

**INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**EXAMINERS' COMMENTS**

<b>SUBJECT</b>	<b>SESSION</b>
Cost and Management Accounting	Certificate in Accounting and Finance – Autumn 2018

**General:**

The overall performance in this attempt showed decline as passing ratio dropped to 38.8% as compared to 54.08% in the previous attempt. However, considering the previous history of this subject, the performance was satisfactory.

The performance suffered mainly on account of Questions 3 and 5. In question 3, 4% of the candidates secured full marks which showed that it was not difficult. The students seemed to suffer from lack of practice as in many cases they used lengthy methods where easier alternatives were available and also made errors because of lack of concentration rather than lack of understanding.

**Question-wise comments:**

**Question 1**

This question carrying 16 marks consisted of two parts. The main requirement of the question was to prepare budgeted income statement under marginal costing, for a manufacturer which produced two joint products along with a bye product; and one of the joint products was processed further and converted into a superior product.

The overall performance remained average as 37.7% of the candidates secured passing marks. The common errors were as follows:

- While computing joint cost of process I, proceeds from sale of by product ZEE were correctly deducted but proceeds from sale of normal loss were ignored.
- Normal production loss of 5% was ignored probably because the students failed to realise that output ratio as given in the question was based on quantities produced rather than input quantities.
- Joint costs were allocated on the basis of production quantities instead of their NRVs. Some students allocated joint cost on the basis of NRV per unit instead of total NRV of the produced units.
- Consolidated budgeted income statement was prepared instead of product wise income statement.
- Fixed portion of conversion cost was not excluded while calculating contribution margin for product XI-Plus.

Most of the students did not take part (b) seriously as it only consisted of two marks. Consequently, either they ignored it altogether or made simple calculation errors.

## **Question 2**

This question required computation of sales required for achieving the target profit and the production capacity utilisation required to achieve the targeted sales. 44.2% candidates secured passing marks in this question. However, only few could achieve high marks as the candidates made several mistakes.

The common mistakes are described below:

- Contribution margin required in next year was computed by considering the existing fixed cost only. Those who considered the increase in fixed cost applied such increase on the entire fixed cost whereas it was mentioned in the question that fixed costs other than depreciation would increase whereas depreciation would remain constant.
- While computing budgeted contribution margin of next year, target profit after tax was added to fixed costs instead of adding target profit before tax. Further, many students multiplied target profit after tax by 1.25 to arrive at the target profit before tax instead of dividing target profit after tax by 0.75 or 75%.
- Instead of computing the contribution margin ratio for the next year based on the given data, many candidates computed it on the basis of figures related to the latest year.
- Very few students were able to correctly calculate the amount of discount and made different types of mistakes.
- Distributor commission was computed on gross sales basis instead of net sales after discount.
- Capacity utilisation was computed by comparing the sales values instead of sales volume. In fact, very few students knew how the increase in sales volume was to be computed i.e. by excluding the impact of price increase from the sales value.

## **Question 3**

According to the scenario given in the question, a component (Beta) was being produced internally for use in various other products of the company, where labour was a limiting factor. The requirement was to decide whether to outsource the production of Beta and utilise the labour to produce product Zee.

Poor performance was noted in this question as majority of the students could not understand the requirement of the question and only 20% students were able to score passing marks. However, about 4% candidates secured full marks which showed that the question was not difficult.

The most common mistakes were as follows:

- Majority of the students tried to solve the question by computing and comparing the cost per unit of the two products, which was totally incorrect / illogical.
- Most of the students were unable to understand that 15,000 units of product Zee would be produced by utilising the labour hours which would become available as a result of outsourcing of Beta.
- Savings in fixed costs were taken as Rs. 17.56 million ( $18,000 \times 870 + 1,900,000$ ) instead of Rs. 1,900,000.

#### **Question 4**

This question on the concept of Economic Order Quantity was well answered and 53% candidates secured passing marks whereas about 5% candidates secured full marks. Performance in each part is discussed below:

#### **Question 4(a)**

The requirement in this part was to compute the economic order quantity in the given scenario. The common mistakes were as follows:

- Annual requirement was worked out without considering the quantity which is lost during storage. Many students computed the quantity lost as 5% of quantity used instead of 5% of quantity purchased.
- Ordering cost per order was computed on the basis of total cost of the purchase department instead of its variable cost only.
- Finance cost was ignored in the calculation of holding cost.

#### **Question 4(b)**

In this part, the requirement was to compare the costs if order size is equal to 48,000 units i.e. EOQ and when the order size is increased to 120,000 units to avail the discount. The common mistakes were as follows:

- In the above comparison, cost to be incurred when order size was 60,000 units was compared instead of EOQ.
- When the order size was 120,000 units, the cost of financing should have been reduced by 5% i.e. in line with the reduction in price. This was ignored.

#### **Question 4(c)**

This part required practical limitations of the EOQ model. The performance in this part was below average. Most of the students resorted to guesswork, whereas many students did not attempt this part.

#### **Question 5**

This question consisted of two parts. The overall performance was not satisfactory as only 26% candidates secured passing marks. However, performance in part (a) carrying 3 marks was good as most of the students were able to mention the advantages and disadvantages of financing a project through debt as compared to equity. Performance in part (b) was however quite poor as a number of mistakes were observed in most of the answers. The most common mistake was that the students did not realise that it was not mandatory for the company to purchase the new plant as the old plant was also working satisfactorily. Hence, they needed to compare the option to continue with the existing plant with the option to purchase the new plant by using incremental revenues and costs. Instead, they only tried to evaluate the purchase of new plant by taking the revenues and expenses associated with the new plant without considering the existing situation. Other common mistakes were as follows:

- IRR was not worked out and conclusion was drawn on the basis of net present value instead of IRR.
- Tax saving on loss of disposal of old plant was ignored.

### **Question 6**

This question required computation of relevant cost of production of a newly developed product and determination of the cost gap where required margin was 30%. The performance in this question remained satisfactory as 46% candidates secured passing marks. Some of the common errors were as follows:

- While determining whether the company should purchase and use raw material X or use material Y which was to be developed internally, only the material cost of producing material Y was considered, whereas labour and factory overheads associated with the production of Y were ignored.
- Since idle direct labour (14,000 hours) was already being paid at 50%, the relevant cost of their utilisation was only the additional amount that was to be paid. However, the additional 1,000 hours (15,000 – 14,000) should have been calculated at 40% above the normal rate. These aspects were not clearly understood and most of the students made various types of mistakes.
- Overheads were recorded for 1,000 hours only instead of 15,000 hours.
- Required margin was computed as 30% of cost instead of 30% of sale price.

### **Question 7**

This question on cash budgeting was well attempted and 51% candidates secured passing marks. However, many candidates made simple calculation errors which were not expected at this stage. Some of the common mistakes are described below:

- Collection from credit sales were taken from October instead of November.
- Payments for purchase of inventory were computed using cost of sales instead of purchases.
- Mark-up was computed as 10% per month instead of 10% per annum.

***THE END***