

EXAMINER'S REPORT

FINAL EXAMINATION – JANUARY 2015

(59) Management Accounting and Business Finance

SECTION A

Management Accounting (75 marks)

Overview

This paper has two sections.

1. **Section A** covers the Management Accounting part for 75 marks and
2. **Section B** covers the Business Finance part for 25 marks.

General Comments

Candidates' performance for this paper is satisfactory. Majority of candidates scored fairly good marks for this paper specially for application and computation parts. But their performances regarding the theory parts of the questions were not that satisfactory. It was noted that most of the candidates had concentrated only on the calculation/computation parts and not on theory parts.

Question No. 01

This question tested the theoretical knowledge in identifying a Cost Center and a Cost Unit and a computation part on Overhead Apportionment, computation of Overhead Absorption rate and cost per unit of the given items. Further, knowledge on EOQ model has also been tested in this question.

Performance: Overall performance for this question was satisfactory.

Part A (a) answers were satisfactory but for part (b) answers were not that satisfactory. Most of the candidates were unable to explain what a cost unit is. Further, many candidates had not provided **examples** to both (a) and (b) of **part A**.

Part (B) answers were satisfactory but mistakes were noted in arithmetical additions/omissions in part (a). Part (b) had been computed correctly .But for part (c) some candidates computed the total costs of **BP** and **P** instead of computing per unit cost of **BP** and **P** separately. Further some candidates had not taken into account the overhead absorption rates in computing the total cost per unit of **BP** and **P** pens.

A very few candidates had computed the correct EOQ for the pair of shoes in part (C). Other candidates had just substituted the figures to the EOQ model without identifying the annual demand for shoes. For this part, it was required to calculate the EOQ for the pair of shoes in year 2015. Therefore, instead of considering annual demand, candidates had considered monthly demand for the calculation. Further, some candidates had considered the imported cost of Rs.650/- when computing the ordering cost per order and accordingly they had shown Rs.15,650/- which is incorrect as ordering cost per order.

Common mistakes:

- Not considering the annual demand for EOQ computation.
- Considering import cost as a part of ordering cost.
- Lack of knowledge regarding the components of Overhead Absorption Rate (OAR).

Examiner suggestions:

- Read questions carefully.

Question No. 02

This question required candidates to prepare the income statement using the absorption costing method and to calculate the cost and the selling price using the job costing method.

Performance for part A: Unsatisfactory. Most of the candidates had not correctly answered to part (A). Those who answered showed the sales amount and cost of selling and distribution overheads correctly in the Income statement and obtained marks only for those. They have not taken correctly the Production Overhead Absorption cost per unit into the calculation. Some of them had prepared the income statement using Marginal Costing basis. Some candidates had shown the budgeted Selling and Distribution expenses of Rs.550,000/- in the income statement. Further, they were unable to identify the over absorption cost and accordingly had not adjusted the over absorption cost in the income statement. Further candidates were unaware of how to calculate the production overhead absorption rate correctly. They have used actual production overhead cost to find the production overhead absorption rate which is incorrect.

Performance for part B: Answers to part (B) is fairly well compared to part (A). However, following mistakes were noted.

- Mistakes in calculating **overheads** for Dept A and Dept B.
- Not understanding the question properly, thereby preparing **job cost** and the **selling price for two departments**.
- Not calculating the **margin on cost**.

Examiner suggestions:

- Read question carefully.

Question No. 03

This question tested the knowledge of Process Costing. Candidates were required to prepare the production cost evaluation statement and the process II account based on it. From this question, the knowledge in computing equivalent units, cost per unit, abnormal gain, closing WIP and the output have been tested.

Performance: But most of candidates were unable to score good marks for this question. They were unable to calculate the equivalent unit of finished goods correctly. Only a very few candidates were able to obtain full marks. Further, most of the candidates have failed to apportion joint cost between joint products based on their sales value.

Possible Reasons: Equivalent units have been computed incorrectly as many candidates had not taken into account the abnormal gain of 130. Some have considered 5,400 as the completed units instead of 4,800 units. Majority showed the value of output of B and Y as 945,000 and 1,417,500 separately, by multiplying 2,100 and 2,700 units by Rs.450/- and Rs.525/- respectively.

Examiner suggestions:

- Read the question properly before attempt.
- Practice similar type of questions.
- Improve handwriting.
- Always show your workings.

Question No. 04

This question required candidates to state uses of cash budget, preparation of flexible budget and computation of given variances.

Performance:

Candidates have performed in a fairly good manner in these areas; however flexible budget was less prioritized by most of the candidates when compared to the variance analysis. It was a question where candidates could have scored easily. However, most of the candidates had identified that fact and answered really well. Overall performance for this question was satisfactory.

Common mistakes are:

- When showing variances, had not shown whether they are favourable or adverse.
- Calculation errors due to identification of (+) and (-) incorrectly when calculating actual selling price and actual labour rate.

Examiner suggestions

- Read the question carefully before attempt.

Question No. 05

It was required from this question to compute the contribution, c/s ratio, break even sales (in value) and Margin of safety. It has also tested the knowledge on limiting factor decisions with ranking when there is a limiting factor.

Performance:

Performance of the candidates was good. Because most of the candidates had scored fairly good marks for this question. Almost all of the candidates had performed well for the part (A). With regard to part (B), most of the candidates have performed well in calculating contribution per unit.

Possible reasons:

Some candidates had not understood what the limiting factor in part (B) is. Therefore they had computed the contribution per limiting factor incorrectly. Also with regards to part (A) - (d), most of the candidates had gone wrong with expected sales under expected profit. Without applying the relevant formula they have calculated the expected profit incorrectly.

Common mistakes are:

- Arithmetical errors.
- Not identifying the limiting factor.

Examiner suggestions:

- Always show your workings
- Improve your hand writing

SECTION B
Business Finance (25 marks)

Question No. 06

This question required candidates to compute the Cost of Ordinary Share Capital, Cost of Debenture and overall WACC on market value.

Performance: overall performance to this question was very unsatisfactory.

Part (a) - This question was very simple and needed only substitution of figures to the formula. Considerable number of candidates did the calculation of cost of equity capital correctly and scored well. Some others, although they wrote the formula correctly and substituted the figures correctly, have not arrived at the correct answer due to arithmetical inaccuracy.

Though this question required candidates to follow "Dividend valuation Method" some candidates have tried to follow "Dividend Growth Model" formula, and accordingly they had to stopped the question halfway due to unavailability of a figure to substitute for figure "g".

Part (b) - performance was very unsatisfactory. A very few candidates were able to get full marks for this part. Though this question specifically mentioned that the debenture is redeemable, some candidates have calculated the cost of debentures using the formula for irredeemable cost of debentures which was incorrect. As it was mentioned that the debentures are redeemable, it was required to use the IRR method to compute cost of debt. Though the value of debenture in the year "0" was Rs.115.20, most of the candidates have used Rs.100/- as the year "0" value which was incorrect. Therefore, it was required for the candidates to thoroughly understand the concept of "present value".

Even from the candidates who did the calculation under IRR method following mistakes were observed:

1. Interest income based on par value was incorrect.
2. The current value of the debt in year "o" was incorrect.
3. The redeemable value at year 3 was incorrect.
4. The IRR formula was incorrect.
5. Incorrect substitution of figures to IRR formula.

Part (c) - Performance was not satisfactory due to incorrect cost of debt computed in part (b) above. Considerable number of candidates had identified the market value of Ordinary Share Capital, Debentures and the total market value correctly. However they had gone wrong in arriving at correct weightages as well as the final answer.

Common mistakes:

- Not using + / - signs correctly.
- Applying the dividend growth % to the formula.
- Incorrect substitutions to formulae.
- Interest on debentures had been computed incorrectly. i.e. 14% interest had been computed on Market value of Rs. 115.20, instead of par value of Rs.100/-.
- Incorrect application of WACC formulae.

Examiner suggestions:

- Correct usage of +/- signs.
- Carefully substitute figures to formulae.

Question No. 07

This question comprised of four (4) parts.

- **Part (A)** theory question on the importance of investment appraisal.
- **Part (B)** theory question on the importance of discounted cash flow methods over non discounted cash flow methods.
- **Part (C)** required calculation of Payback period for given investments and recommendation on selection of best investment.
- **Part (D)** tested on the knowledge of computing of Net Present Value and the IRR method and recommendation on the selection of new machine and knowledge on (b) limitations of using IRR as an investment tool.

Performance: Overall performance was satisfactory.

Part (A) - Most of the candidates had not scored marks for this part due to not attempting this question at all. Those who attempted had given vague answers. It was noted that the candidates had no idea as to why businesses are conducting investment appraisals. Only a few candidates were able to give correct answers to this part.

Part (B) – much generalized answers were given and was able to obtained reasonable marks for this question.

Part (C) – Performance was fairly satisfactory. Though it was a very simple question, some have gone wrong in computing payback period of the given investments. Though it was possible to get answers to nearest months, few of them had given the answer to the nearest years.

Part (D) - Performance was satisfactory **but following were noted.**

- 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.
- It was noted that some candidates have arrived at figures for which the workings were not shown.
- Not familiar with the calculation of IRR.

Some candidates had no proper understanding in selecting the investment based on IRR. Hence most of them had given their decision based on NPV. Some candidates who have calculated correctly were unable to mention the decision and thereby lost marks.

Examiner suggestions

- Carefull in showing the cash out flows and inflows in project calculation (Cost to be shown within brackets and inflows without brackets).
- Always show your additional workings.

SOME TIPS TO SCORE MARKS IN THIS PAPER

- Read the question and the requirement carefully.
- Start each question on a new page.
- Answer theory parts well. You can easily score marks from each theory part.
- Always show your workings / notes to show how you arrived the number.

Eg: Q7 project evaluation

- Write neatly.

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