

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

MANAGEMENT DECISION AND CONTROL - PAPER 12

THURSDAY, 15 DECEMBER 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

Kamu Group of companies is composed of five divisions that produce products for both outside markets and for their sister companies to be used as input materials.

The Managing Director (MD) has just come back from a seminar on transfer pricing, but because he is not an accountant, he did not follow the discussion.

Required:

The MD has asked you, the Management Accountant (Trinity Mutema) of the company to write a report on the following:

- (a) To explain three major objectives of transfer pricing. (6 marks)
- (b) One of the subsidiary produces a bi-product that is only used by its sister company. The bi-product has no outside market. It is also not produced by any other company in the region.

Required:

Advise the MD about transfer pricing methods that could be used to minimize conflicts and disagreements between managers so as to ensure harmony in the group.

(7 marks)

- (c) In the seminar the MD was told that “*full cost is an inappropriate basis for setting transfer prices.*”

Required:

Justify the above statement to the MD.

(9 marks)

- (d) One of the subsidiaries of Kamu Group, KH Oils Ltd, produces cooking oil, which is used in the manufacture of soap, body creams and cosmetics. KH Oils Ltd sells its products to both the open market and to sister companies, Kamu Soap Works and Kamu Cosmetics Ltd. The products similar to those of KH Oils Ltd are available on the open market at competitive prices. KH Oils Ltd sells to sister subsidiaries in the group at cost plus 10% profit mark up.

Required:

Explain clearly why the current transfer price charged by KH Oils Ltd is unlikely to maximize the group's profit and the effect on goal congruence of the group as a whole.

(8 marks)

(Total 30 marks)

Question 2

Explain the following:

- (a) Responsibility accounting. (4 marks)
- (b) Management by exception. (3 marks)
- (c) Controllable fixed costs. (3 marks)

(Total 10 marks)

SECTION B

Question 3

Muda Pharmacy has been approached by two foreign drug-manufacturing companies to distribute anti-malarial drugs. Muda Pharmacy, however, can only choose to work with only one of the companies.

In both cases, Muda will incur both marketing and distribution costs. The two alternative options with their profits are as follows:

Option 1

They have been approached by a Chinese company that manufactures a very effective drug (**Artene**). The drug is new and not known. Muda Pharmacy would need heavy investment in advertising and promotion costs plus recruitment of sales people.

The advertising and promotion costs are expected to be Shs 200 million.

The after tax net profit is projected to be Shs 500 million.

It is expected that during the second year a loss of Shs 315 million will be incurred because of paying severance packages to the sales persons. This is in addition to reduced sales.

Option 2

They have been approached by a German drug company that manufactures a well known and respected malaria drug (**Fansa**).

Since Fansa is a known drug, only Shs 100 million will be incurred in promotions and advertising. All the sub-dealers will buy from them and there will be no need for sales persons.

In the first year of business, the sales will just be enough to pay for the drug and operating expenses.

In the second and third year, Muda will make a net cash flow of Shs 84 million per year.

Required:

- (a) Calculate the net present values of each of the options. (4 marks)

- (b) Calculate the IRR of each of the options. **(8 marks)**
- (c) Based on the computations in (a) and (b) above, advise the management of Muda Pharmacy as to which of the two drugs should be promoted giving reasons for your advice. **(4 marks)**
- (d) What other additional information would you need apart from the computation above to make a correct decision? **(4 marks)**

Hint: State any assumptions on which you base your decisions.

(Total 20 marks)

Question 4

Bujuku Transporters Ltd is a local transport company with over one hundred trucks. In order to minimize repair costs the company started a foundry and fabrication section where they manufacture three commonly used spare parts needed by their trucks.

Due to frequent breakdowns, the demand for the spare parts far exceeds the production capacity of their foundry workshop. Management recently decided to buy some of the spare parts from outside (Katwe).

The following information has been confirmed:

	Spare Part X	Spare Part Y	Spare Part Z
	UShs	UShs	UShs
Variable cost of production	140,000	60,000	80,000
Outside purchase price	260,000	50,000	120,000
Machine hours per unit	4	2	1
Labour hours	4	2	2

Required:

- (a) Assume that the workshop is currently working at full capacity, advise management which spare part should be purchased from outside. **(4 marks)**
- (b) Assuming that labour hours are in excess but machine hours are limited to 8,000 machine hours per week, which component should be produced. **(8 marks)**
- (c) Assuming that labour hours are limited to 4,000 hours per week where as machine hours are as planned, advise management on component the company should produce. **(8 marks)**

(Total 20 marks)

Question 5

New Age Computer Solutions (U) Ltd is planning to research on a possibility of developing, making and marketing an advanced UPS device. Research and development costs are estimated to cost US\$ 36 million.

There is 0.6 Probability that the Research and Development (R&D) will result in a new UPS, and 0.4 Probability that the research will not result into actual production

If the research is not successful, the R&D costs will be a loss.

If the R&D is successful, full production will commence, but the success of the UPS on the market will vary as follows:

	Option.	Probability.	Profits made in Shs million.
(i)	Very successful.	0.45	108
(ii)	Average success.	0.30	20
(iii)	Failure	0.25	(80) Loss

Required:

- (a) Present all the possible outcomes with the use of a decision tree. **(16 marks)**
- (b) From the outcomes in the decision tree should the company go ahead to invest in research and development. **(4 marks)**
- (Total 20 marks)**

Question 6

- (a) Explain the term performance measurement? **(4 marks)**
- (b) Give the principles of performance measurement? **(6 marks)**
- (c) St. Mulumba Education Services Ltd is a private organization that is in the education business. It has seven secondary schools in the different regions of the country and each school is headed by a Headmaster who is in charge of all the aspects of the school (Education, Administration and Finance operations of the school). They report to the secretariat that is headed by the Managing Director, who is assisted by an Accountant to monitor performance of these schools.

Required:

As the Accountant of St. Mulumba Education Services Ltd, describe the major categories of performance measurement that you will use to determine the best performing Headmaster among the seven. Give specific examples of each category.

(10 marks)
(Total 20 marks)