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

**BUSINESS FINANCE** **5163/01**

Optional Module **October 2009**

**2 hours plus 15 minutes reading time**

Additional Materials: Answer Booklet/Paper

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**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.



UNIVERSITY of CAMBRIDGE International Examinations

[Turn over

**You must read the case study below and attempt ALL the tasks which follow.**
**(The case study is fictitious.)**

## A1 ENTERPRISES Ltd

A1 Enterprises Ltd is a medium sized firm that produces electrical components for the computer industry. The business was set up by the owner, Michael Chan, five years ago. Michael has retained overall control by operating as a sole trader for the first three years and then by forming a limited company in which he holds the majority of the shares. He has three factories and employs 350 people. Michael plans to expand production further by building a new factory. This will allow him to combine all production on a single site. He has approached the State Government for financial support for this proposal and they appear to be willing to offer assistance. However, Michael has also become aware that many of the existing workforce are unhappy about the proposal. He has set up a series of meetings with the workers to try to explain the possible financial benefits that the proposal will bring.

A1 Enterprises Ltd currently makes six different products, two at each of the factories. Four of these products are made under licence from a major multinational company and the remaining two products were designed by the company's employees and are protected by a patent. Michael believes that if the new factory is built, there will be considerable cost savings which should contribute to an increase in the overall level of profits. The firm's accountant is more cautious about the likely savings and has pointed out that some costs may rise in the short term.

If all production is moved to one site then the firm's accountant thinks that labour costs may rise. The relocation costs could be high because of the age of the machinery and the disruption of production is likely to result in a loss of sales. He has therefore proposed that Michael should consider closing only one of the factories and expanding the other two sites.

One large factory would produce all of the licensed products and the other would concentrate on the production of the patented products. The accountant has also suggested that the two sections should be run separately with their own management teams, and that they should be free to adopt whatever accounting practices are most appropriate for the business.

Michael is rather concerned about these proposals as he feels that this could result in him losing some control over the firm. Also, his limited knowledge of formal accounting means that he does not fully appreciate how there could be benefits from changing accounting methods.

Michael's cousin, who is a merchant banker, has examined all of the proposals. He has suggested that Michael should adopt the proposal from the accountant. However, it is unlikely that sufficient finance could be raised from the government and the bank and therefore Michael might need to consider either a rights issue or going public. A number of external factors are also likely to affect the business in the immediate future:

- A recently agreed international trade agreement is likely to increase the price of materials and give greater support to developing nations.
- Domestic interest rates are set to rise, while business taxation is predicted to fall.
- A new generation of computer products is likely to be launched in the near future which will require a different set of components.

**Financial information**

**Item A**

Balance Sheet totals for A1 Enterprises Ltd as at 30 September 2009.

| | $000[1] |
|---|---|
| Land and buildings | 2500 |
| Stock | 500 |
| Accumulated depreciation | 900 |
| Cash | 60 |
| Creditors | 280 |
| Fixtures and fittings | 500 |
| Proposed dividend | 120 |
| Plant and equipment at cost | 4800 |
| Debtors | 350 |
| Overdraft | 30 |
| Ordinary shares 1,600,000 @ $2 each | 3200 |
| Corporation Tax | 110 |
| Preference shares 400,000 @ $4 each | 1600 |
| 10% Debenture issued June 2008 | 1200 |
| Profit and Loss Account | To provide the balancing item |

It was reported that the ordinary shares had been issued at a premium of 25%.

**Item B**

Proposed purchase of new machinery:

Purchase price: $650,000
Estimated useful life: 8 years
Residual value: 15% of purchase price
A1 Enterprises Ltd currently uses the straight line method of depreciating fixed assets.

[1] Prices are quoted in $US

**You must attempt ALL of the following tasks. Where appropriate use information from the case study to support your answer.**

**1** **(a)** Explain why a patent is treated as an asset in the accounts of a business. **[4]**

**(b)** Explain why it is likely that the labour costs would rise if A1 Enterprises Ltd relocated. **[6]**

**(c)** Explain what is meant by the term 'merchant banker' and explain what role a merchant banker could play in the operations of A1 Enterprises Ltd. **[6]**

**(d)** Explain **one** benefit and **one** disadvantage of allowing the two sections of the firm to adopt different accounting practices. **[4]**

**[Total: 20]**

**2** **(a)** Explain what effect **each** of the **three** external (PEST) factors mentioned in the case study is likely to have on the future profitability of the business. **[3 x 4 = 12]**

**(b)** Explain how Michael could use a rights issue to raise additional capital and explain **one** advantage of using this method to raise the capital. **[8]**

**[Total: 20]**

**3** **(a)** Use the information in **Item A** to produce a balance sheet for A1 Enterprises Ltd. **[14]**

**(b)** Explain how each of the following would use the information contained in the balance sheet:

**(i)** the government; **[2]**

**(ii)** prospective investors; **[2]**

**(iii)** the firm's suppliers. **[2]**

**[Total: 20]**

**4** **(a)** Explain **two** advantages and **two** disadvantages of operating as a sole trader. **[8]**

**(b)** Explain **both** the legal and financial implications of going public. **[8]**

**(c)** Explain **one** financial advantage and **one** financial disadvantage of operating as a public limited company. **[4]**

**[Total: 20]**

**5** **(a)** Use the information in **Item B** to calculate:

**(i)** the annual depreciation allowance that should be applied to the new machinery; **[6]**

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

**(b)** Explain why A1 Enterprises Ltd should depreciate its fixed assets and how depreciation is treated in the final accounts of the firm. **[8]**

**[Total: 20]**