



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

BUSINESS FINANCE

5173/01

Optional Module

October 2013

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.)

R K Fashions

Rajiv Kumar has been in business for one year and he is reasonably pleased with his achievements during this time. He established his clothing factory in one of the poorest parts of the city as the rent and rates were cheaper and it was easier to recruit staff. Rajiv had used the money he had won on the national lottery to set up his business. He had decided that he would operate the business as a sole trader as he wanted to have total control of all aspects of the business. He invested all of his winnings in the factory and he then made the decision that, if necessary, he would obtain any additional funds by arranging an overdraft. He believed that this would be cheaper than taking out a loan. However, after six months, he was convinced by his accountant that in his situation he should convert the overdraft in to a loan and this he did. 5

R K Fashions make low quality clothing which is mainly sold to overseas customers. Rajiv has set up a website, and currently 75 % of his sales are made via the Internet. He has recently obtained an order from a large retail company and this is likely to mean that he will have to expand his production facilities. Rajiv is considering purchasing additional machinery and operating with the existing workforce rather than taking on additional workers. This would mean that he would have to pay overtime rates and possibly set up a bonus scheme to ensure that the production targets are met. Rajiv is considering extending his borrowing facility with the bank, but his accountant has suggested that he should consider forming a limited company as an alternative method of raising the finance. 10 15

Rajiv recently gave a talk to the students at the local college on how to be successful in business. He began by saying that it was essential to have a clear objective that was related to a given time span. Rajiv stated that his objective was to make maximum profits but he also wished to achieve growth. He pointed out that sometimes there could be conflict between these two objectives. Rajiv then said that it was necessary to monitor all aspects of the business and to have in place some control mechanisms. He pointed out that in his own business he monitored the allocation of overheads and he conducted break-even analysis of investment opportunities. He also stated that introducing budgetary control, variance analysis and ratio analysis would assist in the monitoring process. When he was asked about the concept of limited liability and the doctrine of *ultra vires* audit, he was unable to provide much detail. However, he used this opportunity to suggest that the students should become familiar with all aspects of the accounting model before they attempted to set up a business. He ended his presentation by saying that he hoped he would be invited back in five years time when he expected to be the head of a thriving large multinational company. 20 25 30

Financial information**Item A**

Figures extracted from the records of R K Fashions for the year ending 30 September 2013

	\$
Owner's Capital	25 000 ¹
Premises	80 000
Cash	5 000
Tax provision	2 500
Stock/Inventory	17 000
Vehicles	13 000
Equipment	22 000
Creditors/Trade Payables	29 000
Mortgage	38 500
Loan	30 000
Debtors/Trade Receivables	23 000
Net Profit	38 000
Drawings	To provide the balancing item

Item B

Total Fixed Overhead Costs \$125 000

Product	Floor Space	Number of employees
Women's clothing	4 000 m ²	15
Men's clothing	2 500 m ²	12
Children's clothing	3 500 m ²	8

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) Explain why in some situations it might be cheaper to operate with an overdraft facility rather than a loan agreement. [2]
- (b) Explain how **both** overtime payments and bonus payments would help the business to meet its production targets. [2 x 2 = 4]
- (c) Explain why there could be conflict between making maximum profits and achieving growth. [6]
- (d) Explain what is meant by budgetary control and variance analysis. [2 x 2 = 4]
- (e) Explain what is meant by limited liability and *ultra vires* audit. [2 x 2 = 4]
- [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]
- (b) (i) Identify **two** internal users and **two** external users who would find the information in the balance sheet useful. [4 x 1 = 4]
- (ii) For **each** of the users you identified in (b) (i) above, identify **one** ratio that they would find useful when analysing the balance sheet. [4 x 1 = 4]
- [Total: 20]**
- 3 (a) Explain **both** the legal and financial formalities that need to be followed in order to establish a limited company. [2 x 4 = 8]
- (b) (i) Explain **one** financial advantage and **one** financial disadvantage that would result from establishing a limited company. [2 x 2 = 4]
- (ii) Explain **one** financial advantage of operating as a sole trader. [2]
- (c) Distinguish between ordinary shares, preference shares and debentures as methods of raising capital for a limited company. [3 x 2 = 6]
- [Total: 20]**

- 4 (a) Explain, with **two** examples, what is meant by overhead costs. [4]
- (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]
- (ii) Number of employees [6]
- (c) Explain **two** reasons why the firm should employ this cost-centred approach to the allocation of its overheads. [2 x 2 = 4]
- [Total: 20]
- 5 (a) Explain **two** reasons why it is necessary to depreciate fixed (non-current) assets. [2 x 2 = 4]
- (b) Explain **two** methods which could be used for calculating depreciation of fixed (non-current) assets. [2 x 3 = 6]
- (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 x 2 = 4]
- (d) Explain how depreciation is treated in the year-end financial statements. [6]
- [Total: 20]

