

## Examiner's Report

### AA3 EXAMINATION - JANUARY 2016

### **(AA32) MANAGEMENT ACCOUNTING AND FINANCE**

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#### **OVERVIEW:**

This paper has three sections covering 100 marks,

1. Section **A** includes four compulsory questions for 20 marks
2. Section **B** includes three compulsory questions for 30 marks.
3. Section **C** includes two compulsory questions for 50 marks.

#### **General Comments:**

Candidates' performance for this paper was at a low level. Majority of the candidates have not scored fairly good marks for this paper.

**Section A** questions are similar to the examples available in the study pack. But candidates' performance was unsatisfactory.

Candidates' performance in **Section B** too found to be unsatisfactory despite the similar questions have been shown as examples in the study pack.

In **Section C** candidates obtained good marks for question No.8.

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#### **Question No. 01**

This question tested the retirement schemes available in Sri Lanka and factors to be evaluated when selecting a suitable retirement plan covering 5marks.

#### **Performance:**

Overall performance for this question was not satisfactory. Candidates' performance for **Part (a)** was not satisfactory but the performance for part **(b)** was satisfactory.

#### **Common mistakes are:**

- Writing irrelevant answers such as Long/Short term retirement plans, Investment in stock market and Investing in fixed deposit as answers to part (a).

#### **Examiner suggestions:**

- Read the Self-study Text and other related materials such as business news in the newspapers and business magazines.

## Question No. 02

This question tested on the symptoms of overtrading condition in a business entity and inventory management strategies used by a modern entity.

### Performance:

Although this was a simple question based on theory, overall performance for this question was not satisfactory.

Answers for part **(a)** and part **(b)** were not satisfactory. Most of the candidates wrote incorrect answers to the part (a) while for part (b) only few candidates wrote ABC Analysis, Just in Time (JIT) procurement systems as correct answers.

### Common mistakes are:

- Writing vague and incomplete answers such as liquidity issues, stock pile up to part (a).
- Writing the method of stock issuing methods such as FIFO, LIFO and the Bin card systems as answers to part (b).

### Examiner suggestions:

- Practice past papers and read the Self-study Text.

## Question No. 03

This question tested on knowledge of computation of combined profit volume ratio based on the expected sales proportion and target profit.

### Performance:

Most of candidates could not score marks for this question. Majority of the candidates have obtained marks for the computation of the contribution of two products and for the estimated required total contribution. They could not compute the sales value per unit of A and sales value per unit of B according to the sales proportions. Accordingly they could not compute the combined Profit Volume ratio and assess the expected sales quantity of each product to be sold to achieve the target profit for the part (b).

### Possible Reasons:

- Lack of understanding the concept/theory.
- Lack of practice of questions in the study pack.

### Examiner suggestion:

- Practice similar type of questions available in the Self-study Text.
- Show your workings clearly.

## Question No. 04

This question tested decision tree and related computations.

### Performance:

The performance for this question was unsatisfactory. Lack of practice in drawing a decision tree was noticeable. It was observed that the symbols such as “□”, “○”, were not used and the branches of the decision tree were not named. The computation was incorrect due to not reading and understanding the question properly. Although candidates were required to assess whether the advertising campaign should be undertaken by the company, majority of the candidates have not stated the final decision in their answers.

### Examiner suggestion:

- Practice similar type of questions available in the Self-study Text and past question papers.
- Show your workings.

## SECTION B

## Question No. 05

This question tested on the knowledge of budgetary controls for four marks from part (a) and related computation on flexible budget for six marks from part (b).

### Performance:

For **part (a)** most of the candidates have obtained the four marks by stating the advantages of budgetary controls. But the **part (b)** was prepared by showing the budgeted and actual data without showing the flexible budget and the variance. The original budget for the budgeted units of 50,000 was not flexed to show the flexible units of 40,000 in the operating statement for comparison against actual sales quantity of 40,000 units.

### Common mistakes:

- Variance column was not shown in the operating statement.
- The budgeted figures were not flexed to show the flexible budget against actual data in the operating statement. Therefore most of the candidates have not obtained marks for this part except for the actual fixed cost of Rs.3.8 million due to saving of Rs.1.2 million.
- Profit figure was not arrived and shown in the operating statement.

## Question No. 06

This question tested the computations of Cost of Ordinary Share Capital, Cost of Preference Share Capital, Cost of Debt, overall Weighted Average Cost of Capital (WACC) for 08 marks and underlying assumptions in applying WACC as the discounting factor in investment appraisals for 02 marks.

**Performance:**

Candidates' performance to this question was very unsatisfactory and performance level was low.

The computations related to Cost of capital of Ordinary Share Capital, Preference Share Capital, Debt Capital, and overall WACC needs only substitution of figures to the formula. But candidates' performance was not satisfactory.

Only few candidates did the calculation of cost of ordinary share capital and answered well. Although some candidates have written the formula, they have not substituted the figures correctly or found weak in solving the formula arithmetically.

**Performance to the part (a):**

Cost of Ordinary Share Capital computation was incorrect which resulted in obtaining low marks for this part. This part tested calculating the cost of Ordinary Share Capital simply using the dividend growth model. However, most of the candidates did not use the "g" (growth rate). Further, solving the formula mathematically was found to be difficult for some candidates.

Certain candidates have Computed the Cost of Preference Share Capital incorrectly because they have not identified the market value of the preference share of Rs.280/-.

Marks allocated for Cost of Debt was not obtained by some candidates as a result of not identifying the interest rate of 15% correctly to the formula. Most of the candidates have failed to bring the tax component into the computation.

Some candidates have not even written WACC formula correctly and some were unable to substitute the figures correctly and solve it correctly.

**Performance to the part (b)** was also weak and majority of the candidates could not state the underlying assumptions when applying WACC as the discounting factor in investment appraisals correctly.

**Common mistakes are:**

- Not stating the + sign before the growth rate in the Cost of Equity formula correctly.
- Not applying the dividend growth % to the formula totally.
- Candidates do not know how to solve the formula and arrive at figures accurately. Even when they have written the formulae correctly. This is because they are weak in mathematics.

**Examiner suggestions:**

- Practice past papers since similar type of questions was repeatedly tested in every exam.
- Know the formulae correctly for cost of Equity, cost of debt, WACC.
- Be mindful about using (+) / (-) and the arithmetical accuracy.
- Have a sound knowledge regarding the theoretical aspects of Sources of Capital and Cost of Capital.

## Question No. 07

This question tested on investment appraisal and was comprised of.

- **Part (a)** tested on the calculation of Payback period, Net Present Value (NPV) and Profitability Index.
- **Part (b)** required to assess with reasons whether to go ahead with the proposal.

### Performance:

Overall performance was unsatisfactory and low marks were obtained for the answers.

### Performance Part (a):

Most of the candidates have not scored marks for the **part (a)**. The main reason was that they could not identify the investment of Rs.200 million in year 0 although the delivery and assembly of the machinery will take place in year 1. Further, it was stated the scrap value of the existing machinery to be sold after assembly of the new machinery which is in year 1. Candidates have not read the question properly, therefore scrap of Rs.25 million taken in year 0 and in some cases investment in new machinery was incorrectly taken in year 1. It was noticed that some candidates have taken the depreciation of Rs.40 million to cash flow of the proposal to identify the Pay Back and NPV which is incorrect.

### Performance Part (b):

Most of the candidates have given their decision based on NPV only. They have not mentioned about the Profitability Index in decision making.

### Common mistakes are:

- Incorrect signs were used for initial investment and for scrap value in the project calculation.
- Not considered the scrap value of the machine.
- Depreciation was taken as a cash outflow.

### Examiner suggestions:

- Careful in showing the cash out flows and inflows signs in project calculation (Cash outflows to be shown within brackets or as negative figures and cash inflows without brackets).
- Always show your additional workings and clearly state the assumptions if there is any.
- Practice past papers and other practice questions.

## SECTION C

### Question No. 08

This question was tested on Standard Costing and Variance Analysis.

#### **Performance:**

Candidates performance is very good except **part (f)** and **(g)** as majority of them have calculated the required variances correctly as per the applicable formulae.

#### **Common mistakes are:**

- Actual material cost per drum was not calculated. Instead they have calculated the actual material cost for 10,000 drums.
- In **part (f)** and **(g)** many candidates have not stated the possible causes for an adverse material usage variance and the importance of analyzing material variances into planning and operating elements correctly. Some candidates have provided unnecessarily detailed and irrelevant answers.
- Forgetting to show Adverse (A) / Favourable (F) in calculating variances.

#### **Examiner suggestions:**

- Practice past papers.
- Always show your workings.
- Improve the theoretical knowledge regarding the variances.

### Question No. 09

This question tested the knowledge on limiting factor decision making and make or buy decision based on relevant costing.

#### **Performance:**

Except for few candidates, overall performance was not satisfactory.

For **part (a)**, some candidates have just made an assumption that the Direct Labor hours was the limiting factor without showing any calculation.

For **part (b)** some candidates have failed to calculate contribution per limiting factor correctly. They have calculated the contribution per unit for each product correctly. But they have not calculated the labour time per unit required for each product accurately. As a result they have erroneously calculated the contribution per limiting factor. Some candidates have found difficulty in ranking the products after calculating contribution per limiting factor due to lack of practice and knowledge. Accordingly, **part (c) (i)** and **(ii)** were also incorrect.

**Part (d)** was not attempted by many candidates and overall performance was low. But a handful of candidates have answered for **part (d)** correctly.

**Part (B)** was attempted by many candidates and obtained average marks but very few number of candidates have obtained the full marks for this part. Most of the candidates assessed the calculations based on the total cost of in house production against cost of outside purchase which is incorrect. The assessment should be based on the variable cost and any avoidable cost. It was also observed that the candidates have performed only calculations and have not mentioned any decision in both part (a) and (b) even though the question has clearly states as “Assess whether you would change your advice”. It is worthwhile for candidates to read the question correctly while paying proper attention to action verbs.

It is essential to practice past papers, the practice questions in the study pack to understand the patterns and the formats of the questions. Candidates should be extra conscious in writing formulas, substituting figures for them and about the arithmetical accuracy. It is also required to show the workings pertain to the questions with clarity and state any related assumptions very clearly if there are any.

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**General points to be considered in developing the level of  
Understanding of candidates**

1. Studying well the full contents of the syllabus completely and develop a thorough understanding about the level of knowledge expected for the each unit or area.
2. Candidates should read the question carefully a several times and should show all the relevant workings related to the computations with clarity.
3. State the assumptions clearly if there are any assumptions involved in answering the questions.
4. Handwriting should be legible and the numbers of questions should be correctly written. Re-checking of question numbers etc. before handing over answer scripts is a must.
5. Following correctly the instructions given in the question paper.
6. Perusal of past question papers and suggested answers would help sharpening of knowledge, skills and experience. It is always advantageous because the similar patterns and the structures may repeat in the real examination papers.
7. Referring the study text is essential and practicing the examples of the study text is also vital.
8. Refer books, articles, magazines in relation to this subject and other reading materials related to the relevant subject areas.
9. Time Management is crucial in the examination. By looking at the marks allocated to the each question candidates can make an estimation of the time they require to spend in answering.
10. Appearing for the examination with a firm determination of passing the examination with due preparation.

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