

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL ONE

MANAGEMENT ACCOUNTING & FINANCE– PAPER 6

THURSDAY, 21 JUNE 2012

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. This examination contains Sections **A**, **B** and **C**.
3. Section **A** is bound separately from Sections **B** and **C**.
4. Attempt all the 20 multiple choice questions in Section **A**. Each question carries 1 mark.
5. Attempt **three** of the **four** questions in Section **B**. Each question carries 20 marks.
6. Attempt **one** of the **two** questions in Section **C**. Each question carries 20 marks.
7. Write your answer to each question in a separate answer booklet.
8. Please, read further instructions on the question paper and answer book before attempting any question.

SECTION B

Attempt three of the four questions in this section.

Question 2

- (a) ABC Ltd manufactures and markets refrigerators. The company outsources compressor units that are fixed in the refrigerators. It uses 40,000 compressors every year. It is considering converting its operations to just-in-time system. This will raise the number of orders placed but lower the administration and other costs of placing or receiving orders. Details of the actual and expected ordering and carrying costs are as below:

	Actual	Proposed
Ordering cost (per order)	Shs 100,000	Shs 25,000
Purchase cost (per item)	Shs 2,500	Shs 2,500
Inventory holding cost as % of purchase cost	20%	20%

To implement the new arrangements will require a one-off reorganization costs estimated at Shs 400,000 which will be treated as a revenue item for tax purposes. The rate of corporation tax is 30% and ABC Ltd can obtain finance at 12%. The estimated life span of the new system can be assumed to be 8 years.

Required:

- (i) Determine the effect of the new system on the economic order quantity.
(5 marks)
 - (ii) Determine whether the new system is worthwhile in financial terms.
(8 marks)
 - (b) (i) Distinguish between factoring and invoice discounting as applied to management of trade receivables.
(2 marks)
 - (ii) Explain the indicators of a company that is overtrading.
(5 marks)
- (Total 20 marks)**

Question 3

A confectionary company, Classic Ltd, is considering changing the replacement policy for the ovens it uses in the production of bread. Classic Ltd is to decide between replacing the ovens every two years or every three years. The original cost of each oven is Shs 24,500,000. Maintenance costs and resale values are as follows:

Year	Maintenance cost per annum (Shs)	Resale value (Shs)
1	500,000	
2	800,000	15,600,000
3	1,500,000	11,200,000

Original cost, maintenance cost and resale values are expressed in current price terms. It is expected that maintenance costs will increase by 10% per annum while oven replacement cost and resale values at 5% per annum. The discount rate is 15%.

Required:

- (a) Using the equivalent annual cost approach, determine the best replacement policy. (12 marks)
- (b) A company has a target accounting rate of return of 20% and is now considering the following capital project:

Initial outlay Shs 80 million
 Estimated life 4 years

Estimated profit before depreciation:

Year	Shs million
1	20
2	25
3	35
4	25

The company depreciates its assets by 25% of cost each year and the asset will have no residual value.

Required:

- (i) Determine whether the project should be undertaken or not. (5 marks)
- (ii) Explain why the net present value method is considered superior to other methods of investment appraisal.

(3 marks)
 (Total 20 marks)

Question 4

The following budget and actual data relates to Mamita Ltd for the past three years:

	2009	2010	2011
Budget:			
Sales (units)	10,000	14,000	12,000
Production (units)	8,000	14,200	12,400
Fixed overheads (Shs '000')	10,400	19,170	13,360
Actual:			
Sales (units)	9,600	12,400	10,200
Production (units)	8,400	13,600	9,200
Fixed overheads (Shs '000')	11,200	18,320	16,740

The value of closing and opening inventory of the units produced is arrived at by using first in first out (FIFO) method. The budgeted and actual opening inventory for the year 2009 was 2,600 units and its valuation included Shs 3,315,000 of fixed overheads. The company absorbs its fixed overheads using a predetermined fixed overhead rate per unit which is the same for each year. It is assumed that variable cost per unit and selling prices per unit remained the same for each of the three years.

Required:

- Calculate the under or over recovery of fixed overheads for each year and show how it affected the profit or loss.
(6 marks)
- Absorption costing produces a higher profit than marginal costing. Explain why you agree or disagree making reference to the data provided above as appropriate.
(8 marks)
- Explain reasons why absorption costing is considered unsuitable for decision making.
(6 marks)

(Total 20 marks)

Question 5

- (a) Jeje Dairy Farm Ltd produces ice cream whose standard selling price is Shs 800 per sachet and the cost of producing one sachet provided on the standard cost card is as follows:

	Cost per sachet (Shs)
Direct materials	400
Direct labour	120
Variable overheads	80
Fixed overheads	<u>40</u>
	<u>640</u>

The budgeted output for the month of May 2012 was 16,000 sachets but during the period, 15,000 sachets were actually produced and sold at Shs 760 each.

Required:

Calculate the:

- (i) Sales contribution total variance.
- (ii) Sales contribution price variance.
- (iii) Sales contribution volume variance

(8 marks)

- (b) Resty Ltd manufactures a single product Zesta. Budgeted and actual results for May 2012 are as shown below:

	Budget	Actual results
Production & sales (units)	2,000	3,000
	Shs '000'	Shs '000'
Sales revenue	20,000	30,000
Direct materials	6,000	8,500
Direct labour	4,000	4,500
Maintenance	1,000	1,400
Depreciation	2,000	2,200
Rent and rates	1,500	1,600
Other costs	<u>3,600</u>	<u>5,000</u>
Total costs	<u>18,100</u>	<u>23,200</u>
Profit	<u>1,900</u>	<u>6,800</u>

Required:

Prepare a budget that will be useful for management control purposes assuming that;

- (i) Direct materials, direct labour and maintenance costs are variable while rent and rates, and depreciation are fixed.
- (ii) Other costs consist of fixed cost of Shs 1,600 plus variable cost of Shs 1 per unit made and sold.

(12 marks)

(Total 20 marks)

SECTION C

Attempt one of the two questions in this section.

Question 6

- (a) Explain the payback approach to investment appraisal and highlight its limitations.
(4 marks)
 - (b)
 - (i) Define the term 'working capital' and explain why its management is important to a business.
(3 marks)
 - (ii) Explain the steps that should be taken by a company to ease cash flow shortages in a case where it is not possible for the company to obtain a loan or an overdraft.
(4 marks)
 - (c) Describe the stages involved under the design and operation of an activity-based costing system.
(6 marks)
 - (d) Outline circumstances in which production may be continued even when the selling price has fallen below marginal production cost.
(3 marks)
- (Total 20 marks)**

Question 7

- (a) Define the term 'equity finance' as used in long term sources of finance.
(2 marks)
 - (b) Explain the advantages and disadvantages of equity financing.
(8 marks)
 - (c) Explain the reasons why companies seek a listing on the securities exchange.
(6 marks)
 - (d) Explain any **four** challenges faced by the Uganda Securities Exchange.
(4 marks)
- (Total 20 marks)**