

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Cost and Management Accounting	Certificate in Accounting and Finance – Spring 2016

General:

The overall performance in this paper was good as the result was nearly 50%. Above average performances were witnessed in all the questions except questions 1 and 3.

Question wise comments are as under:

Question 1

This question required preparation of profit and loss account and cash flow statement. The overall response was poor as a number of mistakes were observed. Some of the common mistakes are discussed below:

- Majority of the students were unable to calculate sales revenue correctly. Most such students did not gross up the existing cash sales by adding back the discount and consequently ignored the discount in the calculation of budgeted sale also. Probably, they thought that both discounts would cancel each other, which was not the case.
- Many students applied 15% increase on existing sale instead of applying increase in sales volume and price separately. Similar errors were made in the calculation of other items as well.
- Impact of increase in prices was to be applied to budgeted fixed cost also. Many students ignored it altogether. Some of them applied the increase on all the expenses i.e. they did not exclude depreciation. Some of them separated the depreciation for the purpose of applying the price increase but forgot to add it back for calculating the final figure.
- Many students ignored the impact of price increase on raw material consumption, variable conversion cost and variable operating expenses.
- Most of the students failed to correctly compute the closing finished goods inventory which required breaking up the opening inventory into components i.e. raw material, fixed & variable conversion costs and depreciation and then applying the price increase on value of each component. Many students did not calculate it altogether whereas many of them took it as equal to opening finished goods stock.
- Though calculation of cash flow was quite straight forward, many students didn't attempt it altogether. Those who did attempt seemed to lack practice and made simple errors in the calculation of opening and closing balances of debtors, creditors and accrued expenses. Further, while adjusting the figures, they added the balances which should have been deducted and vice versa.
- Raw material consumed was used in the calculation of payments against purchases.
- Depreciation was not ignored while calculating payments for expenses.

Question 2

This was a theoretical question on the topic of option and tested the concepts of call option, put option and strike price. Most of the students seemed well prepared, especially in parts (a) and (b) and scored very high marks. The most common mistake was that they restricted the concept of option to share trading only. There was also some lack of clarity in many answers as to whether an option is just a right or carries an obligation also.

In part (c) the performance was average as many students did not seem to understand the concepts of “in the money” and “out the money”. Many candidates left it un-attempted also.

Question 3

This question required computation of budgeted and actual profits using marginal costing and reconciling them by using relevant variances. The overall performance was quite poor especially with regard to calculation of variances. The common mistakes were as follows:

- Many students computed the actual profit and budgeted profit to the extent of contribution margin only.
- Many students considered the closing inventory in computing the actual profit but ignored it in the calculation of budgeted profit.
- Many students used weighted average instead of FIFO method to compute material consumption.
- Most of the students made various types of errors while computing actual cost of labour and variable overheads.
- Sales volume variance could have been computed by multiplying the standard contribution margin with the difference between actual and standard sale quantity. However, most of the students multiplied the difference in quantity with the sale price.
- While computing material usage variance, most of the students compared the actual usage of material with the budgeted quantity without adjusting the budgeted quantity on the basis of actual units produced. Similar types of errors were observed in the computation of labour and overhead variances.
- Some of the students only stated the total variances e.g. total material variance was calculated which was not bifurcated into material rate variance and material usage variance.
- Some of the students stated the formulas for variances and did not provide any calculations.

Question 4

This question required calculation of IRR of a project and to assess whether it should be undertaken or not. It was one of the best attempted questions as 79% of the students were able to obtain passing marks.

However, some commonly observed errors are discussed below:

- Fair value of the plant was considered as an outflow.

- Amount payable on expiry of lease term was taken as an outflow at the end of year 2019 instead of 2018.
- Disposal price of Rs. 0.5 million was ignored.
- Some of the candidates could not compute the PV factor correctly.
- Some of the candidates were unable to determine the IRR correctly due to application of incorrect formula.
- Some students started inflows from December 2017 rather than December 2016.

Question 5

This question required allocation of departmental (production as well as service) overheads to the products and passing of necessary journal entries to record applied production overheads and under/over absorbed production overheads.

On an overall basis it was the best attempted question as more than 90% of the students secured passing marks. However, the response with regard to journal entries was very poor. Most of the students confused the recording of applied overheads with recording of actual overheads. Many students omitted it altogether whereas some of them prepared entries without amount.

Question 6

This question required calculation of equivalent production units under weighted average method and passing of journal entries to record the transactions through the entire process accounting system.

This question was also attempted well. However, the common mistakes were as follows:

- Most of the students failed to correctly compute the normal loss correctly. Most of them failed to realise that the opening work in process units were 40% complete and closing work in process units were 60% complete whereas inspection takes place when the units are 50% complete and hence normal loss of 5% had to be computed on opening units as well as units input during the period without deducting the closing units.
- Most of the students computed abnormal gain units at 100% whereas they should have been taken at 50% considering that inspection is conducted when the units are 50% complete.
- Some of the candidates included normal loss in the calculation of EPU whereas many candidates excluded abnormal gain from the calculation as well.
- Many students attempted to record journal entry for the opening WIP by crediting various types of accounts.
- Students who recorded abnormal gain failed to close the same in profit and loss account correctly. However, the same should have been closed by crediting the scrapped units at value of Rs.100 per unit being the notional sale value of abnormal gain units and the remaining balance should have been credited to profit and loss account.
- Many students did not recognise (journalise) the sale value of normal loss. Some of them credited it to P&L account instead of WIP account.
- Some of the students debited finished goods instead of debiting WIP – Process B.

Question 7

This question required calculation of bid price for a special order and tested the concept of relevant and irrelevant costs in decision making. Good performance was witnessed in this question also. Some of the common mistakes are described below:

- Original purchase price of Material B was used instead of the disposal price.
- Most of the students failed to recognise the saving of disposal cost that would be possible if Material C is used for this order. Some of them added the amount of savings instead of deducting it.
- Most of the students did not allocate any cost of skilled labour hours. They failed to recognise the fact that 1440 idle labour hours per month meant that only 720 idle hours can be utilised during the duration of the order which was 15 days.
- While computing variable overhead cost most of the students simply multiplied the labour hours with Rs.400 being the absorption overhead rate. However, the absorption rate should have been reduced by the fixed overhead portion thereof.
- A number of students included the feasibility costs in calculating the bid price for Zeta whereas it was a sunk cost.
- Majority of the students was unable to understand that 20% of selling price may be computed by taking 25% of the relevant costs.

Question 8

This question required calculation of breakeven sales in terms of amount of revenue as well as the quantity in a single product situation. Overall performance was good as most of the students were able to compute the fixed and the variable costs correctly. However, most of them were unable to correctly comprehend the treatment of sales commission. Some of them added it to variable cost to arrive at variable expenses of 62% of gross sales and thus arrived at a contribution margin of 38% of total sales. The contribution margin if computed on gross sales was 39.2% $[(100-2)*40\%]$ resulting in a contribution margin of 40% of net sales $(39.2/98*100)$ as was required in the question. Hence, the proper method to arrive at breakeven gross sales was to divide fixed expenses by 39.2% or to arrive at net sales (after commission) by dividing fixed expenses by 40% and then arriving at breakeven gross sales by dividing net sales by 98%.

Question 9

This question required the candidates to list down the internal and external benefits of sustainability reporting. The performance was at either extreme, i.e. those students (about 25% of the total) who had studied it secured full marks whereas the rest of them mostly scored zero or very low marks. Some of the students could not distinguish clearly between internal and external benefits.

THE END