

CAMBRIDGE INTERNATIONAL EXAMINATIONS
Cambridge Career Award in Business
Advanced Level

BUSINESS FINANCE

Core Module

5173/01

October 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 **6** printed pages and **2** blank pages.



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

The following case study is fictitious.

Case Study: M.R. Ltd

M.R. Ltd is an electrical component manufacturer. It was established by the principal shareholder, Mohammed Riaz, four years ago and has prospered despite the downturn in the manufacturing sector. The firm is still relatively small and only employs eight people, including Mohammed.

The firm produces electrical motors, which are then sold to equipment manufacturers, but Mohammed is keen to extend the range of components (see Item 2.). He is also considering developing his own range of branded equipment. However, Mohammed knows that these developments would require considerable additional capital. Mohammed has met with both his auditor and his bank manager to consider his plans and they have raised a number of questions – 5

- Mohammed needs to produce some fully costed proposals in order to identify the marginal costs of production 10
- He needs to consider how he is going to market his output - directly or through an agent?
- He needs to undertake more research of the market - will the environmental lobby have an impact on the market for electrical goods?
- The expansion of the firm would involve taking into account stricter government regulations – has he made allowances for this? 15
- Has he considered a merger with another firm, or buying in additional components on a 'sale or return basis'?

Financial Information**Item 1****Trading & Profit & Loss Accounts and Balance Sheets for M.R. Ltd at September 2001, 2002, 2003.**

	2001	2002	2003
Number of units produced and sold	40,000	48,000	56,000
Trading & Profit & Loss Accounts	\$000	\$000	\$000
Sales	400	480	560
Production cost - materials	120	144	168
Production cost - labour	80	96	112
Depreciation	40	40	40
Cost of Goods Sold	240	280	320
Gross Profit	160	200	240
Rent and interest	52	52	52
Sales expenses	60	72	84
Total expenses	112	124	136
Net profit	48	76	104
Dividend paid 30 September	40	68	80
Retained profit	8	8	24

Balance sheet as at 30 September 2001, 2002, 2003.

	2001	2002	2003
	\$000	\$000	\$000
Premises	40	40	40
Machinery (at cost)	320	320	320
Accumulated depreciation	80	120	160
Total (a)	280	240	200
Stock	32	32	32
Debtors	48	48	75
Cash	-	-	36
Total (b)	80	80	116
Trade Creditors	24	24	24
Overdraft	76	28	-
Total (c)	100	52	24
Working capital	(20)	28	92
Total (d)	260	268	292
Long Term Loan	40	40	40
	220	228	252
Financed by			
Ordinary shares of \$2 each	200	200	200
Retained profit	20	28	52
	220	228	252

Note that the auditor had not yet signed off the accounts for 2003

Item 2

Proposal to purchase new equipment

Machine A

Outright purchase \$250,000

Expected useful life 9 years

Expected returns	Years 1-3	\$50,000 per year
	Years 4-6	\$75,000 per year
	Years 7-9	\$60,000 per year

Running costs (including labour)

Years 1-6	\$15,000 per year
Years 7-9	\$18,000 per year

Machine B

Outright purchase \$380,000

Expected useful life 12 years

Expected returns	Years 1-4	\$70,000 per year
	Years 5-8	\$90,000 per year
	Years 9-12	\$75,000 per year

Running costs (including labour)

Years 1-4	\$18,000 per year
Years 5-8	\$24,000 per year
Years 9-12	\$30,000 per year

Note: for each proposal there would be an initial training cost of \$8,000 for the first year only.

You must attempt ALL of the following tasks.

- 1 (a) Identify **three** external (PEST) factors mentioned in the case study and explain how they might affect the profitability of M.R. Ltd. [6]
- (b) Explain how the branding of equipment (line 6) could become an asset for M.R. Ltd. [2]
- (c) Explain the role of the 'auditor' (line 8) in the accounting process. [2]
- (d) Explain what is meant by:
- (i) an agent (line 11); [2]
- (ii) marginal costs (line 9/10); [2]
- (iii) merger (line 16); [3]
- (iv) 'sale or return' (line 17). [2]
- [Total: 19]**
- 2 Use the information provided in the balance sheets. Refer to the information in item 1, on M.R. Ltd, to answer the following tasks:
- (a) Totals (a, b, c & d) appear in the balance sheets. Give the correct accounting terms for **each** of the totals. [4]
- (b) Identify **two** internal and **two** external users who would be interested in the published accounts (Item 1) and explain why they would have an interest. [8]
- [Total: 12]**
- 3 (a) Using all available information, select and calculate **three** ratios that could be employed to assess the current financial position of M.R. Ltd. [3 x 3 = 9]
- (b) Using all available evidence produce an assessment of the future profitability and financial standing of M.R. Ltd. [9]
- [Total: 18]**
- 4 (a) Using the information provided in Item 2, calculate the Accounting Rate of Return (A.R.R.) % for **each** of the proposals. [8]
- (b) State, with reasons, which of the proposals should be implemented. [4]
- [Total: 12]**
- 5 The future expansion of M.R. Ltd will be dependent on raising additional capital.
- (a) Identify **four** additional sources of capital that could be employed by M.R. Ltd. [4]
- (b) For **each** of the additional sources provide **one** advantage and **one** disadvantage of using that source. [8]
- (c) State, with reasons, which additional source of capital you would recommend for M.R. Ltd. [4]
- [Total: 16]**

- 6 Using all available evidence, identify and explain how **four** accounting concepts are currently being employed to produce the accounts of M.R. Ltd. **[4 x 3 = 12]**
- 7 (a) Using all available evidence, identify the method of depreciation of fixed assets currently employed by M.R. Ltd. **[2]**
- (b) Identify **one** other method of depreciation that could be employed and give **one** advantage and **one** disadvantage of using this method. **[5]**
- (c) Give **two** reasons why a firm such as M.R. Ltd should make allowances for depreciation. **[4]**
- [Total: 11]**

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