UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Diploma Standard Level

MARK SCHEME for the May 2012 question paper

for the guidance of teachers

CAMBRIDGE INTERNATIONAL DIPLOMA IN BUSINESS

5163 Business Finance, maximum mark 100

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes must be read in conjunction with the question papers and the report on the examination.

- Cambridge will not enter into discussions or correspondence in connection with these mark schemes.

Cambridge is publishing the mark schemes for the May 2012 question papers for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses and some Ordinary Level syllabuses.

1 (a) (i) Explain what is meant by the process of incorporation. [3]

Allow **1 mark** for a simple answer e.g. forming a limited company.

Allow the additional **2 marks** if there is reference to the process of registration of documents, issuing of shares etc.

(ii) Identify the likely expenses associated with the process of incorporation. [3]

Allow **2 marks for each example** of likely expenses to **a maximum of 3 marks.**

Examples include: registration fee, legal fees etc.

(iii) Explain two possible long term financial advantages of becoming an incorporated organisation. [2 × 2 = 4]

Allow **2 marks** for each well explained advantage e.g. every shareholder has limited liability, better credit rating with financial institutions, easier to raise additional capital etc.

(b) (i) Explain why the running costs per unit might increase if the business runs the machine at 80% capacity. [3]

Allow **up to 3 marks** for any well explained reason e.g. running costs are likely to rise as it may be necessary to pay overtime rates to workers. Maintenance costs are likely to rise as the output nears full capacity etc.

(ii) Explain why the sales and distribution costs per unit might decrease if the business runs the machine at 80% capacity. [3]

Allow **up to 3 marks** for any well explained reason e.g. operating at a higher level means that the expenditure on advertising appears to be more effective, the costs of promotion and advertising may be reduced if the providers offer discounts for repeats, transportation costs could be reduced with larger orders etc.

(c) Explain one advantage and one disadvantage that is associated with Anil's status as a sleeping partner. [2 × 2 = 4]

Allow **up to 2 marks** for any well explained advantage/disadvantage e.g. Anil has limited liability for the debts of the business, Anil takes no part in the day to day running of the business etc.

[Total: 20]

2 (a) Explain what is meant by the money cycle. [6]

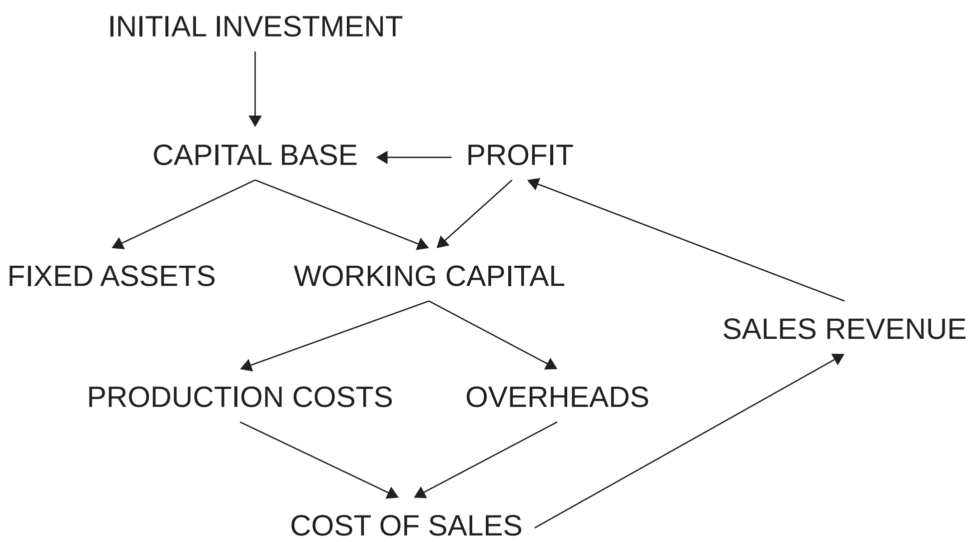
Allow **up to 6 marks** for a well explained answer that describes the money cycle. The answer should refer to costs, revenue, and profits and it should point out that money has to be paid out before revenue is obtained. Revenue and profit is then used to finance the next round of production and sales.

Allow **up to 3 marks** for a vague or incomplete answer.

Allow **4–6 marks** for an answer that includes most or all the elements and provides an explanation of money re-circulating within the business.

If the candidate provides a diagram which shows the flow of money but does not provide an explanation allow **a maximum of 4 marks**.

THE MONEY CYCLE



(b) Explain the role that profit plays within the money cycle. [4]

Allow **up to 4 marks** for an explanation of the role of profits within the cycle.

Allow **2 marks** for any valid point e.g. profits allow the business to reinvest in either fixed assets and/or working capital and therefore promotes growth and continuity, profits result after all the costs and expenses have been covered and therefore the business remains solvent and has liquidity, in addition the retention of profits within the business will allow the business to grow etc.

(c) Using the information in Item A, calculate the weekly net profit that would be achieved at:

(i) 60% capacity level [5]

(ii) 80% capacity level [5]

Allow **up to 5 marks** for each correct calculation

Allow **1–2 marks** for an answer that demonstrates that the candidate has some idea about how to undertake the calculation, but the information has not been correctly extracted from the case study and/or there are errors in the calculation.

Allow **3–5 marks** if the answer clearly indicates that the candidate understands how to calculate net profit and has successfully extracted and processed the information from the case study.

See Appendix 1 for suggested solution [Total: 20]

3 (a) Using your own examples, explain the differences between tangible assets and intangible assets. [10]

Allow **up to 5 marks** for each explanation of the assets providing the answer includes examples of the assets.

Possible content

Tangible assets have some physical form and are mostly fixed in nature e.g. land, vehicles, equipment, buildings. Some current assets are tangible e.g. stocks. Many tangible assets will last for a long time but it is likely that they will lose some of their value due to wear and tear etc. The depreciation of fixed assets allows for this reduction in value.

Intangible assets have some value but they do not have a physical form e.g. patents, goodwill, trademarks, copyright but they still contribute to the net worth of the business and will therefore be included in the balance sheet totals. Many intangible assets have a shorter life span than fixed assets and they are often removed from the balance sheet through a process known as amortisation.

(b) Using your own examples, explain the difference between financing that increases the capital base and financing that increases the level of liquidity. [10]

Allow **up to 5 marks** for each explanation of the difference between financing that increases the capital base and financing that increases the level of liquidity providing the answer includes examples.

Possible content

Increasing capital base is a long term solution by increasing the level of investment in the business. Whereas liquidity tends to be shorter term focusing on cash flow.
Capital base involves issuing shares with an effect on ownership.
Liquidity can be a range of methods including bank loan, factoring, sale and leaseback etc. with no effect on ownership.

Allow 2 marks for an answer that explains what is meant by liquidity i.e. the business is solvent at it has a surplus of current assets over current liabilities.

Allow an additional 2 marks if the answer includes examples of financing e.g. selling additional shares increases the capital base,

[Total: 20]

4 Financial accounting is associated with recording information, summarising information and presenting information.

(a) Explain, using your own examples, what is meant by

(i) recording information [4]

(ii) summarising information [4]

(iii) presenting information [4]

Allow **up to 3 marks** for an answer that only provides a simple overview of financial accounting.

Allow **up to 4 marks per activity** for explaining what is involved in each activity providing that the answer contains a valid example.

Maximum marks for part (a) 12 marks.

Possible content

Financial accounting is concerned with producing the key financial statements that show the financial position of a given organization. It begins with the bookkeeping process and ends with the presentation of the final end of trading period statements such as the balance sheet, the trading and profit and loss account and the cash flow statement.

The role of the financial accountant is sometimes described as involving three processes; recording, summarising and presenting information.

Recording involves ensuring that the raw data has been accurately and correctly entered into the prime entry books e.g. sales, purchases, journal. It is a basic bookkeeping role.

Summarising involves taking large amounts of data that have been accurately recorded and arriving at totals that can then be inserted into the appropriate ledger accounts according to the accepted standards of accounting. It is sometimes referred to as posting.

Presenting involves making the accounting information available in a recognizable and standardised form for the use of both internal and external users e.g. the production of the profit and loss account and the balance sheet.

(b) Explain four differences between the work of a management accountant and the work of a financial accountant. **[4 × 2 = 8]**

Allow **up to 3 marks** for an answer that only provides an overview of management accounting.

Allow **up to 2 marks** for each well explained difference in accounting activities as long as the answer demonstrates how the activity differs e.g. management accounting is mainly for internal use rather than external use,

Other differences include: production on an ad hoc basis, use of information for control purposes, information based on future events rather than recording past events etc.

Maximum marks for part (b) 8 marks.

Possible content

Management accounting is a specialised branch of accounting that involves the accountant in producing reports, based upon the accounting information available, that will be used by the management of the organisation in the decision making process.

Often these are required on an ad hoc basis rather than the fixed time scale associated with financial accounting. Examples of management accounting would include producing budget reports, forecasts and analysing variations.

[Total: 20]

5 (a) (i) **Explain what it is involved in a formal process of appraising any future investment opportunities.** **[6]**

Allow **up to 2 marks** for an answer that provides a vague or incomplete explanation regarding the process of investment appraisal.

Allow **3–6 marks** if the answer clearly explains what is involved in investment appraisal.

Possible content

When making investment decisions it is important that managers adopt an objective approach. This approach should consider whether the investment will allow the organisation to achieve its objectives, whether the costs of the investment will outweigh the benefits received and whether the selected investment is superior to the alternative investment opportunities. In order to do this it is necessary to compare the immediate cash outlay with the potential income that the investment is likely to generate in the future.

There are a number of techniques which can be used to ensure that objective decisions are being taken. These include the following:
- Payback
- Average rate of return
- Discounted cash flow using either (i) net present value or (ii) internal rate of return

(ii) Explain <u>two</u> possible benefits from adopting a formal system of investment appraisal. [2 × 2 = 4]

Adopting a formal process of investment appraisal will ensure that the business will be in a position to achieve the following benefits

- Predetermined criteria against which all investments are judged
- Encourages scientific decision making
- Use of quantitative data
- Objective decision making
- Same systematic approach to all investment decisions
- Avoid past errors for example where equipment has not been used for considerable periods of time (line 30)

(b) Using the information in <u>Item B</u>, calculate the payback period, in years, for:

(i) Machine A [5]

(ii) Machine B [5]

Allow **up to 5 marks** for each correct calculation

Allow **1–3 marks** for an answer that demonstrates that the candidate has some idea about how to undertake the calculation, but the information has not been correctly extracted from the case study and/or there are errors in the calculation.

Allow **4–5 marks** if the answer clearly indicates that the candidate understands how to calculate the payback period and has successfully extracted and processed the information from the case study.

For suggested solution see Appendix 2 [Total: 20]

Appendix 1 – Suggested Solution

Gross Profit = Sales Revenue – Cost of Sales

Net Profit = Gross Profit – Expenses

At 60% capacity
Cost of Sales = $4.50 × 6 000 = $27 000
Sales Revenue = $7.50 × 6 000 = $45 000
Gross Profit = $45 000 – $27 000 = $18 000
Net Profit = $18 000 – ($0.60 × 6 000) = $14 400

At 80% capacity
Cost of Sales = $4.80 × 8 000 = $38 400
Sales Revenue = $6.75 × 8 000 = $54 000
Gross Profit = $54 000 – $38 400 = $15 600
Net Profit = $15 600 – ($0.50 × 8 000) = $11 600

Appendix 2 – Suggested Solution

Machine A has an initial cost of $600 000 and a useful life of 5 years. It will have a residual value of $50 000. The net income from the machine has been estimated at $150 000 per year.

Machine B has an initial cost of $800 000 and has a useful life of 8 years. It will have a residual value of $100 000. The net income from the machine has been estimated at $180 000 per year.

Payback Period = $\dfrac{\text{Initial cost of machine} - \text{Residual value}}{\text{Annual net income}}$

Payback for machine A can be calculated as $\dfrac{\$600\,000 - \$50\,000}{\$150\,000}$ = 3.67 years

Payback for machine B can be calculated as $\dfrac{\$800\,000 - \$100\,000}{\$180\,000}$ = 3.89 years