

CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge Career Award in Business
Advanced Level

BUSINESS FINANCE

5173/01

Core Module

May 2003

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.

You may use a calculator.

Attempt **all** tasks.

Write your answers on the separate Answer Booklet/Paper provided.

At the end of the examination, fasten all your work securely together.

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 the tasks that follow.

(The case study is fictitious)

Case Study: Two Ltd

Thomas Woo, the Chairman of Two Ltd, was quite enthusiastic about the future. He started the firm 15 years ago, producing electrical components in a small workshop at the rear of his house. The firm has grown and diversified - they still produce the components but also provide lighting services for outside broadcasting and they have recently built a recording studio that is available for hire. 5

Although Thomas is confident about the future of his firm, he is also aware that there are challenges ahead and referred to these in his Chairman's Statement, which was produced as part of the Company's accounts.

Extracts from Chairman's Statement:

- 'the future provides several opportunities and several challenges – there is a predicted downturn for the economies of the 'Pacific-rim' ...many new competitors are now entering our traditional markets...the new generation of electronic aids is upon us...the modern consumer is more interested in 'green products' than 'value for money'. 10
- 'we are in danger of being left behind...I am therefore proposing that we should consider increasing the capital base...possibly by going public. 15
- 'the directors and I are recommending a strategy that includes...downsizing and concentrating on core business...the introduction of a cost-centred approach to pricing...much tighter control of working capital...much more emphasis on management accounting in addition to the usual financial accounting practices'.
- 'the profits figure may appear to be somewhat disappointing but the exceptional and extraordinary items listed in the accounts should explain this'. 20

Draft Balance Sheet for Two Ltd as at 29 April 2002

	\$000s		\$000s			
Shareholders Funds				Fixed Assets		
Ord Shares(2Million @\$2)		4000		Premises	2400	
Retained profits	1400	<u>5400</u>		Fixtures	2200	
				Equipment	1400	
Long Term Liabilities				Intangibles	300	<u>6300</u>
Mortgage	2500			Investments		500
Loan	900	<u>3400</u>				
Current Liabilities				Current Assets		
Trade creditors	400			Stock	1600	
Taxation	600			Debtors	1000	
Dividend	400	<u>1400</u>		Cash	800	<u>3400</u>
		<u>10200</u>				<u>10200</u>

Since the draft was prepared the following transactions were discovered:

New equipment worth \$200,000 had been bought on credit.

Additional stock (\$100,000) had been bought on credit.

The firm had paid \$350,000 to the tax authorities.

A debtor had repaid \$100,000.

New equipment purchase:

Purchase price \$200,000

Expected Useful Life = 4 years;

Estimated Residual Value = \$26,000.

Additional Information:

	\$
Annual Turnover	16,000,000
Cost of Goods Sold	13,600,000
Net Profit (before tax and interest)	1,700,000
Interest payments	150,000
Profit (net) available to ordinary shareholders	950,000
Share price	\$2 per share

You must attempt ALL of the following tasks.

- 1 (a) Explain and give **one** example of what is meant by the term 'intangibles'. [2]
- (b) Explain what is meant by the terms 'exceptional and extraordinary items' (line 20) and give an example of **each** item. [4]
- (c) Explain the difference between 'financial and management accounting' (line 18). [3]
- (d) Explain what is meant by the term 'cost-centred approach' (line 17) and give **one** advantage of using such an approach. [3]
- (e) (i) Explain what is meant by the terms 'downsizing and concentrating on core activities' (line 16). [2]
- (ii) Give **one** financial implication of each of the above terms. [2]
- [Total: 16]**
- 2 (a) The Chairman's report had mentioned the possibility of 'going public'. Identify and explain **three** methods that could be employed to sell shares to the general public. [3 x 3 = 9]
- (b) Identify **three** other sources of finance that could be employed by the firm to raise capital, and for **each** source explain the possible effects on the future profitability of the firm. [3 x 3 = 9]
- [Total: 18]**
- 3 Using the information in the Case study, produce a revised balance sheet, in a vertical format, that incorporates all the additional transactions identified by the Chief Accountant. [16]
- 4 The Chairman's report had identified a number of external factors that could influence the firm in the near future. Identify and explain how **three** of these factors might affect the firm. [3 x 4 = 12]
- 5 The new equipment which has been purchased, is depreciated by the firm.
- (a) Using the straight line method of depreciation:
- (i) calculate the annual depreciation allowance [3]
- (ii) calculate the book value of the equipment at the end of Year 3 [2]
- (b) Using the reducing balance method of depreciation (with a discount rate of 40%):
- (i) calculate the depreciation allowance in Year 2 [3]
- (ii) calculate the book value of the equipment at the end of Year 3 [2]
- (c) Explain why a firm such as Two Ltd will find it necessary to allow for depreciation of its fixed assets. [4]
- [Total: 14]**

6 (a) (i) Using the information in the case study, calculate **one** ratio for **each** of the categories below:

- liquidity ratio
- activity (asset usage) ratio
- performance ratio
- investment (shareholder) ratio

[4 x 2 = 8]

(ii) Explain how **each** of the ratios that you have calculated could be employed by those interested in the firm.

[4]

[Total: 12]

7 The management of working capital is an important element in the success of a business.

(a) Explain what is meant by working capital. [3]

(b) Discuss **three** methods that could be employed to ensure that a firm has sufficient working capital. [9]

[Total: 12]

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