

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

MANAGEMENT DECISION AND CONTROL - PAPER 12

CPA(U) EXAMINATIONS

JUNE 2001

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours**
2. Attempt **two** questions in Section **A**; both questions are compulsory. Question **one** carries 30 marks and question **two** carries 10 marks.
3. Section **B** has **four** questions and only **three** questions are to be attempted. Each question carries 20 marks.
4. Please read further instructions on the answer book.

SECTION A

Question 1:

Zoom Limited is well established in the express delivery of parcels and mail to individuals in Uganda. Zoom is now evaluating a new venture, the establishment of a motorcycle courier service offering same day delivery at least within Kampala and Jinja.

The venture would require the purchase of a building in Kampala for Shs.250,000,000 payable immediately. Alterations to the building would cost Shs.150,000,000 to enable it become the control and distribution centre for the venture. The alterations would take a year to complete and operations would not start until the building is ready. Soon after the completion of the building, Zoom Ltd. would take delivery of 100 motorcycles at Shs.4,000,000 each and recruit riders.

Running costs of the operation in current prices are expected to be fixed cost of Shs.750,000,000 per annum and a variable cost of Shs.1,000 per packet. Fixed costs are expected to increase by 8% per year and variable costs by 5% per year. Shs.50,000,000 working capital would need to be injected immediately prior to the completion of the building. A market research survey, undertaken at a cost of Shs.40,000,000 suggests that the price a packet should fetch should be either Shs. 5,000 or Shs. 8,000. At these prices the following number of packets forecast are:-

Expected Packets per year (000)

Probability of demand	Price Shs.5,000	Price Shs.8,000
0.10	175	160
0.20	275	190
0.40	350	210
0.20	375	230
0.10	400	260

The above prices are at current price levels and are expected to increase by 5% at the end of each year. Over the next five years, Zoom Ltd's cost of capital is expected to be 15% per annum, constant. The board wishes to evaluate the venture over the first five years of operations, at the end of which the realisable value of the venture as a going concern is expected to be Shs.1,000,000,000. Unless otherwise stated, assume all cash flows take place at the end of each year. Ignore tax.

Required:-

- (a) To decide with reasons, which price for the packets would maximise profit. **(10 marks)**
- (b) To calculate the expected net present value of the venture for the first five years of operations. **(15 marks)**
- (c) To discuss the limitations of the methods and data used and state what recommendations you would make about the venture. **(5 marks)**

(Total 30 marks)

Question 2:

- (a) Define and outline the requirements of Responsibility Accounting. **(5 marks)**
- (b) Explain the meaning and relevance of the term “Critical Success factors in a business” and give some examples of such factors. **(5 marks)**

(Total 10 marks)

SECTION B

Question 3:

Supreme Ltd. has five years remaining on a lease for premises in which it sells self assembly furniture i.e. “Do it yourself”. Management is considering the investment of Shs.600,000,000 on immediate improvements to the interior of the premises in order to stimulate sales by creating a more conducive and effective environment.

The following information is available:-

- (a) After the improvements, sales revenues are expected to increase by Shs.500,000,000 per annum. The average contribution: sales ratio is expected to be 40%.
- (b) The cost of capital is 16% and Supreme Ltd. has a target return on capital employed of 20% using the net book value of the investment at the beginning of the year.
- (c) At the end of the five year period the premises improvements will have nil residual value.

Required:-

- (a) Prepare two summary statements for the proposal for years 1 to 5 showing residual income and return on capital employed for each year. Statement 1 should incorporate straight line depreciation. Statement 2 should incorporate annuity depreciation at 16%. **(15 marks)**
- (b) Comment on the use of the figures from statement 1 and 2 in (a) above as decision making and management performance measures. **(5 marks)**
- (Total 20 marks)**

Question 4:

Alma Ltd. makes and sells three types of mobile phones for which the following budget/standard information and actual information is available for a period of one month:-

Model	Budget sales Units	Standard unit data		Actual sales Units
		Selling price Shs.	Variable cost Shs.	
Nokai	30,000	100,000	40,000	36,000
Kakati	50,000	80,000	25,000	42,000
Kibosi	20,000	70,000	22,000	18,000

Budget fixed costs are Shs.2,500 million for the one month period. The budget fixed costs are to be charged to the product units at an overall budgeted average cost per unit where it is relevant to do so.

Required:

- (a) Calculate the sales volume variance for each model in total for the one month period where (i) turnover (ii) contribution and (iii) net profit is used as the variance valuation base. **(10 marks)**
- (b) Discuss the relative merits of each of the valuation bases of the sales volume variance calculations in (a) above. **(5 marks)**
- (c) Calculate total sales quantity and sales mix variance for Alma Ltd. for the one month period using contribution as the valuation base. (Individual model variances are not required). **(5 marks)**
- (Total 20 marks)**

Question 5:

The Chief Executive Officer (CEO) of Malibao Ltd. is faced with a decision making situation and one of his Executive Directors has advised him to request the Management Accountant to advise him on

- (i) the cost classifications which should be used or ignored and
- (ii) factors which may affect the behaviour of costs and hence the accuracy of the cost analysis and the relevance of the decisions.

Required:

Write a memorandum to the CEO explaining to him the above statement in the context of whether Malibao Ltd. should make components used in the manufacture of a product or buy the component from an outside supplier.

(20 marks)

Question 6:

A typical budgetary control system in practice does not encourage **goal congruence**, contains **budgetary slack**, ignores the **aspiration levels** of participants and attempts to control operations by **feedback** when **feed forward** is likely to be more effective; in summary the typical budgetary control system is likely to have **dysfunctional effects**.

Required:

- (a) Explain briefly **each** of the **six** terms in italics. **(6 marks)**

- (b) Describe how the major dysfunctional effects of budgeting could be avoided. **(14 marks)**

(Total 20 marks)