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NEW SYLLABUS



FOUNDATION EXAMINATION

SUMMER 2008

MANAGEMENT ACCOUNTING

PAPER, SOLUTIONS

and

EXAMINERS REPORT

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NEW SYLLABUS

The Institute of Accounting Technicians in Ireland

Foundation Examination : Summer 2008

PAPER 2 : MANAGEMENT ACCOUNTING

Wednesday 21st May 2008 - 9.30 a.m. to 12.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

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

Answer ANY FIVE of the six questions. If more than the required number of questions is answered, then only the first five, 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 next page.

QUESTION 1

McHILL Ltd. has recently introduced an activity based costing system to assist with the provision of management information. An initial costing exercise has produced the following information:

Cost Pool	Cost Driver	Annual Projection
Customer orders	No of customer orders	600 orders
Order size	No of CNC machine hours	27,000 hours
Product Testing.....	No of testing hours	4,800 hours
Sales & Marketing	No of sales calls	1,375 calls

Annual estimates of costs

	£/€
Salaries & wages	400,000
Premises costs.....	240,000
Administration costs.....	172,000
Depreciation	150,000

Cost Pool Apportionments	Customer Orders	Order Size	Product Testing	Sales & Marketing
Salaries & wages	20%	40%	30%	10%
Premises costs	10%	50%	25%	15%
Administration costs	30%	20%	20%	30%
Depreciation	20%	50%	25%	5%
Other Cost Allocations				
Indirect Materials	£/€8,000	£/€26,800	£/€12,000	£/€13,650
Health & Safety costs	£/€5,000	£/€5,000	£/€2,500	£/€2,500

McHILL Ltd. has received a new order which entails 50 hours of CNC machining and 5 hours of product testing. The order has resulted from 3 sales calls.

Requirement

- (a) Briefly outline the main problems associated with traditional costing techniques **4 Marks**
- (b) Prepare a statement calculating relevant activity based overhead absorption rates **10 Marks**
- (c) Provide a costing for the new order based on:
 - (i) a mark up of 15% on calculated cost
 - (ii) a margin of 20% on sales price

6 Marks
Total 20 Marks

QUESTION 2

PLANT AX Ltd. is a wholly owned subsidiary of a listed company, which uses a marginal costing system for management accounting purposes. The following projected financial data has been made available by PLANT AX Ltd.

	Quarter 1	Quarter 2
Sales (units)	60,000	70,000
Production (units)	65,000	65,000
Per Unit		
Sales (Price).....	£/€50.00	

Variable Costs

Direct Materials.....	2 kg @ £/€6/kg
Direct Labour	1.5 hrs @ £/€12/hr

- Opening stock of 10,000 units has been recorded at a valuation of £/€280,000.
- Production overhead is absorbed on the basis of 50% of direct labour, based on estimated annual production activity of 280,000 units.
- 60% of production overhead costs are variable while the remainder are fixed.
- General administration and sales overheads are projected at £/€1,200,000 per annum.

Requirement

- | | |
|--|------------------------------|
| (a) Calculate the projected annual fixed production overhead cost for PLANT AX Ltd. | 2 Marks |
| (b) Prepare a statement of stock valuation using absorption and marginal costing at the end of Quarter 1 and Quarter 2. | 4 Marks |
| (c) Prepare a projected divisional profit statement as required by the parent company, using marginal costing techniques. | 8 Marks |
| (d) The new production manager previously operated an absorption costing system and has asked you to rework the profit statement figures on this basis. Prepare a projected divisional profit statement for his attention. | 4 Marks |
| (e) Prepare a reconciliation of the reported marginal and absorption costing profit statement figures. | 2 Marks |
| | Total <u>20</u> Marks |

QUESTION 3

ELISE Ltd. produces a single product and has provided the following data for analysis:

APRIL 2008	ACTUAL	BUDGET
• Sales (units)	18,000 units	20,000 units
• Sales price	£/€105	£/€100
• Materials used	195,000 kg - £/€828,750	10kg @ £/€4.00/kg
• Direct labour	38,000 hours - £/€399,000	2 hours @ £/€12/hr
• Variable overhead costs	£/€154,750	

For budgeting purposes, a pre-determined variable overhead absorption rate of £/€4 per direct labour hour has been calculated.

Requirement

- (a) Prepare a statement of budgeted, actual and flexed profits for the month of April 2008. **4 Marks**
- (b) Calculate the following variances:
- (i) Material price variance
 - (ii) Materials usage variance
 - (iii) Labour rate variance
 - (iv) Labour efficiency variance
 - (v) Variable expenditure variance
 - (vi) Variable efficiency variance
- 12 Marks**
- (c) *Briefly* discuss the behavioural impact of the use of standard costs in an organisation. **4 Marks**
- Total 20 Marks**

QUESTION 4

You are employed in an SME (small/medium sized enterprise) which has grown considerably over the past 18 months. The owner/manager recognises that the finance function must be developed to support the growing business.

Requirement

To assist in this development, prepare a brief paper for him outlining:

- (a) the key differences between financial and management accounting. **6 Marks**
- (b) how management accounting can support business decision making. **6 Marks**
- (c) a definition of the following management accounting terms:
- (i) activity based costing
 - (ii) variance analysis
 - (iii) opportunity costs
- 8 Marks**
- Total 20 Marks**

QUESTION 5

GARR Ltd. has been notified of proposed industrial action at one of its factories and has asked you to assess the impact on the business focussing on production and cashflows.

A strike is planned to commence at the start of **week 3** and may last indefinitely – production will cease at this point. You have ascertained the following additional information.

	Week 1	Week 2	Week 3	Week 4
Budgeted Sales.	800 units	1,000 units	750 units	750 units
Budgeted Production	1,000 units	1,000 units	-	-
		£/€		
Sales Price (per unit)		55		
Production cost (per unit)				
Direct Materials.....		20		
Direct Wages		12		
Variable Overhead.....		12		

- At **Week 1**, opening stocks of 1,200 units are held.
- Trade creditors are £/€82,000. *Two* weeks credit is offered on direct materials and production overhead costs.
- Direct wage accruals related to employer costs are £/€4,000 and are payable in **Week 3**.
- Debtor balances are £73,000 – of which £/€52,000 will be received in **Week 1** and the balance in **Week 2**. Sales are normally all credit with 80% received after *one* week and the balance after *two* weeks.
- Sales demand is expected to continue at a rate of 750 units per week.
- General Overheads are payable at an amount of £/€17,400 per week.
- The cash at bank at the start of **Week 1** is £/€2,580.

Requirement

- | | |
|---|------------------------------|
| (a) Prepare a schedule showing the movement of stock for GARR Ltd for Weeks 1 to 4 . | 3 Marks |
| (b) Prepare a cash budget for Weeks 1 to 6 for GARR Ltd. | 14 Marks |
| (c) Critically evaluate the key issues arising from your projections. | 3 Marks |
| | Total <u>20</u> Marks |

QUESTION 6

KAMA operates a retail outlet, and has provided you with the following profit statements:

	Quarter 1	Quarter 2
	€/£	€/£
Sales	120,000	156,000
Cost of sales	<u>42,000</u>	<u>54,600</u>
Gross profit.....	78,000	101,400
Sales & marketing	(9,000)	(7,800)
Establishment	(15,000)	(15,000)
Administration.....	<u>(5,000)</u>	<u>(5,000)</u>
Net Profit	<u><u>49,000</u></u>	<u><u>73,600</u></u>

Sales and marketing costs are stepped-up to €/£150,000 of turnover and then over €/£150,000 of turnover.

Requirement

- (a) Calculate the breakeven point for the first Quarter's operations and the annual turnover required to achieve a breakeven position. **5 Marks**
- (b) Assuming a margin of safety of 25%, calculate the projected annual profit for KAMA. **5 Marks**
- (c) KAMA is considering opening another retail outlet selling the same products. The same pricing structure will operate and the annual fixed costs of the new outlet are estimated to be €/£85,000. Potentially 5% of existing sales may transfer to the new outlet. Calculate the annual value of sales required to achieve a similar level of profit to the existing outlet. **5 Marks**
- (d) Discuss how cost-volume-profit analysis information can be useful for decision making. **5 Marks**

Total 20 Marks





NEW SYLLABUS

The Institute of Accounting Technicians in Ireland

Foundation Examination : Summer 2008

SOLUTIONS TO PAPER 3

Management Accounting

Author : Ms Celine McCartan FCA, MCIPD

Solution to question 1 Mc Hill Ltd

(a) Problems associated with traditional costing techniques

Traditional costing techniques were developed in the early twentieth century to provide information to developing factory based industries. In these circumstances direct costs such as labour and materials were high; with relatively low levels of overheads; production was organised in large runs with limited change occurring. Hence traditional costing was largely based on a derivative of production volume (eg: machine hours; direct labour costs).

In modern times manufacturing methods have changed in that they are more automated, mechanised and computerised. As a result, cost patterns have changed in that most organisations have higher proportionate levels of overheads, with lower direct costs. These overheads may relate to support functions which assist the production process such as testing and quality control, data processing and corporate administration. Hence many of these costs are driven not by production volumes but by a range of production related data. Activity based costing has been developed to make overhead costing more realistic as a result.

(b) Statement of overhead absorption rates

	Customer Orders €/\pounds	Order Size €/\pounds	Product Testing €/\pounds	Sales & Marketing €/\pounds
Indirect Materials	8,000	26,800	12,000	13,650
Health & Safety costs	5,000	5,000	2,500	2,500
Salaries & wages	80,000	160,000	120,000	40,000
Premises costs	24,000	120,000	60,000	36,000
Administration costs	51,600	34,400	34,400	51,600
Depreciation	30,000	75,000	37,500	7,500
	198,600	421,200	266,400	151,250
Annual projection	<i>600</i>	<i>27,000</i>	<i>4,800</i>	<i>1,375</i>
Activity based overhead absorption rate	€/\pounds331 per customer order	€/\pounds15.60 per CNC machine hour	€/\pounds55.50 per testing hour	€/\pounds110 per sales call

Solution to question 1 (Cont'd)

(c)			€/£
Order	1 No	@ €/£331	331.00
CNC Machining hours	50 hours	@ €/£15.60	780.00
Testing hours	5 No	@ €/£55.50	277.50
Sales & Marketing	3 No	@ €/£110	330.00
Total Order Cost			<u>1,718.50</u>
(i) Mark Up	15% - 257.78	=	£€1,976.28
(ii) Margin	20% - 429.62	=	€/£2,148.12

Solution to question 2

(a) Calculation of annual variable production overhead

Annual production	280,000	units
Projected direct labour	€/£5,040,000	
Total production overhead – 50%	€/£2,520,000	
Fixed production overhead – 40%	€/£1,008,000	

(b) Stock Valuation – Absorption costing

	Quarter 1	Quarter 2
Stock – units	15,000	10,000
Cost per unit		
Direct materials	12	
Direct labour	18	
Production Overhead	9	
	<u>39</u>	
	€/£585,000	€/£390,000

Stock Valuation – Marginal costing

	Quarter 1	Quarter 2
Stock – units	15,000	10,000
Cost per unit		
Direct materials	12.00	
Direct labour	18.00	
Production Overhead	5.40	
	<u>35.40</u>	
	€/£531,000	€/£354,000

(c) Plant AX Ltd

Projected Divisional Profit Statement – Marginal Statement

	Quarter 1	Quarter 2
	€/£	€/£
Sales	3,000,000	3,500,000
Cost of Sales		
Opening Stock	280,000	531,000
Direct Materials	780,000	780,000
Direct Labour	1,170,000	1,170,000
Variable production overhead	351,000	351,000
Closing Stock	(531,000)	(354,000)
Gross Profit	950,000	1,022,000
Fixed Production Overhead	252,000	252,000
Administration & Sales Overhead	300,000	300,000
Net profit	398,000	470,000

Solution to question 2 (Cont'd)

(d) Plant AX Ltd
Projected Divisional Profit Statement – Absorption Costing

	Quarter 1 €/\$	Quarter 2 €/\$
Sales	3,000,000	3,500,000
Cost of Sales		
Opening Stock	280,000	585,000
Direct Materials	780,000	780,000
Direct Labour	1,170,000	1,170,000
Production overhead	630,000	630,000
Closing Stock	(585,000)	(390,000)
Gross Profit	725,000	725,000
Administration & Sales Overhead	(300,000)	(300,000)
Over Absorption of Variable Overhead	27,000	27,000
Net profit	452,000	452,000

(e) Reconciliation of Marginal and Absorption Profit Statements

		€/\$	€/\$
Marginal Costing	Quarter 1	398,000	
	Quarter 2	<u>470,000</u>	
			868,000
Absorption Costing	Quarter 1	452,000	
	Quarter 2	<u>452,000</u>	
			<u>904,000</u>
Difference - represented by difference in Quarter 2 closing stock			<u><u>36,000</u></u>

Solution to question 3

(a)

	Budget (20,000 units)		Actual (18,000 units)		Flexed budget (18,000 units)	
	€/£	€/£	€/£	€/£	€/£	€/£
Sales		2,000,000		1,890,000		1,800,000
Costs						
Materials	800,000		828,750		720,000	
Labour	480,000		399,000		432,000	
Variable overhead	160,000		154,750		144,000	
		1,440,000		1,382,500		1,296,000
Profit		€/£560,000		€/£507,500		€/£504,000

(b)

(i) **Material price variance**

$$(\text{Actual quantity} \times \text{Actual price}) - (\text{Actual quantity} \times \text{Standard Price}) \\ (195,000 \times 4.25) - (195,000 \times 4) = \text{€/£48,750 Adv}$$

(ii) **Materials usage variance**

$$(\text{Actual quantity} \times \text{Standard price}) - (\text{Flexed quantity} \times \text{Standard price}) \\ (195,000 \times 4) - (18,000 \times 10 \times 4) = \text{€/£60,000 Adv}$$

(iii) **Labour rate variance**

$$(\text{Actual Hours} \times \text{Actual Rate}) - (\text{Actual Hours} \times \text{Standard rate}) \\ (38,000 \times 10.50) - (38,000 \times 12) = \text{€/£57,000 Fav}$$

(iv) **Labour efficiency variance**

$$(\text{Actual Hours} \times \text{Standard rate}) - (\text{Flexed hours} \times \text{Standard rate}) \\ (38,000 \times 12) - (18,000 \times 2 \times 12) = \text{€/£24,000 Adv}$$

(v) **Variable expenditure variance**

$$(\text{Actual variable overhead expenditure}) - (\text{Actual hours} \times \text{standard overhead rate}) \\ 154,750 - (38,000 \times 4) = \text{€/£2,750 Adv}$$

(vi) **Variable efficiency variance**

$$(\text{Actual hours} \times \text{standard overhead rate}) - (\text{Flexed hours} \times \text{Standard rate}) \\ (38,000 \times 4) - (18,000 \times 2 \times 4) = \text{€/£8,000 Adv}$$

Solution to question 3 continued on next page

Solution to question 3 (Cont'd)

(c) Behavioural aspects of standards

Standards can be used very successfully to motivate and encourage staff to achieve control and greater efficiency provided there is:

- full participation in the standard setting process.
- realistic standards are used as benchmarks
- timely and accurate reporting is available
- ongoing communication and feedback
- reward based performance measurement
- goal congruence between employee and organisation.

Solution to question 4

To: Managing Director
From: Student Accountant
Date: X/X/XX
RE: Developing aspects of the Finance Function

Key differences between financial and management accounting

Financial accounting is primarily for users of accounting information who are outside the organisation. The users of financial accounting information will be identified in the corporate report as being:

- Equity investors (shareholders)
- Loan creditors
- Employees
- Analysts and advisors
- Suppliers
- Government
- Public

Financial accounting is mainly concerned with what is known as the “stewardship” function. This is the keeping of the financial records, preparing the statutory accounts, keeping track of debtors and creditors, the raising of finance and paying tax.

Management accounting shares the same basic concepts as financial accounting and in many smaller organisations it may be hard to differentiate management accounting from financial accounting.

Management accounting is concerned with the provision and interpretation of information required by management at all levels for:

- Formulating policies
- Planning activities
- Controlling activities
- Decision making
- Performance appraisal

Therefore it is concerned with gathering data, analysing the data, processing data, interpreting data and communicating information so that management can perform its function more effectively. Namely planning, controlling and making decisions.

Like financial accounting you can think of management accounting as a system, where data goes into a process and comes out as information. The essential difference is that in management accounting the users of the information are inside the organisation as opposed to outside. As a result, there are no statutory requirements in management accounting, as the overriding test is the usefulness to management of the information provided.

Solution to question 4 continued on next page

Solution to question 4 (Cont'd)

Management accounting in support of business decision making

Decision Making can be defined as making choices between future, uncertain alternatives. All decision making relates to the future and that a decision is a choice between alternatives in pursuit of an objective. Where no alternatives exist no decision can be made and nothing can be done now that will alter the past. These fundamentals of decision making are of critical importance in determining what information the management accountant should supply to the decision maker.

All the activities of management and therefore all the activities of the management accounting is decision making. Decision making is an all pervasive activity taking place at every level in the organization covering both the short and long term. Plans are activated by decisions and a significant number of decisions require some form of financial or quantitative analysis in order that a rational choice can be made. It is because of this that practicing management accountants are heavily engaged in producing relevant information for decision making purposes. It must be realized that regardless of the amount of quantitative information available the actual decision process includes consideration of qualitative, behavioural and social factors as well as the quantitative ones. Some decisions are based entirely on qualitative factors e.g. Staff appointments, the design of a new house etc. In spite of this there are a vast range of business situations for which quantitative and financial analysis plays a crucial part of making decisions. These can range from long term strategic decisions such as launching new products or buying new capital equipment to short term tactical problems such as make or buy, product pricing etc.

A common element of all these problems is that they rely on the information on costs and revenues which is correctly specified in relevant terms for the particular decision being considered. Consistency of treatment in the traditional accounting sense is not possible in these circumstances, relevance is all important.

Activity based costing

Activity Based Costing (ABC) is a cost management approach that links resource consumption to activities that a company performs and assigns those activities and their associated costs to customers or product lines.

ABC can be thought of as a method of charging overheads to cost units on the basis of benefits received from the particular indirect activity e.g. ordering, planning etc. ABC seeks not only to attribute overheads to product costs on a more realistic basis than simply production volume and also tries to show the relationship between overhead costs and the activities that cause them

Variance analysis

Variance analysis is the evaluation of performance by means of variances whose timely reporting increase the opportunity of remedial action. Variance analysis involves the investigation of the difference between actual costs and budgeted costs. It enables managers to identify problems that need further investigation with the view of implementing remedial action. The value in variance analysis lies with managers being able to isolate where increased costs are actually occurring and take remedial action in that specific area.

Opportunity costs

Opportunity Costs can be defined as the value of the next best alternative i.e. it is the net receipts foregone by not accepting the best available alternative. The definition of Opportunity Costs emphasizes alternatives which of course are the basis of decision making. In a given problem where there are exchange transactions (buying & selling) the opportunity costs are measured by the money outlays. In other circumstances where the resources used are not represented by outlay costs it may be necessary to impute a value for opportunity cost.

Solution to question 5

(a) Stock Movement

Opening Stock	1,200	units
Wk 1 Production	1,000	units
Wk 1 Sales	(800)	units
Stock at Wk 1 end	1,400	units
Wk 2 Production	1,000	units
Wk 2 Sales	(1,000)	units
Stock at Wk 2 end	1,400	units
Wk 3 Production	-	
Wk 3 Sales	(750)	
Stock at Wk 3 end	650	units
Wk 4 Production	-	
Wk 3 Sales	(650)	units
Stock at Wk 4	-	

(b) Garr Ltd Projected Cashflow Statement

	Wk 1 €/\$	Wk 2 €/\$	Wk 3 €/\$	Wk 4 €/\$	Wk 5 €/\$	Wk 6 €/\$
Cash Inflows						
Debtor Receipts	52,000	56,200	52,800	44,000	36,850	7,150
Cash Outflows						
Creditor Payments	-	82,000	32,000	32,000	-	-
Direct Labour	12,000	12,000	4,000	-	-	-
General Overheads	17,400	17,400	17,400	17,400	17,400	17,400
	29,400	111,400	53,400	49,400	17,400	17,400
Net Cashflow	22,600	(55,200)	(600)	(5,400)	19,450	(10,250)
Opening Balance	2,580	25,180	(30,020)	(30,620)	(36,020)	(16,570)
Closing Balance	25,180	(30,020)	(30,620)	(36,020)	(16,570)	(26,820)

Workings

Sales/Cash Received Calculations

	Wk 1 €/\$	Wk 2 €/\$	Wk 3 €/\$	Wk 4 €/\$	Wk 5 €/\$	Wk 6 €/\$
Sales	44,000	55,000	41,250	35,750	-	-
Opening Balance	52,000	21,000				
80% receipts		35,200	44,000	33,000	28,600	
20 % receipts			8,800	11,000	8,250	7,150
TOTAL	52,000	56,200	52,800	44,000	36,850	7,150

Production Calculations

	Week 1	Week 2	Week 3	Week 4
Production	1,000 units	1,000 units		
Direct Materials	20,000	20,000		
Variable Overhead	12,000	12,000		
Creditors Payment			32,000	32,000
Opening Balance		82,000		
TOTAL	-	€/\$82,000	€/\$32,000	€/\$32,000
Direct Labour costs	€/\$12,000	€/\$12,000	€/\$4,000	-

Solution to question 5 (Cont'd)

(c)

The key issues arising from the cashflow projection for Garr Ltd are as follows:

- The company has a peak cash requirement of £36,020 in Week 4 – which would have arisen regardless of the strike as it is due to the timing of creditor payments.
- This cash requirement is addressed as debtors are realised in weeks 3 to 5 and cash balances are accumulated.
- The strike action which sees the cessation of production and sale of all stock reflects a winding up scenario. The cash flow situation will also have to be examined upon resumption of production.
- The general overheads of £7,400 represent a drain on company resources which the company is committed to regardless of production and sales activity.

The main differences between profit and cashflow arise because:

- there are often timing differences related to receipts and payments related to debtors and creditors
- profits are affected by stock valuation and stock movement
- capital purchases incur cash outflows which are not directly related to profit.

Conversely, there are costs charged against profit that do not involve cash (eg; depreciation)

Solution to question 6

Explanatory Note re Sales and Marketing Costs – treated as a fixed cost element of £3,000 up to turnover of £150,000 and a variable rate of 5% of sales turnover.

(a) Breakeven Point

<u>Fixed Costs</u>	<u>(15,000 + 5,000)</u>	=	€£33,334 per quarter
C/S Ratio	.60		
			= €£133,334 per annum
C/S Ratio	65%		
Sales	120,000		
Variable Costs			
Cost of Sales	(42,000)		
Sales & Marketing	<u>(6,000)</u>		
Contribution	<u>72,000</u>	72,000/120,000 x 100 = 60%	

Alternative – based on treating all sales and marketing costs as fixed

<u>Fixed Costs</u>	<u>(15,000 + 5,000 + 9,000)</u>	=	€£44,615 per quarter
C/S Ratio	.60		
			= €£178,461 per annum
C/S Ratio	65%		
Sales	120,000		
Variable Costs			
Cost of Sales	<u>(42,000)</u>		
Contribution	<u>(78,000)</u>	78,000/120,000 x 100 = 65%	

(b) Projected annual profit

		€/£
Sales (<i>Annual Breakeven Turnover x 1.25</i>)		166,668
Cost of Sales (<i>35% of turnover</i>)		<u>58,334</u>
Gross Profit		108,334
Sales & Marketing (<i>5% of turnover</i>)		8,334
Establishment (<i>15,000 x 4</i>)		60,000
Administration (<i>5,000 x 4</i>)		<u>20,000</u>
Projected Net Profit		<u>€£20,000</u>

Alternative – as above

Sales (<i>Annual Breakeven Turnover x 1.25</i>)		223,077
Cost of Sales (<i>35% of turnover</i>)		<u>78,077</u>
Gross Profit		145,000
Sales & Marketing (<i>£/€9,000 + (223,077-150,000 x 5%)</i>)		12,654
Establishment (<i>15,000 x 4</i>)		60,000
Administration (<i>5,000 x 4</i>)		<u>20,000</u>
Projected Net Profit		<u>€£52,346</u>

Solution to question continues on next page

Solution to question 6 (Cont'd)

(c) New Outlet – target profit of €/**£20,000**

Loss of turnover		€/£	
166,668 x 5%	=	8,333	
Cost of Sales		(2,916)	
Sales & Marketing		(417)	
Loss of Profits		5,000	
<u>Fixed Costs + 5,000</u>	=	<u>90,000</u>	= €/£150,000 Sales value
C/S ratio		.60	

Alternative – as above

Loss of turnover			
223,077 x 5%	=	11,154	
Cost of Sales		(3,904)	
Sales & Marketing		(558)	
Loss of Profits		<u>6,692</u>	
<u>Fixed Costs + 6,692</u>	=	<u>91,692</u>	= €/£141,065 Sales value
C/S ratio		.65	

(d)

Cost volume profit analysis applies marginal costing techniques and considers the relationship between costs, volumes of activity and profits generated.

It is viewed as a good guide for short term planning and decision making, where changes are relatively small and existing cost patterns and relationships should remain. When more significant business or organisational decisions are being reviewed, other cost and market information should be examined in detail.

Typical short term decisions where cost volume profit analysis is useful include pricing decisions, product mix, special orders and limited resource situations.



NEW SYLLABUS

EXAMINERS REPORT

Management Accounting

Summer 2008

Statistics								
Question	1	2	3	4	5	6	Total	
No attempting	1,137	1,147	1,282	1,044	1,139	416	1,332	
Average Mark	11.38	9.94	10.96	11.97	11.22	10.19		
Average %	57%	50%	55%	60%	56%	52%		
Overall pass rate	66%		Overall Average mark					51%

General Comment

This was the first management accounting paper set in the context of the new syllabus. Some feedback indicated that students found the paper challenging. It was evident in the overall pass rate of 66% and the quality of scripts submitted that the majority of candidates were well prepared. They were able to present answers in a logical format, with relevant supporting workings evident although some candidates did have difficulty in completing the required five answers.

The examinable requirements were clearly stated on the paper and highlighted on the Institute website in advance of the session. Some candidates were, however, still unclear and a lenient approach was adopted to marking in light of the transitional nature of this subject.

In terms of content, the areas of the syllabus examined were very similar to the pilot paper provided. The compulsory questions in **part (a)** covered the areas of standard costing – practical application through variance analysis, comparison of marginal and absorption costing and activity based costing. **Part (b)** comprised of questions in the area of the role of management accounting and associated management accounting theory, cash budgeting and management accounting for decision making. Therefore, the examination assessed all aspects of the syllabus, broadly in line with the syllabus weightings. All examinable material was addressed in the recommended reading and the terminology used was specific to the actual syllabus.

Areas which were not examined at this session included traditional overhead absorption and overhead apportionment calculations, pricing of stock issues, stock variances, labour costing, business planning and control theory, preparation of operational budgets and relevant costing in decision making scenarios. In the context of the overall syllabus, these areas may be examined in subsequent examination sessions.

The format of the examination comprised of five scenario based, largely computational type questions which assessed the application of key concepts of the syllabus in practical situations; together with a narrative question assessing theory aspects of the syllabus again set in a practical context. The questions were generally designed with a number of sections with marks allocated by section to facilitate time management and to provide candidates with an opportunity to accumulate marks easily, however, this also meant that candidates who did not attempt a particular part of a question disadvantaged themselves in that it was then more difficult to score highly. Occasionally a candidate only submitted in respect of either the computational or the narrative elements of the paper.

In terms of performance for individual questions – the average mark exceeded 50% in all instances except for question 2 and broadly ranged from 10 - 12. The overall average mark was 51% – this represented a wide disparity of marks in line with the quality of scripts submitted. Overall, however the pass rate demonstrates good performance in this first examination which provides a sound foundation to build upon as this subject establishes its level as a mainstream accounting technician subject.

Question 1

This question examined activity based costing, similar to the second question on the pilot paper. The cost pools and drivers were provided in the question, so **part (a)** was an introductory theory question about the problems with traditional costing systems (as opposed to activity based costing). **Part (b)** required the calculation of activity based overhead absorption rates. A few attempted to calculate these all according to machine hours, most did calculate using the correct driver. Some omitted the indirect costs at this stage and incorrectly added them on in their entirety to the costing calculation at **part (c)**. Some omitted the sales and marketing cost from the **part (c)** calculation and while most candidates correctly calculated the mark up, there were a variety of calculations for the sales margin in **(ii)**, some of which did not attract the marks.

Question 2

This question examined the syllabus area of marginal costing and led candidates through a series of requirements aimed at comparing with absorption costing. It was very similar in content and requirement to Question 3 of the pilot paper. This question attracted the lowest overall average mark on the paper and some of the reasons for this are discussed. **Part (a)** calculated the fixed overhead and was well completed; **Part (b)** calculated the stock valuation and was not as well completed. Some candidates prepared the profit statement in response to **part (b)** and some only produced one statement – either marginal or absorption in response to **parts (c) and (d)**. Some strange entries were presented for general administration and sales overheads. Marks were awarded for recognition of the key concepts – i.e.:- fixed overheads excluded from gross profit/contribution calculation in marginal costing, while fixed overheads included in gross profit calculation or absorption costing with potential for under/over absorption, both in the context of the calculations of **parts (c) and (d)** and also in **part (e)**. This question required students to apply their knowledge of this subject and those who did were among some of the excellent answers which did score highly.

Question 3

Issues have been raised by interested parties as to the level of detail required in relation to standard costing variance analysis for this subject. With greater levels of theoretical detail comes a greater level of complexity and the challenge is to adopt a level and an approach which is appropriate to the competencies required of students in this area. This question attempted to strike a balance between theoretical accuracy (by adopting a flexed budget approach) and detailed requirements (by restricting the number of variances examined). Marks were awarded for calculations in **part (a)** and for formulae presentation and calculations in **part (b)**. **Part (c)** was not answered by all candidates who submitted a solution to this question although those who did scored marks accordingly.

Question 4

There was concern expressed that the format of this question was different from the pilot paper. Essentially it examined five areas of management accounting theory – with the first two being the first two items on the syllabus. This question attracted the highest mark for an individual question on the paper, **part (a)**, and was generally answered very well, while **part (b)** wasn't to the same standard. The definitions required by **part (c)** were familiar terms and curiously the one which posed the most difficulty or was not attempted by some candidates was the term 'opportunity cost' which was covered in the same context in the pilot paper.

Question 5

This question examined the preparation of a cash budget in the context of a situation where a cash difficulty could occur. Marks were awarded for each item as well as for overall presentation of the cash budget. **Part (a)** required a stock calculation – most responded with a unit calculation and recognised the stockout situation at week 4. Most candidates also presented **part (b)** in a suitable format with reference to cash inflows and outflows. But it was notable how many also included opening and closing stock entries in a profit and loss type format in answer to **part (b)**. Other common numerical errors related to sales calculations and the timing of creditors. Most answers provided to **part (c)** recognised the implications of the situation for the cashflows of the company.

Question 6

This question dealt with the marginal costing and decision making aspect of the syllabus and examined breakeven analysis, margin of safety and target profit calculations with cost-volume-profit theory in **part (d)**. The information in relation to sales and marketing costs was not well phrased and this led to some confusion. This was recognised and addressed accordingly in the marking plan for this question. Marks were awarded for statement of the relevant formulae for calculation as well as for its practical application. **Part (c)**, the calculation of a target profit statement in a decision making scenario appeared to present the most difficulties to candidates. **Part (d)** was generally well answered.

