

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

MANAGEMENT DECISION AND CONTROL - PAPER 12

THURSDAY, 23 JUNE 2005

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

Following an increase in timber prices and due to the fact that plastic is less affected by weather changes such as rain and sunshine, there has been a shift in demand from wooden party chairs to plastic chairs. Unlike wooden ones, plastic chairs are produced in different designs and colours. This has attracted many companies to manufacture plastic chairs.

One of these companies is Nabugabo Quality Plastics Ltd (NQPL). This company has been producing plastic chairs for the last three years. It sponsored a market research that confirmed expected sales of 200,000 chairs in the coming year.

Figures from its production department indicate the following projected overheads for the coming year:

	Moulding Department Shs million	Assembly Department Shs million	General Factory Overheads Shs million
Variable overheads	320	100	210
Fixed overheads	500	170	350
Practical capacity- Machine hours	1,200,000	800,000	
Budgeted activity machine hours	800,000	600,000	
Machine hours per chair	4	3	
Labour hours per chair	2	3	
Hourly labour rate	Shs 1,000 / hour	Shs 1,100 / hour	

The company policy is as follows:

- Variable overheads are allocated on the basis of machine hours worked in each department.
- General factory fixed overheads are reallocated on the basis of practical machine hour capacity of the two departments.
- The selling price is arrived at by applying a mark up of between 25% and 35%.

Further Information indicates that direct materials per chair are Shs 1,800. NQPL produces better quality chairs than its local competitors, who sell their chairs between Shs 18,000 to Shs 20,000.

Included in the above fixed overheads are costs that are specifically incurred in relation to the chairs produced, these include supervision Shs 4 million, depreciation Shs 24 million and advertisement of Shs 5.4 million.

Required:

- (a) Distinguish between market price and cost-plus price? (4 marks)
 - (b) What do you perceive as the role of costs in pricing? (6 marks)
 - (c) Compute the variable cost and full manufacturing cost of one plastic chair. (7 marks)
 - (d) Taking into consideration the notes above, determine the selling price based on:
 - (i) Full manufacturing costs at a mark up of 25%, 30%, 35%. (4 marks)
 - (ii) Variable manufacturing costs. (3 marks)
 - (e) Based on the information given and your answers above, comment on the cost information and suggest a price range which should be considered. (6 marks)
- (Total 30 marks)**

Question 2

The General Manager of **Achieve Microfinance Ltd** has been attending a seminar on Activity Based Costing (ABC). On his return, he informed the top management that '**Achieve Microfinance Ltd**' was going to introduce ABC system.

The Finance Manager opposed the idea. He argued that '**Achieve Microfinance Ltd**' was a service organization A and therefore, ABC was only appropriate for large production companies and irrelevant for service organizations however large they may be.

Required:

As an independent consultant (called Precious Opio), you are required to write a memo to the General Manager:

- (a) Describing the conditions under which the introduction of ABC is likely to be most effective. (3 marks)
 - (b) Describing the major stages involved in the design of Activity Based Costing System. (4 marks)
 - (c) Explaining the use of Activity Based Cost information in a service Industry? (3 marks)
- (Total 10 marks)**

SECTION B**Question 3**

Kamali Group of Companies is composed of four subsidiaries that are located in different areas of Kampala. It manufactures a wide range of products that are sold in separate markets, but they also sell to each other (inter division sales).

In the financial year ending 30 April 2005, the financial results of the group were as follows:

	Shs million
Sales	4,300
Production cost of sales	<u>2,600</u>
Gross Profit	1,700
Other operating Expenses	<u>1,270</u>
Net profit	<u>430</u>

In the past three years, the Beverages subsidiary which is one of the four subsidiaries of the group has been performing poorly. The shareholders of Kamali Group of Companies are negotiating for its sale, and they have received an offer.

You have been given the following information regarding the Beverages subsidiary:-

- (i) In the year ended 30 April 2005 the Beverages subsidiary earned a gross profit that is 50% of the whole Group's gross profit. Its sales were 10% of the total company sales.
- (ii) The Beverages subsidiary incurred fixed production costs of Shs 158 million and other costs (non production) of Shs 78 million, included in other costs is Shs 19 million which is apportioned to the Beverages subsidiary from the Group's general fixed costs. The Shs 19 million will not be eliminated by the sale or disposal of the Beverages subsidiary.
- (iii) If the subsidiary is not sold, its sales will increase by 10%, its fixed costs will increase by 5% but its variable costs will remain at the same level as a percentage of sales.
- (iv) If the beverages subsidiary is sold, the sales proceeds could be invested to earn Shs 38 million in the coming financial year ending 30 April 2006. The sales of the Beverages subsidiary will affect the sales of other Group products, the lost sales from other divisions will add up to lost contribution to profits of Shs 10 million.

Required:

- (a) Based on the projections for the coming financial year ending 30 April 2006, advise the management of Kamali Group of Companies on whether they should sell the Beverages subsidiary .

(13 marks)

- (b) In case the management decided to sell off the Beverages subsidiary, advise them on any other factors they should consider other than your computations in (a) above.

(7 marks)

(Total 20 marks)

Question 4

Makanga Investments Ltd is a local company. It has been borrowing from banks to finance its projects but of recent the banks have refused to give it more money sighting its high Debt to Equity ratio.

The management of Makanga Investments Ltd has identified five capital investment projects. However, the company has at its disposal Shs 320 million on the bank account for new ventures only.

All the five projects are not divisible and cannot be postponed until a future period. After the projects end, it is unlikely that similar investments opportunities will occur.

Information and expectations of each of the five projects are as follows:

Project	Initial outlay Shs million	Year 1 Shs million	Year 2 Shs million	Year 3 Shs million	Year 4 Shs million	Year 5 Shs million
X	123	35	35	35	35	35
Y	90	36	43	32	-	-
Z	90	31	31	31	31	-
W	90	20	25	30	35	20
Q	75	18	41	41	-	-

Projects X and W have a similar lifespan and they are mutually exclusive. All the five investment projects have similar risk to the company.

Any surplus funds may be invested on a fixed deposit account to earn a return of 9% per year, and the money market in Uganda is assumed to be an efficient market.

Makanga Investments Ltd's cost of capital is 12% per year.

Required:

- (a) Calculate the Expected Net Present Value of each project
(5 marks)
 - (b) Calculate the Expected Profitability Index associated with each project
(5 marks)
 - (c) Rank the five projects using the investment appraisal methods in (a) and (b) above. Explain why these rankings differ.
(4 marks)
 - (d) Recommend to the management of Makanga Investments Ltd the projects that should be selected. Justify your recommendations.
(6 marks)
- (Total 20 marks)**

Question 5

A Management Accountant should always ensure that any good management system enhances the performance of the company. Of great importance he should always consider the behavioural consequences of the system.

Required:

- (a) Briefly explain the role of a Management Accountant in the design of a management accounting system, and why it is necessary to consider the behavioural consequences of its application.
(4 marks)
 - (b) Outline the potential behavioural issues that may arise in the application of:
 - (i) Performance monitoring. (5 marks)
 - (ii) Budgeting. (5 marks)
 - (c) Suggest how the problems mentioned in (b) above could be overcome.
(6 marks)
- (Total 20 marks)**

Question 6

You are the Management Accountant of Henko Holdings Ltd. In the last Board meeting, it was resolved that the company installs a new information system that ensures real time processing. The objectives have been agreed on in the project initiation document. You have been appointed the Project Manager for this project.

Required:-

- (a) Describe the process you will follow to design the project plan. **(8 marks)**
- (b) Explain the meaning and principle of a critical path in project planning. **(4 marks)**
- (c) Managers are normally requested to apply risk management process, while managing projects.

Briefly explain the purpose, meaning and content of the risk management process?

(8 marks)
(Total 20 marks)