Accounting
Technicians
Ireland

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Management Accounting

2nd Year Examination

August 2013

Exam Paper, Solutions & Examiner's Report

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Accounting Technicians Ireland

2nd Year Examination: Autumn 2013

Paper: MANAGEMENT ACCOUNTING

Monday 26th August 2013 - 2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

In this examination paper the €/£ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and the €/£ symbol may be understood by candidates in the Republic of Ireland to indicate the Euro.

Answer FIVE questions.
Answer all three questions in Section A. Answer any two of the three questions in Section B.

If more than the required number of questions is answered, then only the requisite number, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All figures should be labelled, as appropriate, e.g. €/£'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

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SECTION A
ANSWER ALL THREE QUESTIONS

QUESTION 1 *(Compulsory)*

Tannian Ltd. has produced the following budgeted figures for a new product which it hopes to launch.

Direct Material	€/£10 per unit
Direct Labour	€/£5 per unit
Variable Production Overhead	€/£8 per unit
Fixed Production Overhead	€/£27,000 per month
Budgeted Output	9,000 units per month
Selling Price	€/£30 per unit

The following levels of activity took place over the first two months of the products life:

	Month 1	**Month 2**
Production units	9,000	10,000
Sales units	8,500	9,500

Note: Actual prices and costs were the same as budgeted for the first two months.

Required:

(a) Calculate the standard cost per unit and standard profit per unit under Absorption costing principles.

4 Marks

(b) Prepare a profit statement for each month (separately) on each of the following basis:

i. Absorption Costing
ii. Marginal Costing

12 Marks

(c) Prepare a reconciliation of the difference in profit reported in the profit statements prepared in part (b) above.

2 Marks

(d) Clearly explain the reason for the difference in reported profit under the two methods.

2 Marks

Total: 20 Marks

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QUESTION 2 *(Compulsory)*

McGann Ltd. manufactures grips for use on hurleys. The following is a budgeted Income Statement for the for June 2013:

		€/£
Sales Revenue		9,600
Direct Material	4,000	
Direct Labour	960	
Production Overhead	3,600	
Selling Overhead	560	
		9,120
Profit		480

The following information is also supplied:

1. The monthly budgeted production and sales is 4,000 units.
2. The following breakdown between fixed and variable costs applies:

	Variable	Fixed
Direct Materials	100%	n/a
Labour	€/£400	€/£560
Production Overhead	€/£1,440	€/£2,160
Selling Overhead	100%	n/a

Required:

(a) Calculate the following:

i. Contribution for the year;
ii. Contribution per unit;
iii. Contribution / sales ratio;
iv. Breakeven sales volume;
v. Margin of safety %;
vi. Sales volume required to achieve a profit of €/£1,440.

Note: Each section carries equal marks.

12 Marks

(b) Prepare a clearly labelled breakeven chart, showing the breakeven point, margin of safety and expected profit.

6 Marks

(c) In deciding whether to make or buy the packaging in which the grips are sold, list any two qualitative factors that would need to be considered in making this decision.

2 Marks

Total: 20 Marks

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QUESTION 3 *(Compulsory)*

Larkin Ltd. manufactures and sells a single product. The following are the standard cost specifications fo

Direct Material: 6 kgs at a price of €/£6 per kg

Direct Labour: 6 hrs at a rate of €/£8 per hour

Overheads: All Overheads are fixed in nature and for the next period they are budgeted at €/£150,000. It is Larkin Ltd’s policy to absorb overheads at a predetermined rate per labour hour.

Sales: It is budgeted to produce and sell 10,000 units. Selling price is expected to be €/£130 per unit.

For June 2013 the following actual results were reported:

Sales Revenue	€/£1,536,000 (12,000 units sold)
Material	90,000 kgs were used at a cost of €/£432,000
Labour	81,000 hours were worked at a cost of €/£631,800
Overheads	Actual expenditure €/£174,000

Note: There was no closing inventory

Required:

(a) Prepare a standard cost card, showing the standard cost and profit per unit.

4 Marks

(b) Calculate the following variances:

i. Sales price;
ii. Sales volume;
iii. Material price;
iv. Material usage;
v. Labour rate;
vi. Labour efficiency;
vii. Fixed overhead expenditure;
viii. Fixed overhead volume.

10 Marks

(c) Prepare a reconciliation between budgeted profit and actual profit.

6 Marks

Total: 20 Marks

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SECTION B
ANSWER TWO OUT OF THE FOLLOWING THREE QUESTIONS

QUESTION 4

Explain, giving examples, the differences between each of the following:

(a) Variable and Fixed cost;
(b) Normal and Abnormal loss;
(c) Payroll accounting and Labour cost accounting;
(d) FIFO and LIFO methods of inventory valuation;
(e) Sunk and Incremental costs;

Note: Each section carries equal marks.

Total: 20 Marks

QUESTION 5

During the next year **Helebert Ltd.** is planning to launch a new product and budgets to use 56,250 units of a special material. The material will be used during the year at an even rate. Tom Helebert has decided he is going to place orders for 1,125 units at regular intervals during the year.

The costs associated with the material are as follows:

1. Purchase Price €/£3.50 per unit.
2. Ordering costs €/£10 per order.
3. Holding costs €/£0.50 per unit per year.

Required:

(a) Calculate the ordering and holding costs based on the suggested order quantity of 1,125 units per order.

4 Marks

(b) Calculate and explain the Economic Order Quantity.

6 Marks

(c) Calculate the difference in the ordering and holding costs between the order quantities suggested in parts (a) and (b).

4 Marks

(d) The supplier is keen to encourage Helebert Ltd. to order in bulk and has offered a discount of 5% on all purchases for an order quantity of 5,625 units. Advise whether or not this discount is financially beneficial to Helebert Ltd.

In answering part (d) assume the order quantity prior to the discount offer is 1,500 units per order.

6 Marks

Total: 20 Marks

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QUESTION 6

Mary Mouch is in the process of preparing budgets for the period October to December 2013. information has been provided to assist in the budgeting process:

1. Budgeted monthly sales revenue is as follows:

	€/£
October	40,000
November	70,000
December	50,000
January 2014	45,000

Sales are 20% cash and 80% credit. Credit sales are collected over a three month period, 15% in the month of sale, 70% in the month following sale and 15% in the second month following sale. Bad debts of 5% are anticipated on all credit sales.

Total sales revenue in August amounts to €/£30,000 and September's total sales revenue amounts to €/£36,000.

2. Cost of sales is expected to amount to 60% of sales revenue each month.

3. The business maintains its closing inventory levels at 75% of the following month's cost of sales. Inventory at the beginning of October is expected to amount to €/£18,000.

4. 50% of inventory purchased is paid in the month of purchase. The remaining 50% is paid for in the month following purchase. At the 30th September amounts owed for purchases are €/£11,700.

5. A grant of €/£20,000 is expected to be received in mid October.

6. A van which cost €/£8,000 when purchased second hand three years ago is expected to be sold in December 2013 for €/£3,000. At this time the expected net book value of the van is €/£1,800.

7. Equipment costing €/£4,500 will be purchased and paid for in November. The equipment will be depreciated on a straight line basis over three years.

8. Operating expenses are paid as incurred. These have been estimated as follows:

	€/£
October	12,800
November	18,900
December	14,600

The above figures include depreciation on existing assets of €/£2,000 per month.

9. The cash balance on 1st October is expected to amount to €/£8,000.

Required:

(a) Calculate the purchases figure for each month from October 2013 to December 2013.

5 Marks

(b) Prepare a cash budget on a monthly basis and in total for the period October 2013 to December 2013.

12 Marks

(c) Outline any three potential benefits from the preparation of a cash budget as prepared in part (b).

3 Marks

Total: 20 Marks

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2nd Year Examination: August 2013

Management Accounting

Suggested Solutions

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Marks Allocated

Solution 1:

(a)

	€	€	Marks Allocated
Selling Price		30	
Direct Material	10		
Direct Labour	5		
Variable Production Overheads	8		
Fixed Production Overheads (See Working)	3		**2 marks**
Production cost		26	**1 mark**
Profit per unit		4	**1 mark**

(b) (i) **Absorption Costing**

	Month 1 €	**Month 2** €	Marks Allocated
Revenue	255,000	285,000	**2 marks**
Opening Inventory	0	13,000	**1 mark**
Cost of Production	234,000	260,000	**1 mark**
Closing Inventory	13,000	26,000	**1 mark**
Cost of Sales	221,000	247,000	**1 mark**
Profit	34,000	38,000	
Over Absorption		3,000	
Adjusted Profit		41,000	**1 mark**

Working: Production overhead cost per unit
(W1) €27,000 ÷ 9,000 = €3

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(ii) **Marginal Costing**

	Month 1	M	Marks Allocated
	€	€	
Revenue	255,000	285,00	
Opening Inventory	0	11,500	1
Cost of Production	207,000	230,000	1 mar
Closing Inventory	11,500	23,000	1 mark
Variable Cost of Sales	195,500	218,500	1 mark
Contribution	59,500	66,500	
Fixed Cost	27,000	27,000	
Profit	32,500	39,500	1 mark

(c)

Reconciliation of Profit

Absorption Costing	34,000	41,000	
Marginal Costing	32,500	39,500	
Difference	1,500	1,500	
Being			
Opening Inventory @ €3 / unit	0	(1,500)	
Closing Inventory @ € 3 / unit	1,500	3,000	
	1,500	1,500	2 marks

(d)

The reason for the difference in profit is due to the difference in the valuation of inventory.
For example in month 1 the difference is €1,500 (€34,000 in absorption v €32,500 in marginal) **2 marks**
This is due to the fact that in absorption €1,500 worth of the fixed overhead is not written off but instead is carried forward to Month 2. This does not happen in marginal costing as fixed overheads are not included in inventory valuation.

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Marks Allocated

Solution 2:

(a)

(i)

	€	
Sales Revenue	9,600	
-Variable Cost	6,400	1
Contribution	3,200	1 mark

(ii)

	€		
Selling Price	2.40	(€9,600 ÷ 4,000)	1 mark
-Variable Cost	1.60	(€6,400 ÷ 4,000)	
CPU	0.80		1 mark

Or

$\frac{\text{Total Contribution}}{\text{Total Units}} = \frac{€\,3{,}200}{4{,}000\text{ unit}} = €\,0.80 =$ contribution per unit

(iii)

C.P.U. / SP X 100 — 1 mark

€0.80 / €2.40 X 100 = 33.33% — 1 mark

(iv)

$\frac{\text{Fixed Cost}}{\text{CPU}} \quad \frac{€2{,}720}{€0.80} = 3{,}400\text{ units}$ — 1 mark, 1 mark

(v)

Expected Sales (units)	4,000	
BEP Sales (units)	3,400	
Margin of Safety (units)	600	1 mark
Margin of Safety %	15%	1 mark

(vi)

$\frac{\text{Fixed Costs + Target Profit}}{\text{C.P.U.}}$ — 1 mark

$\frac{(€2{,}720 + €1{,}440)}{€0.8} = 5{,}200\text{ units}$ — 1 mark

Working 1

	Variable	**Fixed**
	€	
Direct Material	4,000	
Direct Labour	400	560
Production Overhead	1,440	2,160
Selling Overhead	560	0
	6,400	2,720

Marks
llocated

g:

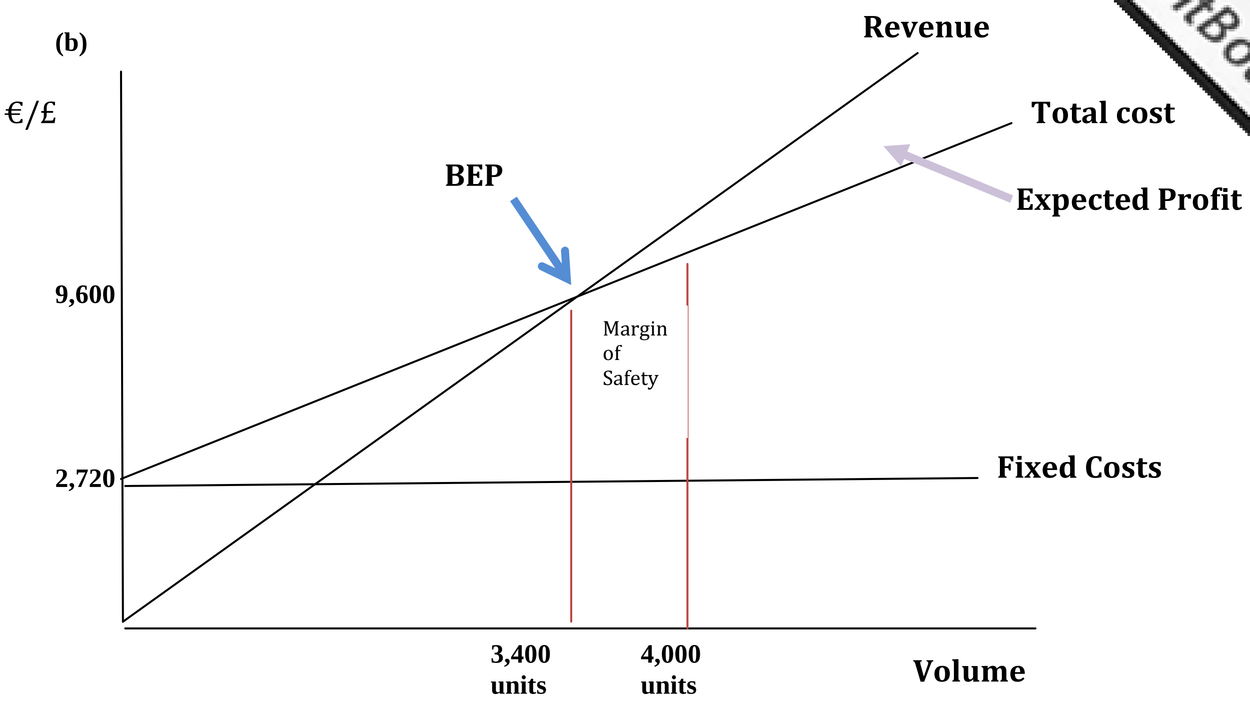
F

TC:

Identifyin

BEP: 1 mark
MOS: 1 mark
Exp Profit: 1 mark

(b)



(c)

Any two reasonable factors x 1 mark each

Factors that would need to be considered before deciding to make or buy the packaging:

1) The reliability of the supplier in terms of delivery time.

2) Quality issues relating to the quality of the suppliers product.

3) The price quoted by the supplier and the risk of the supplier increasing the price of its product.

4) The benefit that the use of a supplier for packaging might bring in terms of being able to concentrate on core competencies.

(other relevant factors would be acceptable)

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Solution Question 3

Marks llocated

(a)

Standard Profit

	€	
Selling Price	130	
Direct Material (6kg x €6 per kg)	36	**1 mark**
Direct Labour (6hrs x €8 per hr)	48	**1 mark**
Overhead (W1) (6hr x €2.50 per hr)	15	**1 mark**
Standard cost	99	
Standard Profit	31	**1 mark**

Working 1

O.A.R. = €150,000 ÷ 60,000 L.H.
= €2.50 per hour

(b)

	€		
€1,536,000 – (12,000 x €130)	= 24,000	Adv	**1 ¼ Mark**
(12,000 – 10,000) x €31	= 62,000	Fav	**1 ¼ Mark**
€432,000 – (90,000 x €6)	= 108,000	Fav	**1 ¼ Mark**
(90,000 – 72,000) x €6	= 108,000	Adv	**1 ¼ Mark**
€631,800 – (81,000 x €8)	= 16,200	Fav	**1 ¼ Mark**
(81,000 – 72,000) x €8	= 72,000	Adv	**1 ¼ Mark**
€174,000 - €150,000	= 24,000	Adv	**1 ¼ Mark**
(12,000 – 10,000) x €15	= 30,000	Fav	**1 ¼ Mark**

Calculation of Actual Profit

Sales		€ 1,536,000
Direct materials	€ 432,000	
Direct labour	€ 631,800	
Overheads	€ 174,000	€ 1,237,800
Profit		€ 298,200

(c) Reconciliation Statement

	€		€		
					1 mark
Budgeted Profit			310,000		
(10,000 x €31)					
Sales Volume Variance			62,000	Fav	
Standard Profit			372,000		
Sales Price	24,000	Adv			
Material Price	108,000	Fav			
Material Usage	108,000	Adv			
Labour Rate	16,200	Fav			
Labour Efficiency	72,000	Adv			
Fixed Overhead Expenditure	24,000	Adv			
Fixed Overhead Volume	30,000	Fav			
			73,800	Adv	**2 marks**
Actual Profit			298,000		**2 marks**

(other reasonable layout accepted)

Format: 1 mark

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Marks Allocated

Solution 4:

(a) All the costs faced by companies can be broken into two main categories: fixed costs and variable costs.

Fixed costs are costs that are independent of output. These remain constant throughout a relevant range. An example of a fixed cost would be rent.

Variable costs are costs that vary with output. As the activity level varies so would the variable cost. Material cost or sales commission would be examples of variable costs.

4 m
(2 ma
per cost
definition/
example)

(b) Normal costs are the normal or regular costs which are incurred in the normal conditions during the normal operations of the organization. They are the sum of actual direct materials cost, actual labour cost and other direct expense. Example: repairs, maintenance, salaries paid to employees.

Abnormal costs are the costs which are unusual or irregular and which are not incurred due to abnormal situations of the operations or productions. Example: destruction due to fire, shut down of machinery, lock outs, etc.

4 marks
(2 marks
per cost
definition/
example)

(c) Payroll Accounting is the computation of the gross pay for each employee and calculation of payments to be made to employees, government, pension funds, etc.

Labour Cost Accounting is the allocation of labour costs to jobs, overhead account and capital accounts

4 marks
(2 marks
per cost
definition/
example)

(d) FIFO and LIFO methods are accounting techniques used in managing inventory. They show the amount of money a company has tied up within inventory of produced goods, raw materials, parts, components, or feed stocks.

FIFO stands for *first-in, first-out*, meaning that the oldest inventory items are recorded as sold first but do not necessarily mean that the exact oldest physical object has been tracked and sold.

LIFO stands for *last-in, first-out*, meaning that the most recently produced items are recorded as sold first.

4 marks
(2 marks
per cost
definition/
example)

(e) A sunk cost is a cost incurred in the past – it cannot be reversed and as such it is irrelevant to any future decision. Examples of sunk costs would include the cost of research already carried out or the cost of materials previously purchased but only being used now.

An incremental cost is a cost that will increase as a consequence of a decision – that is it will be affected by the decision. Having to buy extra materials, employ extra staff as a consequence of a decision would all be incremental costs.

4 marks
(2 marks
per cost
definition/
example)

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Solution 5:

Marks llocated

(a)

Order Cost

$$\frac{56,250}{1,125} = 50 \text{ orders}$$

50 x €/£10 = €/£500

2 ma

Holding Cost

$$\frac{1,125}{2} = 562.5$$

562.5 x €/£0.50 = €/£281.25

€/£781.25

2 marks

(b)

$$\text{EOQ} = \sqrt{\frac{2 \times 10 \times 56,250}{0.50}}$$

= 1,500 units

3 marks
3 marks

This is the order quantity that minimises ordering and holding costs.

(c)

1 mark

	New	**Orig**	**Diff**
Ordering Cost	€	€	€
(56,250/1500) x €10	375.00	500.00	125.00
Holding Cost			
(1500/2) x €0.50	375.00	281.25	93.75
	750.00	781.25	31.25

1 mark
2 marks

(d) Existing Cost

	€
Material 56,250 x €3.50	196,875.00
Ordering	375.00
Holding	375.00
	197,625.00

Revised Cost

2 marks
1 mark
1 mark

Material €196,875 x 95%	187,031.25
Order (56,250 ÷5625) x €10	100.00
Holding (5625 ÷ 2) x €0.50	1,406.25
	188,537.50

2 marks

Therefore availing of the discount is financially worthwhile.
There is a saving of €9,087.50.

(Alternatively the student could look at the impact on each cost).

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Solution Question 6

arks
ocated

(a)

	October	**November**	**December**	
	€	€	€	
Sales	40,000	70,000	50,000	
Cost of Sales	24,000	42,000	30,000	**1 mar**
Opening Inventory	18,000	31,500	22,500	**1 mark**
Purchases	37,500	33,000	27,750	**2 marks**
Closing Inventory	31,500	22,500	20,250	
	24,000	42,000	30,000	**1 mark**

(b)

	October	**November**	**December**	**Total**	
	€	€	€	€	
Inflows					
Grant	20,000			20,000	**1 mark**
Receipts from sales (W2)	35,132	47,364	57,500	139,996	**3 marks**
Sale of van			3,000	3,000	**1 mark**
	55,132	47,364	60,500	162,996	
Outflows					
Equipment		4,500		4,500	**1 mark**
Operating expenses	10,800	16,900	12,600	40,300	**2 marks**
Purchases (W1)	30,450	35,250	30,375	96,075	**2 marks**
	41,250	56,650	42,975	140,875	
Net Cashflow	13,882	(9,286)	17,525	22,121	
Opening balance	8,000	21,882	12,596	8,000	
Closing balance	21,882	12,596	30,121	30,121	**2 marks**

Workings

(W1) Payment for Purchases

	October	**November**	**December**
	€	€	€
Purchases	37,500	33,000	27,750
Paid			
50% month following purchases	11,700	18,750	16,500
50% month of purchase	18,750	16,500	13,875
	30,450	35,250	30,375

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(W2) Receipts from Revenue

arks
cated

	August	**September**	**October**	**November**	**Decem**
	€	€	€	€	€
Revenue	30,000	36,000	40,000	70,000	50,000
Receipts					
Cash (20%)			8,000	14,000	10,000
Credit (80% x 95%)					
15% same month			4,560	7,980	5,700
70% following month			19,152	21,280	37,240
15% 2 months later			3,420	4,104	4,560
			35,132	47,364	57,500

(c)

- A cash budget should be one component of a company's financial goals. Budgeting cash and tracking actual cash provides a way to monitor the company's financial operations and to make planning adjustments where necessary. A cash budget also helps everyone focus on company finances.
- By planning cash receipt and payments, a company can operate its business with less working capital. In addition, a cash budget indicates when surplus cash is available to make short-term investments. This improves the use of money.
- When cash is available, the purchasing manager can use it to negotiate purchasing discounts with vendors.
- If the company needs a loan, the lender will request information in order to assess the financial health of the company. The cash budget provides some of the information required..
- A cash budget helps you track expenses more closely.
- Repaying debt on time is critical in maintaining a good credit rating and maintaining good relationships with suppliers. A cash budget provides the person responsible for finances a means to ensure that bills are paid on time. If there is an anticipated shortfall, the financial manager will know he may have to borrow money in the short term.

Reasonable Benefits (Any 3 x 1 mark each)

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2nd Year Examination: August 2013

Management Accounting

Examiner's Report

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	66%	46%	55%	72%	32%	47%
Nos. Attempting	203	193	203	150	119	134

Statistical Analysis - Overall	
Pass Rate	64%
Average Mark	54%
Range of Marks	**Nos. of Students**
0-39	29
40-49	45
50-59	57
60-69	44
70 and over	29
Total No. Sitting Exam	**204**
Total Absent	48
Total Approved Absent	11
Total No. Applied for Exam	263

General Comment:

This paper was divided into two sections A and B each consisting of three questions. All three questions in section A were compulsory and candidates had a choice of two out of three questions from section B. All of the questions carried 20 marks each. Questions 1, 2, 3, 5 and 6 were mainly computational with some narrative parts whilst question 4 was narrative.
In section B question 4 proved very popular with candidates whilst question 5 proved unpopular.

The paper examined five areas of the syllabus. All of the five areas examined are key elements of the syllabus and given the depth of their coverage in the study text, past exam papers and sample papers should not have posed any difficulty. It is very important that candidates practice questions from those useful resources.

The rote learning that was evident in the May 2013 scripts was not as evident in this paper.
This is very positive and indicates progress because it is important that candidates understand the costing concepts involved within the areas of the syllabus and not just learn their content.

Questions from past exam papers and sample papers will not be replicated for my exam. I wish to promote an understanding of the concepts and divergent thinking rather than rote learning.

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There were many very well presented scripts but there still remains an issue with the prese yout of scripts, particularly in relation to handwriting and labeling of questions.

Question 1

This question was compulsory and required candidates to be familiar with absorption and marginal costing principles. Candidates were required to prepare a profit statement under each of the basis, reconcile the difference in the resulting profit figures and provide an explanation for this difference.

This question was generally well answered with many students understanding the principles and having the ability to differentiate and reconcile the profit differences between the two principles.

However in some cases layout was careless. Many students used the sales units rather than production units and ignored the fact that there was opening and closing inventory.

Whilst many calculated the differences between the two principles they were unable to actually explain why the difference arose.

Question 2

This question was compulsory and examined the principles of breakeven analysis. Although a well answered question very few candidates constructed the breakeven chart as required by part (b) of the question.

It was clear that those that did attempt it were unable to construct a graph and fill in the elements required.

Some candidates constructed the graph without labeling the X and Y axis and those candidates did not earn any marks.

Part (a) of the question was divided into six parts and each part required a formula. I recommend writing down the formula required before the numbers are inserted. Candidates will gain marks for recognizing the formula required.

Many candidates were putting total costs as the numerator and cost per unit as the denominator and vice versa. (not comparing like with like)

Those students earned some marks for being familiar with the concept but lost marks for this approach.

Question 3

This question was compulsory and tested the student's ability to prepare a standard cost card, calculate variances and provide a reconciliation between budgeted and actual profit.

Although generally well answered many candidates got the sales volume, material usage and labour efficiency wrong.

Very few candidates calculated the fixed overhead volume variance correctly.

Part (c) of the question required candidates to reconcile budgeted profit and actual profit by means of an operating statement.

This part of the question was badly answered with many candidates unable to reconcile the difference using the variances they had calculated in part (b).

Question 4

This was a theory question that examined the difference between certain management accounting terms.

This was the most popular question in section B of the paper with most candidates scored very highly.

However, whilst some candidates were fully able to explain the differences they did not provide examples as required.

Those candidates lost marks as a result. It is important to carefully read the requirements of each question.

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Question 5

This question examined the candidates knowledge of the ratios used in the management of inventory levels.

This was the least popular question in section B of the paper.

The few candidates that did attempt this question did not score highly. Most candidates were not familiar with the Economic Order Quantity and the calculation thereof.

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Question 6

This question examined the area of budgeting. It required candidates to calculate the purchases figure, prepare a budget for three months and outline three benefits of preparing a cash budget.
Generally this question was well answered. The calculation of the cash flows from sales and purchases proved the most difficult. However in some cases the layout of the question was poor with candidates not differentiating between cash inflows and cash outflows.
It was surprising the number of candidates that included depreciation as a cash flow.