	\$
Fixed Assets (Non-current assets)			
Premises		80 000	
Vehicles		13 000	
Equipment		22 000	
			115 000
Current Assets			
Stock (Inventories)	17 000		
Debtors (Trade receivables)	23 000		
Cash	5 000		
		45 000	
Current Liabilities			
Creditors (Trade receivables)	29 000		
Loan (Short term borrowing)	30 000		
Tax provision (Current tax payable)	2 500		
		61 500	
Net Current Assets			(16 500)
Net Assets Employed			98 500
Mortgage		38 500	
			60 000
Capital Account (Statement of change in equity)			
Owners Capital (Opening balance)		25 000	
Net Profit		38 000	
Drawings		(3 000)	60 000

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Appendix 2

Allocation of Fixed Overheads

Total Overheads \$125 000

Total Floor Space 10 000 m²

Total Number of Employees 35

Cost centre allocation = Total Overhead \times $\frac{\text{Cost centre total}}{\text{Total for category}}$

$$\text{e.g. Women's clothing (Floor space)} = \$125\,000 \times \frac{4\,000}{10\,000} = \$50\,000$$

$$\text{Women's clothing (Employees)} = \$125\,000 \times \frac{15}{35} = \$53\,571.42$$

Answers (a) (i)	Women's Clothing	– \$50 000
	Men's Clothing	– \$31 250
	Household Textiles	– <u>\$43 750</u>
		<u>\$125 000</u>

(a) (ii)	Women's Clothing	– \$53 571.42
	Men's Clothing	– \$42 857.14
	Household Textiles	– <u>\$28 571.42</u>
		<u>\$124 999.98</u>