

## **GCSE Revision- Unit 2**

### **Finance**

#### **1. What are the advantages and disadvantages of a large business using the following sources of finance: (5 marks)**

**Retained profits:** these are profits that the owners put back into the business. There is no interest to be repaid and no loss of control. However, even though firms are expanding they may not be very profitable and LTD companies are often under pressure from shareholders to pay large dividends which reduces the amount of profit they can retain.

**A new share issue:** The money raised from selling shares does not have to be repaid but more shares means less control for the existing owners.

**Obtaining a loan or mortgage:** Large firms are more likely to get a loan or mortgage as there is less risk of them failing and the interest rate is lower than an overdraft. There is also no loss of control for the existing owners, however, interest costs may still be high and if a mortgage is taken out then the property is used as security and will be given up by the business if debt cannot be repaid.

**Selling unwanted assets:** There is no interest to be paid and no loss of control. It can only happen if the asset is no longer needed and there is a limit to how many assets you can sell before you can't carry on trading.

**Debentures:** A LTD company can issue a debenture to the public which is a long-term loan and the business pays it back with interest, for up to 25 years. People who are issued with debentures don't own any of the business so there is no loss of control.

#### **2. Which two sources of finance are only available to limited firms? (2 marks)**

Selling shares and issuing debentures.

#### **3. What six important pieces of information does the profit and loss account (also called income statement) contain?**

Sales and revenue  
Cost of sales  
Gross profit  
Expenses (overheads)  
Net profit

**Example:**

**EXAMPLE:****TRADING, PROFIT & LOSS ACCOUNT (INCOME STATEMENT) FOR THE YEAR ENDED 31 AUGUST 20\*7**

	£	£
Sales		87 912
Opening stock	4 203	
+ Purchases	38 315	
+ Carriage inwards	234	
- Closing stock	(4 371)	
COS: Cost of Sales		<u>(38 481)</u>
<b>GROSS PROFIT</b>		<b><u>49 431</u></b>
<b>Plus:</b>		
Discount received		649
Rent received		<u>1000</u>
		<b><u>51 080</u></b>
<b>Less Expenditure:</b>		
Wages	28 566	
Carriage outwards	139	
Rent	4 400	
Rates and Insurance	3 561	
Advertising	1 369	
Bad Debts	879	
Depreciation: Fixtures	1 200	
Van	2 500	
		<u>(42 614)</u>
<b>NET PROFIT</b>		<b><u>8 466</u></b>

**TRADING ACCOUNT:**

Shows what the sales of the business have been and the direct selling costs of making those sales – Cost of sales.

**PROFIT & LOSS ACCOUNT:**

Once a business has calculated its Gross Profit, it can then calculate the Profit/Loss made for accounting period.

**4. In a trading, profit and loss account (income statement) how do you calculate the cost of sales figure?**

Cost of sales = opening stock + purchases – closing stock

Example:

Turnover (sales).....870

Cost of sales:

Opening stock.....89

Purchases..... 420

509

Minus closing stock..... (75)

Cost of sales =.....(434)

Gross profit=.....436

**5. How is gross profit calculated in a trading, profit and loss account (income statement)?**

Gross profit= sales (turnover) – cost of sales

**6. What type of business needs to complete an appropriation account? What does this account show?**

A Limited company needs to complete this and it shows where the profit has gone- to the government as tax, to shareholders as dividends, or kept in the business as retained profit.

**7. Why would the following stakeholders be interested in a firms profit and loss account?**

**Shareholders:** existing shareholders are usually entitled to a share of the profits- dividend and potential shareholders will look at how much profit the business makes to help them decide if the business is worth investing in.

**Employees:** will want to know if the business is making a profit or a loss as a profitable business may give them a pay-rise but a loss-making business may make some employees redundant.

**Government:** the government receives corporation tax from the business so the income statement is used to calculate how much.

**8. Gross profit margin % = gross profit/sales revenue x 100**

**In 2015 a tiling firm made a gross profit of £6000 and had sales of £24000. What was the firm's gross profit margin?**

$\text{£}6000 / \text{£}24000 \times 100 = 25\%$

**9. What does the net profit margin take into account?**

This takes into account the percentage of sales revenue that is net profit- so is the fraction of every pound that the company gets to keep after ALL its costs have been paid.

**10. What does a balance sheet (statement of financial position) show?**

It shows the value of what a company is worth. Balance Sheets are used by businesses to help them to understand their financial position at a given moment in time. They show the assets and liabilities of a business and show how the business is using their money.

**11. Define fixed assets and give an example.**

A fixed asset is anything that you own as a business that can be useful to your business for longer than one year, like buildings, machinery or equipment.

**12. Define current assets and give an example.**

Current assets last LESS than 12 Months. Once you use them then they have gone and need to be replaced, for example, stock, cash, debtors (receivables).

**13. What are current liabilities?**

Current Liabilities are things that a business will need to pay out for within 12 months, for example, to creditors (payables), overdraft.

**14. What do you get if you deduct current liabilities from current assets?**

Current assets – current liabilities = Net Current Assets

**15. What are the two types of shareholder FUNDS shown on the balance sheet?**

Share capital- the money put into the business when shares were originally issued.

Retained profit and reserves- profit that the firm has decided to retain.

**16. What are long term liabilities? Give an example.**

These are debts that will take more than one year to repay- bank loans and debentures.

**17. What is the term that describes all the money that has been put into the business?**

Capital employed is the term that describes all the money the business has got from shareholders and borrowing from other people.

**18. Explain why the balance sheet is useful to stakeholders.**

It is useful because they can use the balance sheet to assess the financial health of a business. A business whose net assets are growing is healthy because it's increasing the value of its fixed assets and cash reserves.

**19. Explain how the current ratio and acid test ratio are different.**

The current ratio compares a firm's current liabilities with its current assets so it shows whether a firm has enough money to pay the year's debts. This ratio assumes the firm will be able to turn its stock into cash during the year but the acid test ratio assumes the firm will NOT be able to sell its stock.

**20. What is the ideal figure for the acid test ratio and why?**

The ideal figure is 1. If it is much above 1 then the firm has got too much cash so it would be more profitable to invest this money and if it's below 1 they could struggle to pay their debts.