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

BUSINESS FINANCE **5173/01**

Optional Module

May 2006

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.

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

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UNIVERSITY *of* CAMBRIDGE
International Examinations

You must read the case study below and attempt all the tasks that follow.
[The following case study is fictitious.]

GSK plc

Narinder Singh was recently appointed as a junior partner in a firm of professional management accountants. Most of the firm's clients are multinational companies who approach the firm for the auditing of their books, production of specialist management reports and advice on taxation issues.

Narinder's current portfolio of clients includes a large engineering company, GSK plc, which has been trading for twenty years, and had 'gone public' only two years ago.

Narinder has been asked to produce a report analysing the present financial position of the company and has decided that using ratio analysis will be the most appropriate method of providing the required information.

GSK plc has also asked if Narinder could investigate the most appropriate method for depreciating its fixed assets. The firm is planning a major expansion of its manufacturing capacity and the directors are proposing that the firm should change from the straight line to the reducing balance method of depreciation.

Narinder has also been asked to provide a report detailing alternative sources of funding for the expansion programme and to provide some analysis as to why the actual costs of production appear to vary from the estimated (standard) costs of production.

Narinder has already extracted most of the relevant figures from the books of GSK plc and she is also looking into the external environmental (PEST) factors that are likely to have an impact on the firm in the near future.

Financial Information

Item A

Extract from Profit and Loss Account of GSK plc for year ending 30 April 2006

	US $000
Turnover	139 236
Cost of sales	90 544
Gross profit	48 692
Operating expenses	38 952
	9 740
Income from investments	-
Interest received	702
Net profit before tax and interest	10 442
Interest payable	2 116
Profit before taxation	8 326
Tax on profits	2 988
Profit after taxation	5 338
Extraordinary items	2 448
Profit for financial year	2 890
Dividends	1 522
Retained profit	1 368
Earnings per share	82.84c

Additional Information

Loan capital	$4.91 million
Preference share capital	$500 000
Preference shareholders dividend	$18 000
Number of ordinary shares	12.85 million
Share price	$0.390

Balance Sheet of GSK plc as at 30 April 2006

	$000	$000
Fixed assets		
Tangible assets		20 184
Investments		118
		20 302
Current assets		
Stock	36 324	
Debtors	22 976	
Cash	14 438	
	73 738	
Current liabilities	40 406	
Net current assets		33 332
Total assets less current liabilities		53 634
Creditors	5 028	
Provisions for liabilities	1 994	
Deferred income	558	
		7 580
		46 054
Capital and reserves		
Called-up capital		3 712
Share premium account		338
Revaluation reserve		1 786
Other reserves		294
Profit and loss account		39 924
		46 054

<u>Item B</u>
Purchase of new plant and equipment $2 500 000
Expected useful life 8 years
Residual value $300 000
Assets are reduced using the straight line method of depreciation.

<u>Item C</u>
Standard cost information

<u>Material costs</u>
To manufacture 1 unit of output it is estimated that it would take 20 kilograms of materials at a cost of $15 per kilogram.
In the last production time period the firm produced 1000 units of output, using 23 400 kilograms of materials at a cost of $338 000.

<u>Labour costs</u>
To manufacture 1 unit of output it is estimated that it would take 3 hours of labour input at a cost of $8 per labour hour.
In the last production time period the firm produced 1000 units of output, using 2 900 hours of labour input at a cost of $24 000.

You must attempt ALL of the following tasks.

1 **(a)** Explain what is meant by the term 'multinational company'. **[3]**

(b) **(i)** Explain what is meant by 'going public'. **[2]**

(ii) Identify and explain **two** methods that GSK might have used to 'go public'. **[4]**

(c) **(i)** Identify **two** PEST factors that Narinder might take into account when preparing her report. **[2]**

(ii) Explain how the PEST factors identified in **(i)** above might impact on GSK plc. **[6]**

(d) Explain how Narinder's work as a management accountant would differ from the work of a financial accountant. **[3]**

[Total: 20]

2 **(a)** Using the information in the case study, identify and calculate **four** relevant ratios that Narinder could use in her report to GSK plc. **[4x4=16]**

(b) Identify and explain **two** limitations of ratio analysis. **[4]**

[Total: 20]

3 **(a)** Identify **four** potential sources of funds that GSK plc could employ for its expansion programme. **[4]**

(b) For **each** of the sources identified in **(a)** above, give **one** advantage and **one** disadvantage of using that source of funding. **[8]**

(c) State, with reasons, which source of funding you would recommend that GSK plc should employ for its expansion programme. **[8]**

[Total: 20]

4 **(a)** Explain why a firm such as GSK plc should depreciate its fixed assets. **[6]**

(b) Using the information in the case study, **Item B,** calculate:

(i) the annual depreciation allowance that should be applied to the new fixed assets; **[4]**

(ii) the book value of the fixed assets at the end of year 6. **[4]**

(c) If GSK plc was to change to the reducing balance method of depreciation, explain what would be the likely effect upon the annual depreciation allowances and the effect on the book value at the end of year 8. **[6]**

[Total: 20]

5 Using the information in the case study, **Item C**, calculate:

(a) the direct material price variance; **[4]**

(b) the direct material usage variance; **[4]**

(c) the direct material total variance; **[2]**

(d) the direct labour rate variance; **[4]**

(e) the direct labour efficiency variance; **[4]**

(f) the direct labour total variance. **[2]**

[Total: 20]

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