

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL TWO

MANAGEMENT DECISION AND CONTROL - PAPER 10

FRIDAY, 17 JUNE 2011

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours 15 minutes.**

The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.

2. Section **A** has **one** compulsory question carrying 30 marks.
3. Section **B** has **four** questions and only **three** questions are to be attempted. Each question carries 20 marks.
4. Section **C** has **two** questions and only **one** question is to be attempted. Each question carries 10 marks.
5. Please read further instructions on the answer book, before attempting any question.

SECTION A

Question 1

Exalto Ltd is a holding company of Duon Ltd, Exta Ltd and Fulso Ltd. Each subsidiary company maintains its own accounting records and prepares an annual summary of its results. These results are shown below for the year ended 31 May 2011:

	Duon Ltd Shs million	Exta Ltd Shs million	Fulso Ltd Shs million
Sales	150	200	400
Variable production costs	50	70	230
Fixed production costs	60	50	80
Administration costs	30	25	40
Profits	10	55	50
Net assets and liabilities	400	550	415

Additional information:

- Subsidiary companies are free to trade with each other without any interference from the group head office. The respective managers of the companies negotiate transfer prices between each other. During the year and included in the above costs and revenues are the following transactions:
 - Duon Ltd sold goods for Shs 20 million to Exta Ltd. The price was agreed on a unit basis between the managers of the units. The variable production costs of these items in Duon Ltd were Ushs 18 million. Duon Ltd was operating under capacity and agreed to a transfer price that was above its own variable costs.
 - Fulso Ltd sold goods for Shs 15 million to Exta Ltd. the price was agreed on a unit basis between the managers. The variable production cost of these items was Shs 9 million. Fulso Ltd was also operating under capacity and negotiated a transfer price based on its total production costs.
- As part of the shareholder agreement, Exalto Ltd charges management fees to the subsidiaries. These costs are included in the administration costs for each company at a percentage of sales as follows: Duon Ltd: 7%, Exta Ltd: 25% and Fulso Ltd: 25%.

Part of these management fees is to cover training costs at the company academy located at the group head office and it is also for services rendered during procurement tenders for services to be rendered to all operating companies.

3. At the start of each year, the group's chief finance officer sets for each company a target return on capital employed. The target depends on the level of competitiveness of the industry in each respective country. For the year ended 31 May 2011, these targets were: Duon Ltd: 6%, Exta Ltd: 3% and Fulso Ltd: 15%.

Required:

- (a) Discuss the shortcomings of the above performance summaries when measuring the performance of each division. **(5 marks)**
- (b) Discuss the potential problems of negotiated transfer prices and how these have impacted on the performance of each company for the year ended 31 May 2011. **(6 marks)**
- (c) Prepare an alternative statement that is more useful for measuring and reporting the performance of each company. **(15 marks)**
- (d) Discuss how the use of "dual" transfer prices could affect the measurement of the divisional performance within the group. Illustrate your answer with suggested dual prices. **(4 marks)**
- (Total 30 marks)**

SECTION B

Question 2

Shot Uganda Ltd manufactures two products, Haks and Raks, in the same production facility.

Budgeted information for each product for the forthcoming quarter is as follows:

	Haks	Raks
Selling price (Shs '000)	670	385
Cost per unit: (Shs '000)		
Raw material @ Shs 11,000 per kg	220	55
Labour	180	100
Production overhead: (Shs '000)		
• Variable	95	90
• Fixed	35	25
Selling and administration overhead: (Shs '000)		
• Variable	35	35
• Fixed	<u>40</u>	<u>40</u>
	<u>(605)</u>	<u>(345)</u>
Profit per unit	<u><u>65</u></u>	<u><u>40</u></u>

Additional information:

1. Labour is to be regarded as a variable cost and is charged at Shs 20,000 per hour.
2. The unit fixed costs are based on the following budgeted sales estimates:
Haks 500 units
Raks 1,000 units

The sales estimate has been prepared by the sales manager based on the above selling prices.

Before finalizing the production plan for the forthcoming quarter, the production manager pointed out to the management accountant that he was concerned about meeting the budgeted sales volumes. Firstly, there was no stock of finished goods on hand at the beginning of the quarter and secondly, the supply of raw materials and labour for the quarter was limited.

According to his forecasts, the maximum availability of these two resources for the quarter was as follows:

- Raw materials 13,000 kilograms
- Labour 10,000 hours

Required:

- (a) Does the company have sufficient quantity of materials and labour to meet the sales requirements? Justify your answer with appropriate computations.

(10 marks)
- (b) Determine the optimal production plan that will maximize profits for the forthcoming quarter.

(10 marks)

(Total 20 marks)

Question 3

Wipron Trading Company produces two products A and B and the following budget has been prepared:

	A	B	Total
Sales units	120,000	40,000	160,000
Sales (Shs)	600,000	400,000	1,000,000
Variable costs (Shs)	480,000	120,000	600,000
Contribution (Shs)	120,000	280,000	400,000
Total fixed costs (Shs)			300,000
Profit (Shs)			100,000

Required:

- (a) Compute the break-even point in total and for each product. **(5 marks)**
- (b) The company proposes to change the sales mix in units to a ratio of 1:1 for products A and B. Advise on whether this change is desirable. **(15 marks)**
- (Total 20 marks)**

Question 4

- (a) Abacus Ltd makes four components W, X, Y and Z of a product with the following information:

Component	W	X	Y	Z
Units	1,000	2,000	4,000	3,000
Unit variable costs	Shs '000'	Shs '000'	Shs '000'	Shs '000'
Direct labour	4	5	2	4
Direct material	8	9	4	6
Variable overheads	<u>2</u>	<u>3</u>	<u>1</u>	<u>2</u>
	<u>14</u>	<u>17</u>	<u>7</u>	<u>12</u>
Fixed costs	1,000	5,000	6,000	8,000

External sub-contractors have offered to make the above components for the following prices per unit:

Component	W	X	Y	Z
Sub-contractor prices Shs '000'	12	21	10	14

Required:

Advise the company whether it should outsource the components. **(12 marks)**

- (b) PCB Bank in a departure from a former parastatal decided to merge over 18 divisions into 6 major divisions. The managing director of the bank in an address to the press noted the following "... large service organizations such as banks used to be noted for their relatively unsophisticated budgeting and control systems. However, with the increasing competitive market, many organizations are now changing and need to become leaner and meaner thus the need for this restructuring".

Required:

Explain the features in service organizations that may create problems for the application of activity-based costing methods.

(8 marks)

(Total 20 marks)

Question 5

- (a) "The learning and experience curves are mathematical models but their application to management accounting problems require careful thought"

Required:

Management accountants have long had problems with the use of learning curve theory in budgetary control. Explain these problems.

(8 marks)

- (b) In the new and fast evolving industrial environment, the usefulness of standard costs is being challenged by industrialists and new approaches are researched and sought. The Japanese have pioneered target costs to replace standard costs.

Required:

- (i) Describe what target costs are, how they are developed and used.

(6 marks)

- (ii) Identify and explain the shortcomings that have been identified with standard costs leading to their being rejected by industrialists.

(6 marks)

(Total 20 marks)

SECTION C

Question 6

The managing director of your company has just attended a trade symposium where the main presenter has stated the following "... for any company to be able to survive and compete effectively in this century, it must be able to use its transactions information system effectively, interrogate its management information system constantly, use its decision support system judiciously, and top management should rely on its executive information system always".

His main contention was that the finance and customer services departments were not giving him adequate information for decision making.

Required:

Write a memo to the managing director explaining how he can use the above systems in the two mentioned areas of the company.

(10 marks)

Question 7

You have been engaged as a consultant to the Rukshie Group. At present the group source their raw materials locally, manufacture their products in a single factory, and distribute them worldwide via an international distribution company. However, their manufacturing facilities are restricting them from expanding. So, they are considering outsourcing some of their manufacturing operations to developing economies.

Required:

- (a) Discuss the concept of the value chain and how the changes being considered by the Rukshie Group may impact on the management of contribution/profit generated throughout the chain.

(6 marks)

- (b) Discuss how profit-sharing arrangements might be used by the Rukshie Group in the context of the changes being considered. Suggest one non-financial target that may be used as part of these gain sharing arrangements.

(4 marks)

(Total 10 marks)