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

YEAR III SEMESTER II – INTAKE II (GROUP A)
END SEMESTER EXAMINATION – JANUARY 2017

AFM 31130 Strategic Management Accounting

Date	:	16th January 2017
Time	:	5.30 p.m. - 8.30 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.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Question No. 01

A. Explain the consequences of introducing transfer pricing to be based on the full cost of goods transferred plus a mark-up between two of the companies Lanka Ltd. and Mahaweli Ltd. which are in the Ceylon group as given in the following scenarios;

i. Lanka Ltd. has spare production capacity which could be used to manufacture 25,000 units of a component each month. The variable cost of production would be Rs. 25 per unit, and Lanka Ltd. estimates that the fixed cost associated with this production capacity will amount to Rs. 2 Mn per month.

(05 Marks)

ii. By using one unit of the component produced by Lanka Ltd. and incurring additional variable costs of Rs. 50 per unit, Mahaweli Ltd. could manufacture a product which it could sell for Rs. 300 per unit. Mahaweli Ltd. has plenty of spare production capacity.

(05 Marks)

iii. Lanka Ltd. argues that the transfer price of components sold to other companies within the Group should be calculated as full cost of production plus a 40% mark-up, which is the formula applied in determining selling prices to external customers.

(05 Marks)

B. Identify two other transfer pricing rules that will be suitable for use by the Ceylon Group Ltd.

(05 Marks)

(Total 20 Marks)

Question No. 02

PQ Ltd. is a divisionalised company. Decision on bonuses and promotions for Divisional Managers are at the discretion of the company's Directors, but are significantly influenced by each division's Return on Investment (ROI). For purposes of ROI calculations, fixed assets are measured at their net book value at the end of the financial year.

The following forecasts are available for the company's three divisions for the year ended on 31st December 2017

	Sales Rs Mn	**Net profit Rs. Mn**	**Capital as at 31st December Rs. Mn**
Division P	30	10	100
Division Q	50	20	200

After the above forecasts were prepared, one possible extra project was identified for each division. These projects would commence on 1st January 2017, and each Divisional Manager must decide by that date as to whether or not to accept his or her division's extra project. Details of these possible extra projects (which would continue for several years if accepted) are as follows:

Division P could increase its market share. This would result in extra sales of Rs. 10 million in 2017 and Rs. 15 million in each subsequent year. The profit margin on sales would be 25%. The only additional investment required would be an increase of Rs. 25 million in the division's working capital for the duration of the project.

Division Q could invest Rs. 10 million in a new delivery vehicle, which would be depreciated at a rate of 20% per annum on straight-line method. Annual sales would increase by Rs. 20 million, and the profit margin on sales would be 30% before depreciation. An additional working capital investment of Rs 20 million would also be required.

Required:

i. For 2017, calculate the ROI for both divisions, and for PQ Ltd. as a whole, assuming that the extra projects are not accepted.

(09 Marks)

ii. Calculate the ROI of each extra project for 2017.

(06 Marks)

iii. Explain whether each Divisional Manager is likely to accept his proposed extra project and what decision would be in the best interest of the company's shareholders in each case

(05 Marks)

(Total 20 Marks)

Question No. 03

i. Explain the 'Balanced Score Card' (BSC) approach to measuring performance of a finance company.

(10 Marks)

ii. Explain 'continuous improvement' ('Kaizen') as a technique for improving relationships in procurement in a construction company.

(10 marks)

(Total 20 Marks)

Question No. 04

An executive from a manufacturing company does not have any knowledge on Strategic Management Accounting (SMA). He wishes to obtain advice from you on budgeting within a framework of SMA. Give your response to the followings;

i. Stage of budgeting process and its administration
ii. Multiple functions and conflicting roles of budgets
iii. Use of IT for budgeting
iv. Zero Based Budgeting and its advantages
v. Activity Based Budgeting and its advantages

(4 × 5= 20 Marks)

<u>Question No. 05</u>

A. Lanka Traders sell a standard handbag with a brand name. Company has fixed costs of Rs. 30 million per year plus variable costs of Rs 2,000 per bag. Each bag is sold for Rs 3,000.

Required

i. Compute the number of handbags to be sold annually to breakeven.

(02 Marks)

ii. Compute the number of handbags to be sold to earn an operating profit of Rs 10 million

(02 Marks)

iii. The company is considering an expansion that will increase fixed costs by 20% and reduce variable costs by Rs 200 per bag. Compute the new breakeven point in units and in rupees. Should Lanka Traders undertake the expansion. Justify

(03 Marks)

iv. State 3 qualitative factors that should be considered by the company before finalise the decision to expand

(03 Marks)

B. Jaffna Traders has three product lines of belts, A, B, and C, with contribution margins of Rs 360, Rs. 240, and Rs 120 respectively. The marketing manager forecasts sales of 200,000 units in the coming month, consisting of 20,000 units of A, 100,000 units of B, and 80,000 units of C. The company's fixed cost for the period is Rs. 36 million.

Required

i. Compute the company's breakeven point in units, assuming that the given revenue mix is maintained

(02 Marks)

ii. Compute the total contribution when 200,000 units are sold, assuming that the given products mix is maintained

(04 Marks)

iii. Prepare an income statement if 20,000 units of A, 80,000 units of B and 100,000 units of C are sold. Compute the breakeven point for the revise product mix

(04 Marks)

(Total 20 Marks)