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

BUSINESS FINANCE **5173/01**

Optional Module **October 2010**

2 hours plus 15 minutes' reading time

Additional Materials: Answer Booklet/Paper

8742351069

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

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UNIVERSITY *of* CAMBRIDGE
International Examinations

You must read the case study and attempt ALL of the tasks which follow.

(The case study is fictitious.)

Than Gems Ltd.

Li Than has been in business for exactly fifty years. He first started out operating as a franchisee, selling jewellery, but he was unhappy with the profit margins that he could achieve and he therefore decided to establish his own retail outlets. Initially, he set up as a sole trader, but as his business grew, he took on four partners and then four years ago they formed Than Gems Ltd., a private limited company. This expansion allowed the firm to set up its own manufacturing facilities as well as the existing retailing outlets.

Despite some difficult trading conditions, the company is doing well and has now achieved a twenty percent share of the market. Li and his directors believe that this success is because they are in touch with market trends and they have an effective management accounting team.

However, a recent report from the management accountants has suggested that in the near future the firm is likely to face a serious problem of overtrading. They have suggested two strategies for solving this problem. They can either divide the company into two parts (each to be run independently) or convert the company into a public limited company. At a recent emergency board meeting, the board members were divided equally as to which approach to take, and the matter has been postponed until the next board meeting in one month's time.

In the meantime, the financial accountants have been redrafting the company's year-end financial statements as the auditor is unhappy about a number of items that have been included. In particular, he is concerned that the company appeared to have changed its method of valuing stocks and that it is engaging in the practice of 'window dressing'. Although most of the board members do not really understand these problems, the finance director has indicated that he will investigate how they have arisen.

The auditor has also recommended that the company should control its costs more closely by introducing cost centres to allocate overheads more effectively and that the working capital should be monitored more closely. He has suggested that this will require the introduction of a system of cash budgeting for each of the departments of the company.

Financial Information

Item A

Cash Budget Information

Opening cash balance June 1 $47 000
Opening overdraft June 1 $12 500

Revenues

Cash sales	June	$120 000
	July	$100 000
	August	$75 000
	September	$65 000

The directors decided to offer sales on credit starting from June 1. The payment details are:

- no initial deposit and then 50% payable in the month following purchase
- 25% payable in each of the next two months.

The sales figures for the credit sales are as shown below.

Credit sales	June	$50 000
	July	$80 000
	August	$64 000
	September	$104 000

Interest received from investments July 1 $30 000

Expenditure

Wages	$11 500 per month	
Materials purchased	$12 000 per month	
Consumables	$8 700 per month	
Administration costs	$6 500 per month	
Repayment of overdraft	July	$4 000
	August	$1 250

Annual insurance - paid in four equal instalments (July-October) Total premium $5 400

Purchase of replacement machinery $242 000 paid in three instalments (June-August)
50% in June, 25% in July and August

Item B

The company has three manufacturing departments. The Total Fixed Overheads of the company to be allocated among the departments is $450 000.

The criteria that the company uses for allocating the overheads are: numbers of workers employed, floor space and value of equipment employed. The figures for each of these criteria are as shown below.

The departments employ a total of 64 workers. The distribution of the workforce is:

Department 1	24 workers
Department 2	32 workers
Department 3	8 workers

The total floor space given over to manufacturing is 12 000 sq. m. The floor space occupied by each of the departments is:

Department 1	3 600 sq. m.
Department 2	2 400 sq. m.
Department 3	6 000 sq. m.

The total value of all machinery employed in the manufacture of products is $3 000 000. The value of machinery used by each department is as follows:

Department 1	$1 750 000
Department 2	$650 000
Department 3	$600 000

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

1 **(a)** Explain the benefits of a franchise agreement to **both** a franchisee and a franchisor. **[2 x 3 = 6]**

(b) Explain what is meant by a profit margin. **[3]**

(c) Explain what is meant by overtrading. **[3]**

(d) Explain what is meant by 'window dressing'. **[4]**

(e) Explain what is meant by working capital and produce a formula that could be used to calculate working capital. **[4]**

[Total: 20]

2 **(a)** Explain **two** advantages and **two** disadvantages of forming a private limited company. **[4 x 2 = 8]**

(b) Explain **two** advantages and **two** disadvantages of forming a public limited company. **[4 x 2 = 8]**

(c) Explain **two** methods that could be used to 'go public'. **[2 x 2 = 4]**

[Total: 20]

3 **(a)** Use the information contained in **Item A** to produce a **four-month** cash budget for the period June to September. **[14]**

(b) **(i)** Explain **one** reason why a company allows customers to buy goods on credit. **[3]**

(ii) Describe **one** method that a company could employ to ensure that it receives all of the credit payments that are due. **[3]**

[Total: 20]

4 **(a)** Describe the main duties of a financial accountant. **[8]**

(b) Explain how the duties of a management accountant will differ from those of a financial accountant. **[8]**

(c) Explain how the job of an internal auditor will be different from that of an external auditor. **[4]**

[Total: 20]

Question 5 is on the next page.

5 **(a)** **(i)** Explain what is meant by a cost centre. **[2]**

(ii) Describe how the company would benefit from adopting a cost-centred approach within their accounts. **[6]**

(b) Use the information in **Item B** to calculate the appropriate allocation of fixed overheads to **each** of the departments, by using the following criteria:

(i) number of employees **[4]**

(ii) floor space **[4]**

(iii) value of machinery employed. **[4]**

[Total: 20]

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