

INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

| SUBJECT | SESSION |
|--------------------------------|--|
| Cost and Management Accounting | Certificate in Accounting and Finance – Spring 2015 |

General:

The overall performance in this attempt was almost the same as in the last attempt. Most of the students fared badly in questions which required in-depth analysis of data. On the other hand, the questions requiring straightforward calculations were performed better. Question-wise comments are given below:

Question 1

According to the question, a company produced three types of products which were sold in packets. The candidates were required to calculate breakeven sales in rupees as well as in number of packets of the three products, assuming that ratio between sales quantities of the three products would be as per the projections.

The important thing to note was that 5 packets of C-Plus, 3 packets of I-Plus and 2 packets of V-Plus (since the sales ratio in terms of quantity was 5:3:2) represented a combination. Breakeven sales in rupees divided by sales value of this combination could have given the sales in number of combinations; and multiplying the number of combinations by 5, 3 and 2 could have given the number of packets of C-Plus, I-Plus and V-Plus respectively. Similarly, fixed cost divided by contribution margin on this combination could have given the number of packets to break even, as discussed above and the number of packets so arrived could have been used to arrive at the break-even sales in rupees.

Following common mistakes were noted:

- Fixed cost were to be calculated by multiplying fixed production overhead rate with planned production in packets and fixed selling and distribution overhead rate with projected sales quantities. But commonly students multiplied planned production quantity or projected sales quantity with sum of both the rates instead of their respective rates.
- Many students tried to compute the break even on individual product basis instead of the overall basis.
- Many students did not understand the treatment of commission. They either multiplied the net sales by 5% to arrive at the amount of commission or multiplied the net sales by 1.05. The correct method was to divide the net sale by 0.95 to arrive at the gross sales before commission. Many students ignored the commission altogether and computed the break even on the basis of net sales.

- Many students tried to solve the question by working out a weighted average. Though some of them were able to produce a correct answer but the method was too lengthy and took a lot of their time.

Question 2

It was a simple question requiring computation of net present value of a project. More than 60% students were able to secure passing marks in this question. Some of the common mistakes were as follows:

- First year sale was given. Next year's sale should have been calculated by applying increase in volume by 6% and increase in price by 5% separately i.e. by multiplying the previous year's sales by 1.06 and 1.05. Many students applied a combined increase of 11% which was incorrect.
- To find out cost of sale, the students used a number of different methods. The correct method was to divide sales by 1.25 or multiply sale by 0.80. However, many candidates computed it by multiplying sales by 0.75. Some of the students followed the correct method for the first year but thereafter they increased it by 5% each year i.e. took the effect of cost increase but ignored the volume increase.
- Majority of the candidates ignored the changes in working capital altogether. A number of candidates included the increase in working capital in their calculations but ignored the recovery thereof, at the end of the project.
- Many candidates could not compute the PV factor correctly.
- A number of candidates were unable to determine the IRR correctly as they had little idea of interpolation.

Question 3

This question tested the students on variances and marginal v/s absorption costing. It turned out to be the most poorly attempted question of this paper. There were four parts and performance in each part is discussed below:

- (a) The candidates were required to explain the under/over absorbed production overheads. Generally the response was poor. Most of the candidates gave incomplete answers.
- (b) It was quite surprising that very few students calculated spending variance and volume variance correctly. Many of them did not attempt this part altogether.
- (c) This part required preparation of budgeted profit and loss statement under marginal costing. The overall performance was again very poor. Very few students were able to calculate the opening and closing inventory correctly by excluding the impact of fixed costs from the value of inventory under absorption costing. Many students ignored this aspect altogether and took the value of inventory as given in the question which was based on absorption costing. Other common errors were as follows:
 - The fixed selling and administration expenses were ignored.

- Net contribution margin was not calculated. Instead, only net profit was calculated.
- (d) Since very few students were able to work out the profit under marginal costing correctly, this part requiring analysis of profit under marginal and absorption costing could not be performed. Some candidates gave general comments on the two methods and the difference between them, which were not required.

Question 4

This was a straightforward question on process accounting, requiring calculation of equivalent production units, cost of goods transferred and accounting entries in the cost accounting system. Majority of the students who attempted the question scored passing marks. However, working out correct normal loss and hence abnormal loss again proved difficult for many students. Further, many candidates followed the weighed average method instead of FIFO method. There were many students who did the first two parts correctly but were unable to pass journal entries, which is quite alarming. Failure to pass correct journal entries depict serious conceptual weakness. The students must try to overcome this weakness otherwise they would face serious problems in the remaining papers and also in their practical life.

Question 5

This question required evaluation of two proposals, one related to expansion of existing facility and the other related to installation of plant for further processing of the products which were being sold without further processing. All such questions are usually solved using the same approach i.e. by comparing the incremental revenues and incremental costs. However, majority of the students made a number of mistakes in the process, mostly because of lack of conceptual understanding and also because of their inability to grasp the overall situation presented in the question.

Common mistakes are discussed below:

- Majority of the students could not calculate incremental revenues and costs for the expansion option. Main reason thereof was that the candidates were unable to compute the existing plant capacity of 21261 hours by dividing the total variable conversion costs in December 14 by conversion costs per hour. Therefore, they were also unable to work out the increase in production and consequently the increase in revenues and costs due to expansion of existing facilities.
- Under the refining option, most candidates were able to determine the incremental contribution margin due to refining correctly. However, they were unable to calculate the total increase in contribution margin because of the same reasons, as discussed above i.e. because they could not determine the quantity that the plant would be able to refine.
- In case of expansion option, some students computed the enhanced production due to expansion for both products correctly but they determined the increase in contribution margin on the basis of one product only.

Question 6

In this question, the costs of producing a new product were given and the candidates were required to determine the percentage of discount that should be negotiated with the foreign supplier of raw material in order to earn the target profit. The question was quite straightforward and majority of the students performed well and many of them scored full marks as well.

The errors observed were as follows:

- A number of students were unable to determine the fixed and the variable overheads using the high-low method.
- According to the question, 6% of input quantity i.e. quantity before loss, was estimated to be lost during the process. Many students treated it as 6% of the quantity actually used after the incurrence of loss. There is a very fine difference between the two and the students should understand such issues with clarity.
- According to the question, 30 minutes in each shift were to be used for setting up the machines. Hence, the actual time available for production in an 8-hour shift was 7.5 hours. The labour cost pertaining to setting up time was ignored by many candidates.
- While determining the required amount of discount, many students ignored the impact of custom duty.

THE END