

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

MANAGEMENT DECISION AND CONTROL - PAPER 12

WEDNESDAY, 19 JUNE 2002

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours**
2. Section **A** has two compulsory questions. 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

- (a) The overriding feature of information for decision-making is that it should be relevant for the decision being taken. However, decision-making varies considerably, at different levels within an organization, thus posing difficulties for the management accountant.

Required:

- (i) Describe the characteristics of decision making at different levels within an organization.

(6 marks)

- (ii) Explain how a management accountant must tailor the information provided for the various levels.

(6 marks)

- (iii) Give an example of a typical management decision, state at what level this would normally be taken and what specific information should be supplied to the decision maker.

(6 marks)

- (b) Go Travel Ltd has earnings based on commission:

	Commission
Airline bookings	8%
Rental car bookings	16%
Hotel bookings	20%

During a normal working month, the company is expected to book the following business on which these commissions would be taken

	Shs
Airline bookings	300,000,000
Rental car bookings	120,000,000
Hotel bookings	<u>110,000,000</u>
	530,000,000

Monthly fixed costs include the following:

Advertising	15,000,000
Rent	10,000,000
Utilities	4,000,000
Other costs	35,000,000

Required:

Calculate the net income expected.

(4 marks)

- (c) It is predicted that an increase in advertising will increase bookings thus:

	Increase
Advertising	Shs 9,000,000
Airline bookings	30%
Rental car bookings	10%

Required:

Should Go Travel Ltd increase its advertising? **(3 marks)**

- (d) Go Travel Ltd is considering hiring an extra member of staff but with a usual contractual agreement. The new person would be paid a salary of Shs 1,000,000 per month plus 40% of the commission on all extra business he brings in. Go Travel Ltd estimates that the new person could bring in the following extra bookings:

	Shs
Airline bookings	75,000,000
Rental car bookings	36,000,000
Hotel bookings	<u>66,000,000</u>
	177,000,000

Extra costs associated with the new hire would be:

Utilities	1,500,000
Other costs	250,000

Required:

Assuming that the predictions are reasonably accurate, advise Go Travel Ltd as to whether the extra person should be hired.

(5 marks)
(Total 30 marks)

Question 2

“Lean manufacturing” has made Japanese production systems relatively efficient compared to other developed economies.

Required:

Explain what you understand by the **“lean manufacturing”** and discuss whether it can be adopted successfully in Uganda.

(10 marks)

Question 3

- (a) Kapukushi Ltd is reviewing its credit control activities. At present, debtors pay at the end of the second month after the sales (for example, January sales are paid for at the end of March).

It is estimated that by recruiting additional staff and pursuing more active credit control policies, debts could be collected one month earlier than at present. The extra costs for the first month would be Shs 2,000,000. Because of the effect of automation, these costs are expected to decrease by $\frac{1}{4}\%$ per month indefinitely.

Credit sales in the first month are expected to be Shs 250,000,000 with a monthly growth of $\frac{1}{2}\%$ which is expected to continue indefinitely. The cost of capital $1\frac{1}{4}\%$ per month.

Required:

Appraise the proposed in-house credit control system and advise whether it would be worthwhile.

(10 marks)

- (b) If Kapukushi decides to change its credit control system, an option being considered is to have the whole operation dealt with externally by a computer bureau. The bureau has quoted a fixed rate of Shs 5,000,000 per month plus an initial systems and programming charge. This would reduce Kapukushi's Ltd's existing administrative costs by Shs 4,000,000 per month indefinitely and avoid Shs 2,000,000 extra costs mentioned above.

Required:

State the maximum amount that should be paid for the initial systems charge.

(6 marks)

- (c) Indicate what other factors should be considered before a final decision is taken about the change of the credit policy.

(6 marks)

(Total 20 marks)

Question 4

Mula Ltd is an engineering company which is organized for management purposes in the form of several autonomous divisions. The performance of each division is currently measured by calculation of its return on capital employed (ROCE).

Mula Ltd's existing accounting policy is to calculate ROCE by dividing the net assets of each division at the end of the year into the operating profit generated by the division during the year. Cash is excluded from the net assets since all divisions share a bank account controlled by Mula Ltd's head office. Depreciation is on a straight-line basis.

The divisional management teams are paid a performance related bonus conditioned upon achievement of 15% ROCE target. On 10 June 2002, the divisional managers were provided with performance forecasts for 2002 which included the following:

Forecast	Net assets at 31 December 2002	2002 operating profit	ROCE
	Shs	Shs	
Exide division	4,400,000,000	649,000,000	14.75%
UBL division	480,000,000	120,000,000	25%

Subsequently, the manager of Exide division invited members of her management to offer advice. The responses she received included the following:

Administrator:

"We can achieve our 2002 target by differing payment of a Shs 90,000,000 target payable before end of December 2002 until 1 January. I should add that will thereby immediately incur a Shs 2,000,000 late penalty."

Works Manager:

"We should replace a number of our oldest machine tools (which have nil book value) at a cost of Shs 320,000,000. The new equipment will have a life of eight years and generate cost savings of Shs 76,000,000 per year. The new equipment can be on site and operational by 31 December 2002."

Financial Controller:

"The existing method of performance appraisal is unfair. We should ask head office to adopt residual income (RI) as the key performance indicator, using the company's average 12% cost of money for a finance charge."

Required:

- (a) Compare and appraise the proposals of the divisional administrator and the works manager, having regard to the achievements of ROCE performance target and any longer-term factors you think relevant.
(9 marks)
 - (b) Explain the extent to which you agree or disagree with the financial controller's position.
(7 marks)
 - (c) Explain the value and use of non-financial indicators
(4 marks)
- (Total 20 marks)**

Question 5

You have been appointed a Chief Management Accountant of a well-established company with a brief to improve the quality of information supplied for management decision-making. As a first task you have decided to examine the system used for providing information for capital investment decisions. You find that discounted cash flow techniques are used but in a mechanical fashion with no apparent understanding of the figures produced.

The most recent example of an investment appraisal produced by the accounting department showed a positive Net Present Value (NPV) of Shs 75,000,000 for a five year life project when discounted at 15% which you are informed 'was the rate charged on the bank loan raised to finance the investment'. You note that the appraisal did not include any consideration of the effects of inflation neither was there any form of risk analysis.

Required:

- (a) Explain the meaning of a positive Net Present Value (NPV) of shs 75,000,000.
(5 marks)
 - (b) Comment on the appropriateness or otherwise of the discounting rate used.
(5 marks)
 - (c) Explain how you would deal with inflation in investment appraisals.
(5 marks)
 - (d) Explain what is meant by "risk analysis". Describe ways in which it can be applied in investment appraisals and the benefits (if any) that can be derived.
(5 marks)
- (Total 20 marks)**

Question 6

Wide Ltd had the following extracts from its budgets

Period	1	2	3	4	5
Opening inventory (units)	4,000	2,500	3,300	2,500	3,000
Sales (units)	15,000	20,000	16,500	21,000	18,000

	Period 1	Period 2	Period 3
	Cost of budgets Shs '000		
Direct labour	270,000	444,000	314,000
Direct materials	108,000	166,400	125,600
Production overhead (without depreciation)	117,500	154,000	128,500
Depreciation	40,000	40,000	40,000
Administration overhead	92,000	106,600	96,000
Selling overhead	60,000	65,000	61,500

You are also given the following information:

- (i) Production above 18,000 units incurs a bonus in addition to normal wage rates.
- (ii) Any variable costs contained in selling overhead are assumed to vary with sales. All other variable costs are assumed to vary with production.

Required:

- (a) Calculate the budgeted production for periods 1 to 4
(4 marks)
 - (b) Prepare a suitable cost budget for period 4
(10 marks)
 - (c) Critically analyse the assumptions on which cost budgets are prepared.
(6 marks)
- (Total 20 marks)**