



Institute of Incorporated Public Accountants

Module 13:

**Advanced Management
Accounting**

Wednesday 27th. August 2014

2:00pm – 5:00pm

Instructions: Answer five questions
You must answer the three questions in
Section A

Answer any two questions in
Section B

All questions carry equal marks

Time Allowed: 3 Hours

Section A - Compulsory Answer all three questions

The following scenario relates to the first three questions.

Style Bags Ltd is a new company set up to manufacture life style handbags. The business is owned and managed by three recently returned immigrants. Mary, who worked with a big fashion house in New York, is in charge of design. Pat, who spent several years in the UK clothing industry, is in charge of production. Elizabeth, who worked in marketing in Australia, is in charge of marketing. Together they have pooled their accumulated savings to invest in the company. They have recruited a small number of employees to work on an hourly basis. The marketing manager has visited several big stores, with samples of their first collection of winter season handbags. The big stores have placed provisional orders, based on the proposed sales price for each type of hand bag as follows;

- Lux bag: A high quality leather bag in a range of colours and embroidered in detailed Celtic motifs. It features an inbuilt tracer chip that enables the bag to be located up to range of one kilometre.
Sales price €150.
- Q bag: High quality leather in just three types of colours but with some basic embroidery.
Sales price €140
- B bag: This is a basic handbag with the emphasis on functionality
Sales price €90.

The company had also recruited a part time accountant- Joe- to prepare some estimates. After some weeks Joe decided to accept a full time position with a UK company. This has created anxiety amongst the owners, as they were relying on Joe to produce finalised figures, before contracting with the big stores at the agreed sales prices. You have been recruited to review the information prepared by Joe, and compile total costs for each type of handbag. Joe's estimates are set out on the following pages.

Pat, the production manager, had just returned from a seminar on "costing for the non-accountant". The speaker at that seminar talked about the traditional method of allocating overheads, and an activity based costing approach. She is confused about the difference since the total overheads remain unchanged. Anyway since overheads are incurred regardless of production shouldn't they just concentrate on direct costs?

As fashion trends vary considerably from season to season it is policy to produce only for contracted sales, and avoid finished goods inventory.

Section A - Compulsory Answer all three questions

Information prepared by the former part-time accountant Joe

| | Lux bag | Q bag | B bag |
|--------------------------------------|----------------|--------------|--------------|
| Projected sales price per bag | €150.00 | €140.00 | €90.00 |
| Budgeted production and sale of bags | 400 | 700 | 900 |
| Leather and dyes per handbag | €60.00 | €50.00 | €30.00 |
| Direct Labour cost per bag | €45.00 | €30.00 | €15.00 |
| Labour hours per unit | 3 | 2 | 1 |
| Machine hours per unit | 5 | 3 | 2 |

Budgeted Overheads for the period under review

| | |
|--------------------------------------|----------------|
| Depreciation machine and other costs | €25,650 |
| Set up costs | €4,000 |
| Stores receiving | €5,400 |
| Quality Inspection | €15,000 |
| Embroidery and inks | €6,000 |
| Total Overheads | €56,050 |

Question 1

Required

(a) Compute the Profit or Loss for each type of handbag, where overheads are allocated to handbags applying the traditional overhead basis. **[10 marks]**

(b) Compare and contrast the traditional Total Absorption Costing approach for absorbing overheads with the Activity Based Costing approach. **[10 marks]**

Total [20 marks]

Section A - Compulsory Answer all three questions

Question 2

The former accountant had also compiled the following additional information

Additional information provided from the previous accountant's file.

| Overhead | Amount | Cost Driver |
|--------------------------------------|----------------|--------------------|
| Depreciation machine and other costs | €25,650 | Machine hours |
| Set up costs | €4,000 | Production runs |
| Stores receiving | €5,400 | Requisition raised |
| Quality Inspection | €15,000 | Production runs |
| Embroidery and inks | €6,000 | Labour hours |
| Total | €56,050 | |

The number of requisitions raised by stores for each type of handbag is budgeted at 25.

The number of handbags budgeted to be produced in any particular run is 20 units regardless of the type of handbag being produced.

Required

- (a) Using the additional information given above compute the Profit or Loss for each type of handbag, using an activity based costing approach.

[20 marks]

Section A - Compulsory Answer all three questions

Question 3

Elizabeth the marketing manager, has gone over the sales price estimates for each type of bag with you. In her negotiations with the big stores she noticed that there was a certain degree of flexibility in relation to sales price and volume for their luxury bag. All the stores showed the same pattern between volume and sales price. She wondered if they were selling the Lux bag at the optimum price. Set out below are a range of volumes and sales prices, that she feels could be obtained from any of the big stores.

| <u>Lux Bags</u> | <u>Sales Price</u> |
|------------------------|---------------------------|
| 200 | €240.00 |
| 240 | €222.00 |
| 280 | €204.00 |
| 320 | €186.00 |
| 360 | €168.00 |
| 400 | €150.00 |
| 440 | €132.00 |
| 480 | €114.00 |

Required

- (a) Compute the optimum sales price, sales quantity, and total contribution for the Lux handbag. It may be assumed that the direct labour and materials costs for the Lux handbag are the only variable costs.

[10 marks]

- (b) Comment on the appropriateness of the optimum sales price model, for determining the optimum sales price for Lux bags.

[10 marks]

[20 marks]

Section B- Compulsory Answer any two questions

Question 4

The board of Digital tech was reviewing a summary of its first year results

| | Budgeted | | Actual |
|----------------|-----------------|-------|---------------|
| Volumes | 12,000 U | 17% | 14,000U |
| Sales | €144,000 | (3%) | €140,000 |
| Costs | €93,000 | 17% | €109,185 |
| Profit | €51,000 | (40%) | €30,815 |

Chief executive

On examining the figures above the chief executive said -"I don't understand it. Sales volumes are up 17%, whilst sales revenues are down 3%, which is within the estimated error. Taking cost increases of 17% along with a fall in revenues of 3%, should only mean a fall in profits of 20% and not 40%. There must be something wrong with the accounts." You are the newly appointed IIPA company accountant replacing the outgoing accountant, who has retired and gone to live in Bermuda.

"Well can you explain this to us"- the chief executive said turning to you. You enquire if the retiring accountant left any other files. The chief executive hands you a file, whilst proposing to adjourn the meeting and reconvene the following Friday. At that meeting you will be expected to offer some explanations as to the change in profit.

The information contained in the file was as follows;

| | Actual | | Budget | |
|---------------------------|----------------|--|----------------|--|
| Sales Volumes | 14,000 u | | 12,000 u | |
| Selling price unit | €10.00 | | €12.00 | |
| Production volumes | 14,000 u | | 12,000 u | |
| Total Direct materials | 7,700 kg | | 6,000 kg | |
| price per kilogram | €5.80 | | €6.00 | |
| Total labour hours | 9,450 hours | | 9,000 hours | |
| Rate per hour | €4.50 per hour | | €4.00 per hour | |
| Fixed Production overhead | €22,000 | | €21,000 | |
| Market size | 45,000 u | | 36,000 u | |

Section B- Compulsory Answer any two questions

Question 4 –continued

Required

You are required to produce the following:

(a)

- (i) Sales price. [1 mark]
- (ii) Sales volume variance in terms of standard contribution. [2 marks]
- (iii) Material price and usage variance. [3 marks]
- (iv) Labour efficiency and rate variance. [3 marks]

(b) Analyse the sales volume variance between:

- (i) Market share. [2 marks]
- (ii) Market size. [2 marks]

(c) Reconcile the budgeted profit with actual net profit and comment thereon [7 marks]

Total [20 marks]

Question 5

(a) Set out the four perspectives of performance measurement that is incorporated in the Balance Score Card. [2 marks]

(b) Outline the difference between a lead measure and a lag measure. [2 marks]

(c) Select either a hotel or an airline, and for each perspective in relation to the example chosen set out

- (i) Two objectives.
- (ii) How those objective would be measured. [16 marks]

Total [20 marks]

Section B- Compulsory Answer any two questions

Question 6

(a) Explain the purpose of a cost quality report 4 marks

(b) Drury-Management & Cost Accounting- outlines four categories of cost that might be included in a cost quality report.

Required

List and discuss the four categories of cost.

16 marks

Total [20 marks]

END OF EXAMINATION