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# Management Accounting

2<sup>nd</sup> Year Examination

**May 2010**

**Paper, Solutions & Examiner's Report**



### NOTES TO USERS ABOUT THESE SOLUTIONS

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**Accounting Technicians Ireland**  
**2<sup>nd</sup> Year Examination: Summer 2010**  
**Paper : MANAGEMENT ACCOUNTING**

Thursday 20<sup>th</sup> May 2010 – 2.30 p.m. to 5.30 p.m.

**INSTRUCTIONS TO CANDIDATES**

In this examination paper the €/£ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and by candidates in the Republic of Ireland to indicate the Euro.

Answer FIVE questions.

Answer all three questions in Section A. Answer any two of the three questions in Section B

If more than the required number of questions is answered, then only the requisite number, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All figures should be labelled, as appropriate, e.g. €/£'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

**SECTION A**  
**ANSWER ALL THREE QUESTIONS**

**QUESTION 1** (Compulsory)

Sleeplite Ltd uses a standard costing system and the following information relates to production and sales for the product line, Zuzz for the month of April:-

	<b>Budget/Standard</b>	<b>Actual</b>
Sales	20,000 units	19,000 units
Sales price	£/€28.00	£/€29.00
Materials used	2 kg per unit	41,500 kg
Material price per kg	£/€5.00	£/€5.20
Labour hours	1 hour per unit	19,200 hours
Labour rate per hour	£/€10.00	£/€9.00

**Requirement:-**

**(a)** Prepare a statement showing the budgeted and actual gross profit for the month of April.

**4 Marks**

**(b)** Calculate each of the following variances:

- (i)** Sales price variance
- (ii)** Sales volume variance
- (iii)** Materials price variance
- (iv)** Materials usage variance
- (v)** Labour rate variance
- (vi)** Labour efficiency variance

**12 Marks**

**(c)** Provide a possible explanation for the material and labour variances reported.

**4 Marks**

**Total 20 Marks**

**QUESTION 2** (*Compulsory*)

Mr Jones has set up in business making a renewable energy product. He has provided you with the following budgeted sales and production information per unit:-

	£/€
Sales price	1,200
Direct materials	400
Direct labour	250
Variable production overhead	120
Fixed <b>production</b> overhead	200
Fixed administration & general overhead	150

Mr Jones has projected his activity levels as follows:-

	Sales (units)	Production (units)
July	300	500
August	600	750
September	600	1,000

Fixed overhead costs have been projected on the basis of annual activity of 10,000 units and will be incurred constantly over the year. There is no opening stock.

**Requirement:-**

- (a) Prepare a budgeted statement of profit for each month using:
- absorption costing
  - marginal costing

**16 Marks**

- (b) Briefly explain the differences between the reported profits for each month.

**4 Marks**  
**Total 20 Marks**

**QUESTION 3** (*Compulsory*)

The following information is available for Skiwink Ltd. in relation to raw material stocks of aluminium:-

**Raw materials**

2 May	Purchases received	10,000 kg @ £/€20.00/kg
14 May	Purchases received	5,000 kg @ £/€21.00/kg
15 May	Issued to production	8,000 kg
19 May	Purchases received	10,000 kg @ £/€19.50/kg
22 May	Issued to production	10,000 kg

The standard production cost sheet shows aluminium priced at £/€22.00 per kg

**Requirement:**

- (a) Prepare a statement showing the amount charged to production and the value of the stock of aluminium held after each stock transaction using each of the following methods of stock accounting:

First in, first out  
 Last in, first out  
 Weighted Average  
 Standard Cost

**12 Marks**

- (b) In the context of materials costing, prepare a table setting out the advantages, disadvantages and most suitable uses of each method of valuation.

**8 Marks**  
**Total 20 Marks**

**SECTION B**  
**ANSWER TWO OUT OF THE FOLLOWING THREE QUESTIONS**

**QUESTION 4**

Prepare a memorandum for the owner of a growing firm to explain the following:

- the role of financial accounting;
- the role of management accounting;
- the users of accounting information;
- the key differences between financial and management accounting.

**Total 20 Marks**

**QUESTION 5**

Gilsen Ltd manufactures and sells interior furnishings. They have recently completed financial projections for the year ahead and they now require a cash budget to present to their bank manager.

They have provided you with the following information to assist with calculations:

- Sales are projected at 66,000 units for the year with expected revenue of €/£660,000 for the year. Sales and corresponding production is spread evenly throughout the year, with no movement in stocks anticipated. There are opening debtors of one month's credit sales.
- 50% of sales are paid in cash and avail of a 2% discount offer. The remaining customers take 1 months credit, although 5% of these will result in bad debts.
- Products are produced in batches of 500 and each batch requires 400kg of raw materials and 150 hours of labour.
- Materials costs are estimated to be €/£2 per kg and the main supplier allows 2 months credit. Creditors at the start of the year are €/£20,000 and these are paid in the first quarter.
- Direct labour is projected at a cost of €/£12.00 per hour inclusive of all employer costs. 60% of labour costs are paid in the month incurred and the remainder, representing employer costs, is paid in the following month. At the start of the year €/£8,000 is owed in respect of employer costs.
- Production overheads are estimated at €/£4,000 per month for the first six months, increasing to €/£5,000 in the second half of the year.
- Sales and marketing costs are estimated at 5% of turnover and are paid in the month of sale.
- The company intends to purchase a new machine costing £/€130,000, which will be paid for in Quarter 3
- At the start of the year the company bank balance is overdrawn by £/€104,000

**Requirement**

**(a)** Prepare a statement setting out quarterly cash budgets for the year.

**14 Marks**

**(b)** Discuss the terms flexible budgeting and zero based budgeting.

**6 Marks**

**Total 20 Marks**

**QUESTION 6**

LANG Ltd manufactures and sells two main products – GLAN and GLIS. The company has recently implemented an activity based costing system and has provided you with the following information:

	<b>GLAN</b>	<b>GLIS</b>	<b>TOTAL</b>
<b>Production &amp; Sales (units)</b>	10,000	20,000	30,000
<b>Sales Price (per unit)</b>	€/£50	€/£20	
<b>Production Cost (per unit)</b>			
Direct materials	€/£15	€/£8	
Direct Labour	€/£10	€/£5	
Machine hours	15,000	5,000	20,000
No. of production runs	20	20	40
No. of sales orders	100	2000	2,100

**Production overheads by Cost pool**

	€/ £
Set Ups	50,000
Machine overheads	130,000
Inspection	30,000
Distribution	105,000

**Requirement:**

- (a) Detail the main steps involved in setting up an Activity Based Costing (ABC) system.

**2 Marks**

- (b) Identify the cost drivers for each of LANG Ltd's cost pools.

**4 Marks**

- (c) Prepare a statement showing the:
- total overhead cost for the production of products GLAN and GLIS,
  - overhead cost per unit, and
  - total cost per unit.

**12 Marks**

- (d) Calculate the profit or loss for each product.

**2 Marks****Total 20 Marks**

## 2<sup>nd</sup> Year Examination: Summer 2010

### Management Accounting

### Solutions

**Students please note:** These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

#### QUESTION 1 *Suggested solution*

##### (a) Statement of Gross Profit

	Budget £/€		Actual £/€	
Sales		560,000		551,000
Materials	200,000		215,800	
Labour	200,000		172,800	
Gross Profit		160,000		162,400

##### (b)

Sales Price Variance

*(Actual Sales Quantity x Actual Price) – (Actual Sales Quantity x Standard Price)*

$$\begin{array}{r r r r r} (19,000 & \times & 29.00) & - & (19,000 \times 28.00) \\ 551,000 & & & - & 532,000 & = & \mathbf{\text{£/€}19,000 \text{ fav}} \end{array}$$

Sales Volume Variance – using profit margin

*(Actual Sales Quantity x Standard profit per unit) – (Standard Sales Quantity x Standard profit per unit)*

$$\begin{array}{r r r r r} (19,000 & \times & 8.00) & - & (20,000 \times 8) \\ 152,000 & & & - & 160,000 & = & \mathbf{\text{£/€}8,000 \text{ adv}} \end{array}$$

Material price variance

*(Actual Quantity x Actual price) – (Actual Quantity x Standard Price)*

$$\begin{array}{r r r r r} (41,500 \times 5.20) & - & (41,500 \times 5.00) \\ 215,800 & - & 207,500 & = & \mathbf{\text{£/€}8,300 \text{ adv}} \end{array}$$

(ii) Materials usage variance

*(Actual Quantity x Standard price) – (Standard Quantity required for actual output x Standard price)*

$$\begin{array}{r r r r r} (41,500 \times 5.00) & - & (19,000 \times 2 \times 5.00) \\ 207,500 & - & 190,000 & = & \mathbf{\text{£/€}17,500 \text{ adv}} \end{array}$$

(iii) Labour rate variance

*(Actual Hours x Actual Rate) – (Actual Hours x Standard rate)*

$$\begin{array}{r r r r r} (19,200 \times 9.00) & - & (19,200 \times 10) \\ 172,800 & - & 192,000 & = & \mathbf{\text{£/€}19,200 \text{ fav}} \end{array}$$

**QUESTION 1** (Cont'd)

(iv) Labour efficiency variance

*(Actual Hours x Standard rate) – (Standard Hours required for Actual Output x Standard rate)*

(19,200 x 10)	-	(19,000 x 1 x 10)		
192,000	-	190,000	=	<b>£/€2000 adv</b>

**(c) Explanation of materials and labour variances****Material Variances**

Sleeplite have reported a adverse materials price variance of £8,300. This may have arisen due to general changes in market conditions (eg: inflation – causing the cost of materials to rise.). Alternatively, they may have decided to source more expensive, better quality materials for production, perhaps from a different supplier.

Sleeplite also reports an adverse materials usage variance of £17,500. This could result from careless handling of materials resulting in wastage or loss – possibly caused by Lower skilled workers. Changes to production methods, pilfering or poor standard setting may also have contributed to this adverse variance.

**Labour Variances**

Sleeplite have reported a favourable variance of £19,200 on labour rates. This may relate to the grade of staff being used which are less expensive (ie: use of less skilled and hence lower graded staff). Alternatively it could be as a result of a reduction in negotiated pay rates, or an incorrect standard being applied.

The adverse labour efficiency variance of £2,000 could be attributable to less skilled or experienced staff who have proved to be cheaper to employ, hence the favourable labour rate variance, but have taken longer to do the job. There could also be underlying industrial relations issues or changes to production processes or equipment used.

**Question 2 Suggested solution****(a) (i) Budgeted Absorption Costing Statement**

	July		August		September	
	€/ £	€/ £	€/ £	€/ £	€/ £	€/ £
Sales		360,000		720,000		720,000
Opening Stock	-		194,000		339,500	
Direct Materials	200,000		300,000		400,000	
Direct Labour	125,000		187,500		250,000	
Variable Production Overhead	60,000		90,000		120,000	
Fixed Production Overhead	100,000		150,000		200,000	
Closing Stock	(194,000)	291,000	(339,500)	582,000	(727,500)	582,000
<b>Gross Profit</b>		<b>69,000</b>		<b>138,000</b>		<b>138,000</b>
Administration & general overhead		125,000		125,000		125,000
Over absorbed fixed production overhead		66,667		16,667		(33,333)
<b>Net Budgeted Profit/(Loss)</b>		<b>(122,667)</b>		<b>(3667)</b>		<b>46,333</b>

**Workings**Stockholding (units)

	Sales (units)	Production (units)	Stockholding
July	300	500	200
August	600	750	350
September	600	1,000	750

Closing Stock Calculations

July	200 units @ (400 + 250 + 120 + 200 = 970)	= 194,000
August	350 units @ 970	= 339,500
September	750 units @ 970	= 727,500

Budgeted Fixed Overhead

Fixed production overhead	200 x 10,000 = 2,000,000 pa	= 166,667pm
Administration & general overhead	150 x 10,000 = 1,500,000pa	= 125,000pm

Fixed Production Overhead

July	500 units x €/ £200	= €/ £100,000
August	750 units x €/ £200	= €/ £150,000
September	1,000 units x €/ £200	= €/ £200,000

Under/Over absorbed fixed production overhead

July	166,667 – 100,000	66,667 under- absorbed
August	166,667 – 150,000	16,667 under-absorbed
September	200,000 – 166,667	33,333 over-absorbed

**Question 2 (Cont'd) Suggested solution****(ii) Budgeted Marginal Costing Statement**

	July € / £ € / £		August € / £ € / £		September € / £ € / £	
Sales	360,000		720,000		720,000	
Opening Stock	-		154,000		269,500	
Direct Materials	200,000		300,000		400,000	
Direct Labour	125,000		187,500		250,000	
Variable Production Overhead	60,000		90,000		120,000	
Closing Stock	(154,000)	231,000	(269,500)	462,000	(577,500)	462,000
<b>Contribution</b>	<b>129,000</b>		<b>258,000</b>		<b>258,000</b>	
Fixed Production Overhead	166,667		166,667		166,667	
Administration & general overhead	125,000		125,000		125,000	
<b>Net Budgeted Loss</b>	<b>(162,667)</b>		<b>(33,667)</b>		<b>(33,667)</b>	

**Workings**Closing Stock Calculations

September	200 units @ (400 + 250 + 120 = 770)	= 154,000
October	350 units @ 770	= 269,500
November	750 units @ 770	= 577,500

**(b) Reconciliation and Explanation of Differences in Profits**

	<b>Absorption Costing Profit/(Loss)</b> £	<b>Marginal Costing Loss</b> £	<b>Difference</b> £	<b>Explanation</b>
July	(122,667)	(162,667)	-40,000	Fixed Overhead included with production costs and stockholding under absorption costing. Loss reduced by element of fixed production overhead in stock - 200 units @ £200
August	(3,667)	(33,667)	-30,000	Increase in stock of 150 units with corresponding element of fixed overhead included in stock valuation under absorption costing method. - 150 units @ £200
September	46,333	(33,667)	-80,000	Carrying stock under absorption costing method includes a further cost of 400 units @ £200 as a result of stockholding increase

**QUESTION 3 Suggested Solution**

**(a)** First in, first out

Date	Received			Issued (charged to production)			Balance		
	Quantity (kg)	Value /kg (£)	Total Value (£)	Quantity (kg)	Value /kg (£)	Total Value (£)	Quantity (kg)	Value /kg (£)	Total Value (£)
2/5	10,000	20.00	200,000				10,000	20.00	<b>200,000</b>
14/5	5,000	21.00	105,000				15,000		<b>305,000</b>
15/5				8,000	20.00	<b>160,000</b>	7,000		<b>145,000</b>
19/5	10,000	19.50	195,000				17,000		<b>340,000</b>
22/5				2,000 5,000 3,000	20.00 21.00 19.50	40,000 105,000 58,500 <b>203,500</b>	7,000	19.50	<b>136,500</b>

**(b)** Last in, first out

Date	Received			Issued (charged to production)			Balance		
	Quantity (kg)	Value /kg (£)	Total Value (£)	Quantity (kg)	Value /kg (£)	Total Value (£)	Quantity (kg)	Value /kg (£)	Total Value (£)
2/5	10,000	20.00	200,000				10,000	20.00	<b>200,000</b>
14/5	5,000	21.00	105,000				15,000		<b>305,000</b>
15/5				5,000 3,000	21.00 20.00	105,000 60,000 <b>165,000</b>	7,000	20.00	<b>140,000</b>
19/5	10,000	19.50	195,000				17,000		<b>335,000</b>
22/5				10,000	19.50	<b>195,000</b>	7,000	20.00	<b>140,000</b>

**QUESTION 3 (Cont'd) Suggested Solution**

(c) Weighted Average

	Received			Issued (charged to production)			Balance		
Date	Quantity (kg)	Value /kg (£)	Total Value (£)	Quantit y (kg)	Value /kg (£)	Total Value (£)	Quantit y (kg)	Value /kg (£)	Total Value (£)
2/5	10,000	20.00	200,000				10,000	20.00	<b>200,000</b>
14/5	5,000	21.00	105,000				15,000	20.33	<b>305,000</b>
15/5				8,000	20.33	<b>162,667</b>	7,000	20.33	<b>142,333</b>
19/5	10,000	19.50	195,000				17,000	19.84	<b>337,333</b>
22/5				10,000	19,84	<b>198,400</b>	7,000	19.84	<b>138,933</b>

(d) Standard Cost

	Received			Issued (charged to production)			Balance		
Date	Quantity (kg)	Value/ kg (£)	Total Value (£)	Quantity (kg)	Value/ kg (£)	Total Value (£)	Quantity (kg)	Value/k g (£)	Total Value (£)
2/5	10,000	22.00	220,000				10,000	22.00	<b>220,000</b>
14/5	5,000	22.00	105,000				15,000	22.00	<b>330,000</b>
15/5				8,000	22.00	<b>176,000</b>	7,000	22.00	<b>154,000</b>
19/5	10,000	22.00	220,000				17,000	22.00	<b>374,000</b>
22/5				10,000	22.00	<b>220,000</b>	7,000	22.00	<b>154,000</b>

\* Favourable Materials price variances would arise as a result of using the standard cost.

**QUESTION 3 (Cont'd) Suggested Solution**

(b)

	Advantages	Disadvantages
First in First Out (FIFO)	<ol style="list-style-type: none"> <li>1. Actual costs system – unrealised profit/loss eliminated</li> <li>2. Encourages good storekeeping practices (issuing oldest stocks first)</li> <li>3. Stock valuation comprises recent valuation</li> </ol>	<ol style="list-style-type: none"> <li>1. Not relevant cost in times of inflation – product costs understated &amp; profits overstated, for decision making purposes</li> <li>2. Can be administratively clumsy</li> <li>3. Cost comparison of batches difficult</li> <li>4. Limited decision making uses</li> </ol>
Last In First Out (LIFO)	<ol style="list-style-type: none"> <li>1. Actual cost system</li> <li>2. Up to date relevant market costs charged to production</li> <li>3. Realistic costing approach useful in some decision-making scenarios</li> </ol>	<ol style="list-style-type: none"> <li>1. Stocks are valued at oldest prices – may distort profits</li> <li>2. Not acceptable to for financial reporting purposes</li> <li>3. Can be administratively clumsy as purchase batches only partially charged to production</li> </ol>
Weighted Average	<ol style="list-style-type: none"> <li>1. Relatively straightforward administratively</li> <li>2. Moderates effects of price changes on stock valuation and production charges</li> <li>3. Useful for cost comparison exercises</li> </ol>	<ol style="list-style-type: none"> <li>1. Although realistic, not based on actual meaningful costs</li> </ol>
Standard Cost	<ol style="list-style-type: none"> <li>1. Creates a constant benchmark against which actual prices can be easily compared</li> </ol>	<ol style="list-style-type: none"> <li>1. Can be complex, requiring detailed projections and forecasting</li> <li>2. Only useful if standard cost is relevant and up to date</li> </ol>

**QUESTION 4 Suggested Solution****To: Managing Director****From: Student Accountant****Date: X/X/XX****RE: Explanation of role of accounting**

The role of financial accounting is to provide summary financial information about your organisation to external users. Financial accounting is formally defined as

'the classification and recording of monetary transactions of an entity in accordance with established concepts, principles, accounting standards and legal requirements and presentation of a view of those transactions during and at the end of an accounting period'

Financial accounting is the means by which the financial results and performance of a business, organisation or company are reported. Financial accounts are normally required both by law and for taxation purposes and they must be prepared in accordance with accounting standards. They are usually presented in the form of an Income & Expenditure Account / Profit & Loss Account and Balance Sheet for the accounting period. Financial accounting is concerned primarily with the actual historic performance and is reported in monetary terms to present an accurate, true and fair view of the organisation's financial performance for the reporting period.

The role of management accounting is to provide information internally within the organisation to assist with effective and efficient management. Management accounting is formally defined as:

'the preparation and presentation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operations of the undertaking'.

Management accounting is the means by which the internal financial results and performance of a business, organisation or company are measured in order to effectively manage. Typical management accounting reports include Budgets, Variance Analysis Reports, Cost – Volume Profit/Breakeven Analysis, Job Costing Reports; Overhead Apportionment reports, Marginal and Absorption Cost Statements. Management accounting involves the use of internal management information systems to analyse past, present and future information to inform management in decision making and to assist with planning, control and decision making. Management accounting information can be used to contribute to the

**QUESTION 4 (Cont'd) Suggested Solution**

effectiveness of an organisation through planning, control, communication and motivation.

The users of accounting information fall into two distinct groups

(i) External users – this includes Equity investors (shareholders); Loan creditors; Analysts and advisors; Suppliers; Government; Public

(ii) Internal users – this mainly relates to management, however may also include some special interest groups.

The following table sets out the key differences between financial and management accounting

<b>Financial Accounting</b>	<b>Management Accounting</b>
Primary users are external	Internal reporting for management
Must comply with legal requirements – often subject to audit	Not required by law – prepared on a discretionary basis to assist management. No audit required
Based on historical records. Often report on the past year	Analyses past, present and future information
Provides overview of performance	Provides detailed analysis
Format and content dictated by accounting standards and other guidelines	Format may comprise financial and non-financial information and are specific to management requirements.
Prepared in accordance with accounting standards	No formal guidelines for preparation – rather developed techniques
Normally annual time-bound requirement	Can be ad hoc in nature – daily, weekly, monthly

**QUESTION 5 Suggested Solution**

## (a) Cash Budget

	<i>Quarter 1</i> £	<i>Quarter 2</i> £	<i>Quarter 3</i> £	<i>Quarter 4</i> £	<b>TOTAL</b> £
<b>Cash Inflows</b>					
Cash Sales	80,850	80,850	80,850	80,850	323,400
Credit Sales	78,375	78,375	78,375	78,375	313,500
	<b>159,225</b>	<b>159,225</b>	<b>159,225</b>	<b>159,225</b>	<b>636,900</b>
<b>Cash Outflows</b>					
Creditors	28,800	26,400	26,400	26,400	108,000
Labour – Net	35,640	35,640	35,640	35,640	142,560
Labour – Employer costs	23,840	23,760	23,760	23,760	95,120
Production Overheads	12,000	12,000	15,000	15,000	54,000
Sales and Marketing Overheads	8,250	8,250	8,250	8,250	33,000
Purchase of equipment	0	0	130,000	0	130,000
	<b>108,530</b>	<b>106,050</b>	<b>239,050</b>	<b>109,050</b>	<b>562,680</b>
Net inflow/(outflow)	50,695	53,175	(79,825)	50,175	74,220
Opening balance	(104,000)	(53,305)	(130)	(79,955)	(104,000)
Closing balance	<b>(53,305)</b>	<b>(130)</b>	<b>(79,955)</b>	<b>(29,780)</b>	<b>(29,780)</b>

## 1. Sales workings

	<b>Cash</b>			<b>3 months</b>		
	50%	2%	Net	50%	5%	Net
Quarter 1	82,500	1,650	80,850	82,500	4,125	78,375
Quarter 2	82,500	1,650	80,850	82,500	4,125	78,375
Quarter 3	82,500	1,650	80,850	82,500	4,125	78,375
Quarter 4	82,500	1,650	80,850	82,500	4,125	78,375
	330,000	6,600	323,400	330,000	16,500	313,500

Opening debtors represent one months sales - included above - at similar sales level

## 2. Purchases calculations

66,000 units/500 = 132 batches x 400 kg = 52,800 kg @ £2 = € / £105,600 per annum  
 = € / £26,400  
 Per quarter  
 = € / £ 8,800  
 Per month

	<i>Quarter 1</i>	<i>Quarter 2</i>	<i>Quarter 3</i>	<i>Quarter 4</i>
Opening creditors	20,000			
Month 1	8,800			
3 months purchases		26,400	26,400	26,400
	28,800	26,400	26,400	26,400

**QUESTION 5 (Cont'd) Suggested Solution**

## 3. Labour calculations

66,000units/500 = 132 batches x 150 hours = 19,800 hours @ €/£12.00 =  
 €/£237,600 per annum

	Total	60%	40%
Per month	€/£ 19,800	€/£11,880	€/£7,920
Per quarter	€/£59,400	€/£35,640	€/£23,760

Quarter 1 employer cost payment £8,000 + £7,920 + £7920 = £23,840

## 4. Production overheads

Per quarter – 4000 x 3 = €/£12,000; 5,000 x 3 = €/£15,000

## 5. Sales and marketing overhead

Sales per month £55,000 x 5% = €/£2750 x 3 = €/£8,250

(b)

**Flexible budgeting**

Flexible budgeting can be defined as

*'a method of budgeting which recognises cost behaviour patterns and is designed to change as the volume of output changes'*

In order to be able to prepare flexible budgets it is necessary to distinguish between fixed and variable costs as each react differently to changes in the volume of output. Flexible budgeting allows an organisation to analyse performance and carry out comparisons in a more meaningful way by flexing the budget to the actual volume of output achieved. This approach is often used in manufacturing companies to deal with various scenarios.

**Zero Based Budgeting**

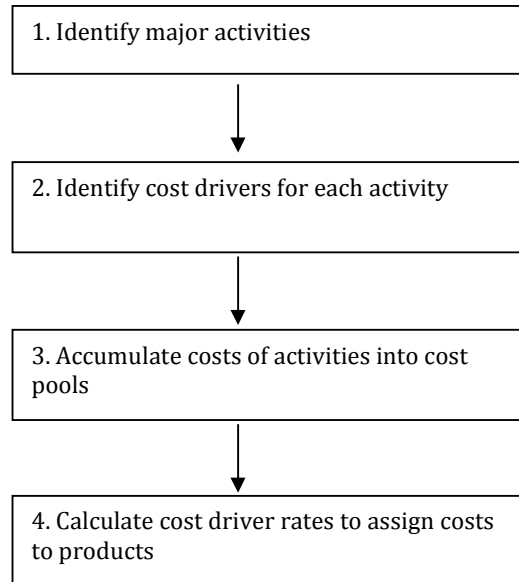
Zero based budgeting is defined as

*'a method of budgeting whereby all activities are re-evaluated each time a budget is formulated. Each functional budget starts with the assumption that the function does not exist and is at zero cost. Increments of cost are compared with increments of benefit, culminating in the planning maximum benefit for a given budgeted cost'*

Zero based budgeting is an alternative approach, developed in 1970's, whereby a cost benefit approach is used, starting with a Nil budgetary allocation, until each item of cost expenditure is justified. By adopting this through, questioning approach budgetary allocations can be matched with organisational objectives and ensures that expenditure benefits the organisation. This approach is used often used in government agencies and non-for-profit organisations.

**QUESTION 6 Suggested Solution**

(a) There are four main steps involved in setting up an Activity Based Costing (ABC) system



(b)

<b>Cost pool</b>	<b>Cost driver</b>
Set Ups	No. of production runs
Machine overheads	Machine hours
Inspection	Production units
Distribution	Sales Orders

(c)

	<b>GLAS €/£</b>	<b>GLIS €/£</b>	<b>TOTAL €/£</b>
Set Ups	25,000	25,000	50,000
Machine overheads	97,500	32,500	130,000
Inspection	10,000	20,000	30,000
Distribution	5,000	100,000	105,000
<b>Total Overhead Cost</b>	<b>137,500</b>	<b>177,500</b>	<b>315,000</b>
<b>Per Unit</b>	<b>€/£13.75</b>	<b>€/£8.88</b>	
Direct Materials	15.00	8.00	
Direct Labour	10.00	5.00	
<b>Total Cost per Unit</b>	<b>€/£38.75</b>	<b>£21.88</b>	

**QUESTION 6 (Cont'd) Suggested Solution**

(d)

	<b>GLAS</b> <b>€/£</b>	<b>GLIS</b> <b>€/£</b>
Sales Price	50.00	20.00
Cost per unit	38.75	21.88
Profit/(Loss) per unit	11.25	(1.88)

# 2<sup>nd</sup> Examination: Summer 2010

## Management Accounting

### Examiner's Report

#### Key Statistics

	Q1	Q2	Q3	Q4	Q5	Q6	Total
No attempting	866	864	863	600	458	665	872
Average Mark	14.15	13.12	12.31	11.66	10.49	11.03	61.18
Average %	70.75	65.60	61.55	58.30	52.45	55.00	
<b>Overall pass rate</b>	<b>85.21%</b>						

#### General Comment

The overall performance at this, the first session of the 2<sup>nd</sup> Year Management Accounting examination, was very good. The average mark recorded at this session was 61% and the Pass Rate was 85%.

The examination assessed all aspects of the syllabus and most candidates made a good attempt at the required 5 questions. In terms of performance for individual questions – the average mark exceeded 50% in all cases and ranged from 10 – 14. The straightforward nature of the paper allowed good scope for maximum marks in a number of questions and indeed there were some high marks awarded.

The format comprised of a compulsory section with three scenario based, largely computational type questions assessing the application of key concepts of the syllabus in practical situations; and a second section where the candidate was required to answer 2 out of 3 questions, which included a mainly narrative question together with other computational/theory questions.

Candidates who were well prepared presented answers in a logical and professional format, with relevant supporting workings evident and accordingly many scored highly.

#### Question 1

This question examined standard costing in the context of variance analysis. Most candidates scored well, however mistakes were most common in respect of materials usage, labour efficiency and sales variances. A small minority did not express the variance in monetary terms and others did not indicate whether the variance was 'favourable' or 'adverse'. Answers to part (c) varied, with those who restated the variance or its calculation not scoring to the same extent as those who critically analysed the possible causes of the variance.

**Question 2**

This question required the comparison of absorption and marginal costing approaches and again there were many excellent solutions provided. A minority of candidates only submitted one costing approach or confused the treatment of production overheads. Some marks were lost by candidates who did not accurately perform the stock calculations or did not address the issue of under/over absorption. The standard of answers to part (b) varied from excellent to poor. Generally however this question was well answered by most candidates.

**Question 3**

This question examined the pricing of stores issues in the context of the material element of a costing system. Candidates lost marks in this question either because of errors in calculations or not completing all the required elements of the question. Many omitted standard cost calculations completely and/or did not provide examples of suitable uses for each valuation method. It is also important to highlight the specific requirement of the question which asked for the 'amount charged to production' as well as stock valuation at the end of the period. Some solutions presented did not clearly identify the production cost and while it was evident that they were able to perform the calculations, it was not possible to award full marks in this situation.

**Question 4**

This was a straightforward narrative type question on the appropriate subject of financial and management accounting and the significant majority who attempted this question did provide a good answer. In some instances, the solution would have benefitted from further elaboration. Those who scored higher, provided solutions which were well presented and well structured as well as being comprehensive in terms of content.

**Question 5**

This question examined cash budgeting – an important element of the cost planning and control aspect of the syllabus. The question entailed using the information to prepare a number of calculations in order present quarterly cash projections. This question attracted the lowest overall average score of reflecting a number of errors in calculations. It was also the least popular question in the optional section. Most candidates demonstrated that they were familiar with the cash budget layout – with a small number presenting or including items relevant to the profit & loss/ income & expenditure statements (eg: bad debt or depreciation). The standard of answers to part (b) varied from excellent to one sentence, which in some instances was not correct. This is possibly an area for further work

**Question 6**

This question examined overhead apportionment in an Activity Based Costing scenario. The standard of answers varied somewhat but were in general very good. Errors, where they occurred related to the use of an incorrect cost driver and or adopting a more traditional approach. Again it was important for students to complete all the requirements of the questions as marks attach specifically to each element.