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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE PROGRAMME

YEAR I SEMESTER II (INTAKE V – GROUP A)

END SEMESTER EXAMINATION – JULY 2016

AFM 10430 Intermediate Management Accounting

Date	:	21st July 2016
Time	:	9.00 a.m. – 12.00 p.m.
Duration	:	Three (03) hours

Instructions to Candidates:

- Answer **ALL** questions.
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Formula Sheet is provided.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Question No. 01

i. Nimal has recently graduated from a Business School and joined the family business as a Management Accountant. At the first management meeting with production, marketing and human resource managers, a great deal of time was spent in discussing the unit cost of company products. What kinds of decisions can be taken by the functional managers by using the unit cost information?

(05 Marks)

ii. The accountants at Pink Perfumery decided to increase the price of a perfume called Rose from Rs. 600 per bottle to Rs. 700. Pink Perfumery's Management Accountant expects that this price change will reduce the volume of sales by 20 percent. Current sales are 50,000 bottles per month and total variable costs of sales quantity is Rs. 20 million.

Required:

a. Total contribution per month after this price change.
b. How certain can the accountant be, that the volume will decline by 20 percent if the selling price increases to Rs.700? What effect does this uncertainty have on the accountant's decision to increase the selling price?

(10 Marks)

iii. Win Lanka is a national hotel group that operates more than 10 hotels. The performance of the manager of each hotel is evaluated by using financial measures. Many of the hotel's managers are not happy about this practice. They believe that there can be conflict between good performance and achieving short - term profits. They are also unhappy that their profit reports include a share of Head Office costs and other costs that they cannot control.

Required:

a. Explain why non - financial performance measures are important in the service sector.
b. Explain why, and how, non - controllable costs should be shown in the profit reports.

(10 Marks)

(Total 25 Marks)

Question No. 02

i. What are the strategies that can be taken to minimize the adverse effect of the following variances.
   - Labour efficiency variance
   - Material usage variance

(05 Marks)

ii. Sunshine Company makes a cologne called Smile. The standard cost for one bottle of Smile is as follows.

Manufacturing Cost Elements	**Standard**				
	Quantity		**Price Rs.**		**Cost Rs.**
Direct materials	6 grams	X	0.90	=	5.40
Direct labour	0.5 hrs	X	12.00	=	6.00
Manufacturing overhead	0.5 hrs	X	4.80	=	2.40

During the month, the following transactions occurred in manufacturing 10, 000 bottles of Smile.

- 58 000 grams of materials were purchased at Rs. 1.00 per gram.
- All the material purchased were used to produce the 10,000 bottles of Smile.
- 4,900 direct labor hours were worked at a total labor cost of Rs. 56,350.
- Variable manufacturing overhead incurred was Rs. 15,000 and fixed overhead incurred was Rs. 10,400.

The manufacturing overhead rate of Rs. 4.80 is based on a normal capacity of 5,200 direct labor hours. The total budget at this capacity is Rs. 10,400 fixed and Rs. 14,500 variable.

Required:

a. Material price variance
b. Material usage variance
c. Labour rate variance
d. Labour efficiency variance

e. Variable overhead expenditure variance
f. Fixed overhead expenditure variance
g. Total cost variance

(20 Marks)

(Total 25 Marks)

<u>Question No. 03</u>

i. How do divisional managers use budgeting as a controlling technique?

(05 Marks)

ii. Discuss whether and how functional managers can be motivated by getting them involved in setting functional budgets

(05 Marks)

iii. In July 2016, the budget committee of Kandy Stores assembled the following data.

- Expected sales: August Rs. 550,000, September Rs. 600,000, October 750,000.
- Cost of goods sold is expected to be 6% of sales.
- Desired ending merchandise inventory is 40% of the following (next) months cost of goods sold.
- Total operating cost is estimated as 10% of sales value plus Rs 100,000.

Required:

a. Material purchase budget for the month of September.
b. Budgeted income statement for the month of September

(05 Marks)

iv. Galle Store has prepared the following summary from its functional budgets for three months ending on March 31, 2017.

	Rs.'000	Rs.'000
Sales (100,000 units)		1,500
Opening inventory (zero units)	nil	
Production costs (115,000 units)		
Direct materials	460	
Direct labor	575	
Variable overhead	115	
Fixed overhead	230	
	1,380	
Closing inventory (15,000 units)	(180)	
Cost of Sales		1,200
Gross Profit		300
Other overhead costs		(200)
Net Profit before tax		100

The Directors of the company have now met to review the above statement. They have decided to revise the budget as follows:

- Due to competition, reduce the selling price by Rs.2 per unit and with the reduction in selling price, the demand for the product will increase to 125,000 units.
- Increase some of the unit production costs: direct labour by 5% and variable overhead by 2%. No change is expected in any other costs.
- Increase production to 150,000 units.

Required:

Re-arrange the budgeted Income Statement according to the marginal costing method for the three months ending on March 31, 2017 considering the changes proposed by the Directors of the company.

(10 Marks)

(Total 25 Marks)

Question No. 04

i. Why do managers wish to apply pay back method instead of the IRR method to evaluate long term capital projects?

(05 Marks)

ii. Investigations by the team of Consultants have revealed that at the end of 2016 the Managing Director of the Western Division rejected the opportunity to lease a new building and equipment to set up a new fitness club at a total cost of Rs. 5 million for five years. If they go for this business new fitness equipment are to be introduced costing Rs. 3 million.

The forecast financial information for this proposed club is as follows:

	Rs.'000	
Revenue	6,750	
Staff costs	3,710	
Other operating costs	1,600	(including depreciation of the equipment)
Operating profit before tax	1,440	

Tax at a rate of 30% is payable on the same year.
It is company's policy that investments of this type should be appraised over five years using the Net Present Value (NPV) method.

Required:

a. Net Present Value of this investment assuming cost of funds to be 12%.

b. State two factors that are to be considered before finalizing the decision.

(10 Marks)

iii. Nimal bought a car one year ago for Rs. 4,000,000. Now he wants to obtain the license to introduce this car for hiring purpose. Hiring car licenses are limited in supply and, hence, cost a great deal. Nimal finds a license for sale at Rs. 500,000. A radio and the meter that should be fitted to the car will cost Rs. 100,000. He decides to drive his car himself.

He thinks he can earn Rs. 1,200,000 each year after all cash costs are paid. After five years he expects to sell the license and the car for Rs 400,000 and Rs 2,000,000 respectively.

Required:

If Nimal could earn 8% elsewhere on his funds, what is the NPV for the project?

(10 Marks)

(Total 25 Marks)

Formula Sheet

The following variances are reported for both variable and absorption costing systems:

Materials and labour

1	Material price variance	=	(standard price per unit of material – actual price) × quantity of materials purchased
2	Material usage variance	=	(standard quantity of materials for actual production – actual quantity used) × standard price per unit
3	Total materials cost variance	=	(actual production × standard material cost per unit of production) – actual materials cost
4	Wage rate variance	=	(standard wage rate per hour – actual wage rate) × actual labour hours worked
5	Labour efficiency variance	=	(standard quantity of labour hours for actual production – actual labour hours) × standard wage rate
6	Total labour cost variance	=	(actual production × standard labour cost per unit of production) – actual labour cost

Fixed production overhead

7	Fixed overhead expenditure	=	budgeted fixed overheads – actual fixed overheads

Variable production overhead

8	Variable overhead expenditure variance	=	(budgeted variable overheads for actual input volume – actual variable overhead cost)
9	Variable overhead efficiency variance	=	(standard quantity of input hours for actual production – actual input hours) × variable overhead rate
10	Total variable overhead variance	=	(actual production × standard variable overhead rate per unit) – actual variable overhead cost

Sales margins

11	Sales margin price variance	=	(actual unit contribution margin* – standard unit contribution margin) × actual sales volume

(*Contribution margins are used with a variable standard costing system whereas profit margins are used with an absorption costing system. With both systems, actual margins are calculated by deducting *standard* costs from actual selling price.)

12	Sales margin	=	(actual sales volume – budgeted sales volume) ×
14	Fixed overhead volume variance	=	(actual production – budgeted production) × standard fixed overhead rate
15	Volume efficiency variance	=	(standard quantity of input hours for actual production – actual input hours) × standard fixed overhead rate
16	Volume capacity variance	=	(actual hours of input – budgeted hours of input) × standard fixed overhead rate
17	Total fixed overhead variance	=	(actual production × standard fixed overhead rate per unit) – actual fixed overhead cost