FOUNDATIONS IN ACCOUNTANCY

Foundations in Financial Management

Pilot Paper

Time allowed: 2 hours

This paper is divided into two sections:
Section A – ALL 10 questions are compulsory and MUST be attempted
Section B – ALL 6 questions are compulsory and MUST be attempted

Present Value and Annuity Tables are on pages 8 and 9

Do NOT open this paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper FFM

ACCA

Section A – ALL 10 questions are compulsory and MUST be attempted

1 Exactly one year ago, $100 of treasury bill was issued with a coupon rate of 4%, redeemable at par nominal value two years after issue. The treasury bill currently has a market value of $102.25.

What is the interest yield on the treasury bill, calculated to the nearest two decimal places?

A 3.91%
B 4.00%
C 1.71%
D 2.20%. **(2 marks)**

2 Quilt Co grants credit terms of 30 days net to customers but offers an early settlement discount of 1% for payment within seven days.

What is the compound percentage cost of the discount to Quilt Co, to the nearest percentage?

A 17%
B 18%
C 19%
D 20%. **(2 marks)**

3 The following statement has been made about an essential elements of a contract:

'All contracts need to be in a strict legal form in order to be binding'

Is this true or false?

A True
B False. **(1 mark)**

4 Which of the following statements are true/false?

Statement 1: Positive covenants are promises by a borrower to do something.
Statement 2: Quantitive covenants are promises to keep within financial limits set by the lender.

	Statement 1	Statement 2
A	False	True
B	False	False
C	True	False
D	True	True.

(2 marks)

5 'An unconditional order in writing to pay the addressee a specified sum of money either on demand or at a future date'.

What does the above definition describe?

A Bill of Exchange
B Loan stock. **(1 mark)**

6 A company purchases a non-current asset with a useful economic life of 10 years for $1.25 million. It is expected to generate cash flows over the ten year period of $250,000 per annum before depreciation. The company charges depreciation over the life of the asset on a straight-line basis. At the end of the period it will be sold for $250,000.

What is the accounting rate of return for the investment (based on average profits and average investment)?

A 20%
B 15%
C 33%
D 25%. **(3 marks)**

7 The following statements have been made about a bank's rights in relation to its customers:

(i) The bank has the right to be repaid overdrawn balances on demand, except where the overdraft terms require a period of notice.
(ii) The bank can use the customers' money legally or morally acceptable way that it chooses
(iii) A customers' money must always be available for immediate withdrawal, irrespective of the terms of the deposit.

Which of the above statements are true?

A (i) and (ii) only
B (i), (ii) and (iii)
C (i) and (iii) only
D (ii) and (iii) only. **(2 marks)**

8 A company has material B in its inventory, which it purchased in error at a cost of $800. The company is deciding whether to: (i) use it as a substitute for material A which would cost $500 to buy in; or (ii) sell material B for $510 cash LESS selling costs of $20; or (iii) use it in another contract.

If the company decides to use that material in another contract, what is its relevant cost?

A $800
B $510
C $500
D $490. **(2 marks)**

9 The following statements have been made about the probable long-term effects of introducing a just-in-time system of inventory management:

(i) Inventory holding costs increase
(ii) Labour productivity improves
(iii) Manufacturing lead times decrease

Which of the above statements are true?

A (i), (ii) and (iii)
B (i) and (ii) only
C (i) and (iii) only
D (ii) and (iii) only. **(2 marks)**

10 A company has the following non-current assets:

	20X5	20X6
Non-current assets at closing net book value	$200,000	$250,000

Depreciation for the 20X6 income statement is $30,000. No disposals were made in the period.

What is the correct figure for cash purchases of non-current assets during 20X6?

A $50,000
B $80,000
C $250,000
D $20,000. **(3 marks)**

(20 marks)

Section B – ALL SIX questions are compulsory and MUST be attempted

1 Bulb Co is a company specialising in the manufacture of a large range of light bulbs. Over the last six months, the business has begun to expand, with an increase in sales of 20% compared to the same six month period last year. This expansion has given rise to a need for increased working capital. The company has very little cash at present, and needs to accurately ascertain its working capital requirements for the next year. The following forecast figures are available.

Turnover for the year	$65,000,000
Costs as a percentage of sales:	
Direct materials	20%
Direct labour	25%
Variable overheads	15%
Fixed overheads and selling and distribution costs	23%

The following average time periods are expected:

(i) Inventories

Raw materials are held in inventory for eight weeks and finished goods are held for six weeks. All finished goods inventories and work-in-progress inventories include direct materials, direct labour and variable overhead costs. Assume that goods remain in work in progress for two weeks and are 75% complete as regards direct materials and 50% complete as regards direct labour and variable overheads.

(ii) Accounts receivable

All customers are credit customers and take on average nine weeks to pay.

(iii) Accounts payable

The credit taken is four weeks for all expense categories.

Required:

(a) Calculate the working capital requirement of Bulb Co for the next year. Assume that there are 52 working weeks in the year. (14 marks)

(b) Bulb Co has decided that it should apply to the bank for an overdraft or short term loan to cover the increase in its working capital requirements over the next year. Having run its business with very little debt for many years now, it is unsure what factors the bank will take into account when deciding whether to lend to the company.

Describe THREE factors that the bank will consider when deciding whether to grant this loan or overdraft to Bulb Co. (6 marks)

(20 marks)

2 Waste Co is a waste management company, with one sole shareholder/director, Mr Trusty. As the business has expanded rapidly over the last two years, Mr Trusty has had less time to focus on credit control. This has resulted in a steady deterioration in accounts receivable collection and a rapid increase in Mr Trusty's overdraft despite high profits. Mr Trusty's bank has now refused to extend his overdraft any further and has suggested that he either employ a credit controller or factor his accounts receivable.

Required:

(a) Explain the meaning of 'debt factoring' (accounts receivable factoring) to Mr Trusty, distinguishing between 'with recourse' and 'without recourse' agreements. (6 marks)

(b) State four roles that a credit controller may play. (4 marks)

(10 marks)

3 Describe FOUR advantages of having a centralised treasury department. (10 marks)

4 Curtain Co is a small family-run business, which makes made-to-measure curtains for its customers, who are local furnishing stores. Curtain Co does not deal directly with the general public. Its turnover for the next year is forecast to be $600,000. Curtain Co is always overdrawn and pays interest on its overdraft at 8% per annum.

Once a pair of curtains has been made, an invoice is raised and sent with the curtains to the customer. Invoices are settled by cheque for each pair of curtains, often resulting in several cheques from the same customer each month. It is now considering introducing a new system, whereby it invoices customers at the end of each month for their total despatches that month, requesting payment by standing order or direct debit within thirty days. It is expected that all Curtain Co's customers would take advantage of the full credit period, but not exceed it.

Curtain Co's owners have concerns about the cost of offering increased credit as, at present, customers pay their invoices 14 days, on average, after the month of sale. The business currently pays $1.80 for each cheque banked; it would expect to bank 2,000 cheques over the coming year if it does not make changes in the payment method. Its bank does not charge it for receipts into its account by standing order or direct debit.

Required:

Calculate:

(i) current total finance costs (cheques and interest); and

(ii) new total finance costs (cheques and interest) if the new system is introduced.

Conclude from these calculations whether the new system should be introduced. (10 marks)

5 Clear Co specialises in the production of UPVC windows and doors. It is considering whether to invest in a new machine with a capital cost of $4 million. The machine would have an expected life of five years, at the end of which it would be sold for $450,000.

If the new machine were to be purchased, the existing machine could be either sold immediately for $250,000, or hired out to another company at a rental amount of $100,000 per annum, payable in advance for three years. If the machine is hired out rather than sold, it will have no residual value at the end of the three year period. The existing machine generates annual revenue of $8 million and its running costs are $840,000 per year.

If the new machine is purchased, revenues are expected to increase by 20% per year. In addition to this, however, machine running costs are also expected to increase. Estimates have shown that, in the first year with the new machine, running costs will increase by 18%. In every subsequent year thereafter, running costs will continue to be 18% higher than each previous year's costs.

The company's cost of capital is 10%.

Required:

Calculate, to the nearest $'000, the net present value of the proposed investment, over five years and state with reasons whether the machine should be purchased.

(15 marks)

6 Educate Co is a fast-growing company specialising in the provision of adult education. It currently has ten language schools and three information technology schools. It is estimated that the education sector will grow by 15% over the next five years. The company is keen to take advantage of the opportunities which are available and is seeking to raise funds to finance its growth.

Since the company is 'highly geared' its advisors have suggested that it should seek to raise funds through some sort of share capital issue, rather than a loan.

Required:

(a) Explain FOUR reasons why a company might seek a stock exchange listing. (10 marks)

(b) Explain the meaning of the term 'highly geared' and why it is important to a company trying to raise extra finance. (5 marks)

(15 marks)

Present Value Table

Present value of 1 ie $(1 + r)^{-n}$

Where r = discount rate
n = number of periods until payment

Periods (n)	Discount rate (r) 1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	2
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	3
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	4
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	5
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	6
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	7
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	8
9	0.941	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	9
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	10
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.305	11
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319	12
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290	13
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263	14
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694	2
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579	3
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482	4
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402	5
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335	6
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279	7
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233	8
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194	9
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162	10
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135	11
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112	12
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093	13
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078	14
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065	15

Annuity Table

Present value of an annuity of 1 ie $\frac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate
n = number of periods

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736	2
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487	3
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170	4
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791	5
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355	6
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868	7
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335	8
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759	9
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145	10
11	10.37	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495	11
12	11.26	10.58	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814	12
13	12.13	11.35	10.63	9.986	9.394	8.853	8.358	7.904	7.487	7.103	13
14	13.00	12.11	11.30	10.56	9.899	9.295	8.745	8.244	7.786	7.367	14
15	13.87	12.85	11.94	11.12	10.38	9.712	9.108	8.559	8.061	7.606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528	2
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106	3
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589	4
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991	5
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326	6
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605	7
8	5.146	4.968	4.779	4.639	4.487	4.344	4.207	4.078	3.954	3.837	8
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031	9
10	5.889	5.650	5.426	5.216	5.019	4.833	4.569	4.494	4.339	4.192	10
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327	11
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439	12
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533	13
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611	14
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675	15

End of Question Paper

Answers

Section A

1 A Interest yield= coupon rate /market pricex100%=4/102.25x100%=3.91%

2 A (100/(100-1))365/23-1=17.3%

3 B

4 D

5 A

6 A ARR = average annual profits (after depreciation)/average investment
Annual depreciation = (cost-residual value)/10 = $100,000 per year
Profits after depreciation = $250,000–$100,000 = $150,000
Average investment = ($1,250,000+$250,000)/2 = $750,000
Therefore ARR = $150,000/$750,000 = 20%

7 A

8 C

9 D

10 B

	$
Non-current assets as at 31 December X6	250,000
Add back depreciation	30,000
Non-current assets as at 31 December X5	(200,000)
	80,000

Section B

1 Bulb Co

(a) Working capital requirements.

Current assets		$	$
Raw materials	(8/52x$13m)		2,000,000
Finished goods:			
– raw material	(6/52x$13m)	1,500,000	
– labour	(6/52x$16.25m)	1,875,000	
– variable o/head	(6/52x$9.75m)	1,125,000	
			4,500,000
WIP:			
– raw material	(2/52x$13mx75%)	375,000	
– labour	(2/52x$16.25mx50%)	312,500	
– variable o/head	(2/52x$9.75mx50%)	187,500	
			875,000
Accounts receivable	(9/52x$65m)		11,250,000
Total current assets			18,625,000
Less current liabilities:			
Accounts payables:	(4/52x$53,950,000m)		(4,150,000)
Working capital requirement			14,475,000

Working 1: Annual costs

		$
Turnover	$65,000,000	
Direct materials	$65mx20%	13,000,000
Direct labour	$65mx25%	16,250,000
Variable o/heads	$65mx15%	9,750,000
Fixed o/heads and selling and distribution.	$65mx23%	14,950,000

(b) Factors

The character of the borrower
Since Bulb Co is a company, the bank will need to assess the experience and integrity of the directors of Bulb Co. In order to do this, the bank is likely to require a personal interview with at least some of the directors of Bulb Co. The bank will also assess integrity by reading the financial press and searching the internet for any signs of any disputes between the company or its directors with any other companies, organisations or individuals.

The ability to borrow and repay
The bank wants to be sure that Bulb Co will be in a position to repay the money. This assessment of the ability to repay will include as assessment of the company's key ratios, in order to ascertain its financial health. In considering the company's ability to repay, the bank will consider the levels of any outstanding debt. Also, the bank may check whether the company has the authority to borrow the funds it is requesting. The company's articles of association provide this information.

The margin of profits
The bank lends money in order to make money. It needs to ensure that it makes enough of a profit to warrant the risk that it takes by lending. Therefore it will only lend money to Bulb Co if it can make a return that warrants the risk of lending. Most banks have lending policies which require them to charge different interest rates to customers depending on the reason for the borrowing. This is because some types of lending are more risky that others, therefore higher interest rates reflect higher risk.

The bank may want to take some form of security for the lending, probably over the company's property.

Purpose of borrowing
The purpose of borrowing affects not only the interest rate but also the bank's decision as to whether to lend in the first place. It will normally lend in order to finance working capital, provided that the company's liquidity position is still manageable. The bank will carry out some financial analysis, looking at Bulb Co's key ratios, in order to assess this.

Amount of borrowing
Firstly, the bank will need to make sure that Bulb Co is not asking for more money that it needs for the purpose specified. If it is, this casts doubt over its ability to repay.

Secondly, the bank needs to be sure that Bulb Co is asking for enough money. If it is not, the bank may well end up having to lend more in order to safeguard the original loan.

Repayment terms
Banks will pay close attention to the repayment terms when considering granting a loan. Obviously, being sure that a borrower will repay is critical and a bank should not lend money just because the borrower has security for the loan. Taking ownership of and selling any of the borrower's assets would be a cumbersome process and is really a last resort.

Payment terms need to be clearly agreed, documented and realistic given the borrower's financial position.

Insurance
The bank will need to be satisfied that Bulb Co's business is adequately insured. An underinsured business can be disastrous. In addition, Bulb Co may wish to obtain payment protection insurance just to make sure that it can meet all of its loan repayments.

NOTE: Only THREE factors were required.

2 Waste Co

(a) Debt Factoring
'Debt factoring' is a service provided by factors whereby the factor collects accounts receivable on behalf of their client and often invoices their client's customers as well. The factor also advances, to its client, a proportion of the money it is due to collect (typically about 80% is advanced.)

Mr Trusty would find this service useful because he could both receive cash early and also delegate the administration of his invoicing, accounting and accounts receivable collection work.

There are two types of factoring arrangements: 'with recourse' and 'without recourse' agreements. With the first of these agreements, although the factor advances monies, the risk of non-payment of accounts receivable balances stays with the client. If a balance is not recovered, the factor has 'recourse' to their client for the money. If the agreement is 'without recourse' the factor bears the risk of non-payment.

Debt factoring has to be paid for, usually as a percentage of the amounts advanced and as a percentage of turnover. Agreements without recourse to the client cost more. Mr Trusty would have to compare the cost to those of employing an individual to do his invoicing and obtaining insurance against unpaid accounts receivable balances. In addition there may be some stigma attached to debt factoring as clients sometimes assume that a business using a factor must be in financial difficulty.

(b) Roles of a credit controller

May include some/all of the following:

- Updating the sales ledger
- Dealing with customers' queries
- Assessing creditworthiness of new customers
- Establishing/updating payment terms for customers
- Regular review of the sales ledger
- Pursuing overdue accounts receivable balances
- Providing references for customers

NOTE: only FOUR factors were required.

3 Rich Co

Advantages of a centralised treasury department

- foreign currency management becomes easier, since the foreign currency expenditure in one company can be matched with receipts in the same currency in another group company.
- higher interest rates may be attainable on investments because the department has larger amounts of cash available for investment.
- the treasury department may be a profit centre in its own right, resulting in an increased likelihood of a profit being made.
- lower interest rates may be sought for borrowing, since borrowing can be arranged for the group as a whole.
- the level of cash held for precautionary purposes can be minimised since only one amount will be required for the whole group.
- experts can be employed with specialised knowledge, more qualified to manage risk and make better investment decisions.

NOTE: only FOUR advantages were required.

4 Curtain Co

Cost of offering credit

Old payments system
Interest under old system=$600,000x14/365x8%=$1,841 per annum
Cost of cheques=2,000x$1.80=$3,600
Total cost=$1,841+$3,600=$5,441

New payments system
Interest under new system=$600,000x30/365x8%=$3,945

Overall saving under new system=$5,441-$3,945=$1,496.
Since the system results in a saving rather than a cost it should be introduced.

5 Clear Co

NPV of the project

	Time					
	0	1	2	3	4	5
	$'000	$'000	$'000	$'000	$'000	$'000
Rents received	100	100	100			
New machine cost	(4,000)					
New machine residual value						450
Increased rev ($8mx20%)		1,600	1,600	1,600	1,600	1,600
Increase in running costs (w2)		(151.2)	(329.6)	(540.1)	(788.6)	(1,081.7)
Net cash flows	(3,900)	1,548.8	1,370.4	1,059.9	811.4	968.3
Discount factors	1	0.909	0.826	0.751	0.683	0.621
Present value	(3,900)	1,407.9	1,132	796	554.2	601.3

The net present value of the investment is $591,000 to the nearest $'000, therefore the machine should be purchased.

Working 1
Options for new machine
(i) Sell now for $250,000
(ii) Rent for three years, income $100,000 per annum, receivable in advance.
PV=($100,000x1)+($100,000x1.736)=$273,600

Therefore best use is to rent it out.

Working 2

	Time				
	1	2	3	4	5
	$'000	$'000	$'000	$'000	$'000
Current machine running costs	840	840	840	840	840
New running costs (increase 18% year on year).	991.2	1169.6	1380.1	1628.6	1921.7
Increase in costs	151.2	329.6	540.1	788.6	1081.7

6 Educate Co

(a) Reasons for a stock exchange listing

Access to a wider pool of finance
The level of finance available to a private unlisted company is limited. Therefore, if a company needs more finance than is currently available to it, it may seek a stock exchange listing. A stock exchange listing may also improve the company's credit rating, meaning that more investors are willing to invest in it.

Enhancement of the company's image
A company's image is generally improved when it becomes listed, as it is perceived as being more financially stable. This may result in increased custom and increased buying power.

Increased marketability of shares
It is not very easy for a shareholder in a private company to sell their shares. Once a company is listed on the stock exchange, its shares become far more marketable, thus making them far more attractive.

Facilitation of growth by acquisition
Should a listed company wish to make an offer to takeover another company, they are in a much better position to do so than in an equivalent unlisted company. This is because the terms of the offer will probably include an exchange of the shares in the acquiring company for those of the target company.

Transfer of capital by the founder owners
A stock exchange listing gives the founder members more opportunity to sell their shareholding, or part of it, leaving them free to invest in other projects.

NOTE: only FOUR reasons were required.

(b) The term 'gearing' refers to the extent to which a company is funded by debt as compared to equity. If a company is said to be highly geared, then it means that there is more prior charge capital (usually long term loans and preference shares) than equity.

It is important when a company is trying to raise funds because if a company's gearing is already high, lenders will be reticent to providing further funds in the form of loans. This is because debt needs to be service i.e. interest needs to be paid. Therefore, the business is particularly susceptible to problems if there is a fall in sales, since there is less profit from which to pay interest.

Section A
1, 2 or 3 marks per question totalling 20 marks

Section B

			Marks
1	**(a)**	**Working capital requirements**	
		Calculation of costs (w1)	
		Direct materials	1
		Direct labour	1
		Variable o/heads	1
		Fixed o/heads and selling and distribution	1
		Calculation of current assets	
		Raw materials	1
		Finished goods	3
		WIP	3
		Receivables	1
		Calculation of payables	1
		Working capital requirement	1
			14
	(b)	**Factors**	
		Each factor well described	2
			6
			20
2	**(a)**	**Factoring**	
		Definition 1	
		Includes administration	1
		With recourse agreements	2
		Without recourse agreements	2
		Other points	1
		Max marks	6
	(b)	**Roles of credit controller**	
		Each role	1
		Max marks	4
		Total marks	10
3		**Centralised treasury department**	
		Max of 3 marks per advantage to a maximum of	10
4		**Curtain Co**	
		Current interest cost	3
		Cost of cheques	2
		Total cost	1
		New interest cost	2
		Overall saving	1
		Conclusion	1
			10

			Marks
5		**NPV**	
		Old machine calculation	3
		New machine cost	1
		Residual value	1
		Increased sales	2
		Increased running costs	4
		Net cash flow	1
		Present values	1
		Net present value	1
		Conclusion	1
			15
6	**(a)**	**Stock exchange listing**	
		Max of 3 marks per reason to a max of	10
	(b)	**Highly geared**	
		Each valid point 1 mark	5
			15