Institute of Incorporated Public Accountants

Module 13:

Advanced Management Accounting

Wednesday 30th May 2012

2pm – 5pm

Instructions:	**Answer five questions**
	You must answer the three questions in Section A
	Answer any two questions from Section B
	All questions carry equal marks

Time Allowed: 3 Hours

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Section A - Compulsory   Answer all questions

The following scenario relates to question 1, 2 and 3 and should be read before attempting the questions.

Handy Blend Limited is an Irish design and manufacturing company of hand held kitchen devices and tools. The philosophy of the company, since its establishment in 1978, is to design and produce high quality attractive tools at affordable prices. The origin of the company came about from the demise of a family engineering business that suffered badly due to the fallout of the oil crisis of 1976, and the subsequent Irish recession that saw Ireland with the highest unemployment rate in Europe.

The founders of the company, which included managers and employees, decided to use their engineering skills to develop a range of hand-held kitchen tools for sale primarily in the Irish and UK markets. The company has received a number of design awards for the quality of the design and functionality of their products over the past forty years. This in turn has led to significant growth in sales not only in their traditional markets but also across the European Union. Both revenues and profitability has also seen growth and the company expanded in terms of capital infrastructure with employees now numbering almost two hundred.

In recent years, in line with the Euro-zone and banking crises, Handy Blend Limited has seen a dramatic fall in profitability and liquidity while sales revenue has fallen but not to the same degree as the other financial indicators. Having faced and come through previous recessions the company is conscious of the need for sustainable profitability and liquidity to ensure survival. A number of development projects are now ready to come to market and the business plan developed for the next three years provides for sales growth as per the following figures.

	Year 1	Year 2	Year 3
Sales (units)	80,000	90,000	100,000
Production (units)	85,000	92,000	100,000

The plan allows for an average selling price of €100 per unit with an average variable cost of €60 per unit. The budgeted fixed production overhead absorption rate for the above plan was set at €30 per unit based on normal production levels of 80,000 units for the current year. Fixed non-production overheads are budgeted at €1,000,000 per annum. The company plan does not allow for any variances except for production volume variances.

At a recent management meeting the newly appointed management accountant expressed some concerns about how this plan may adversely affect the overall business. The managing director has asked that more detailed analysis be brought to next weeks meeting.

He also directed the management accountant to look at the pricing options for a newly designed product called the Handy Whisk that is ready to launch in the market as a joint venture with a Chinese manufacturing company. Contracts have been signed between Handy Blend Limited and the Chinese partner in relation to the joint venture. It is of strategic importance to Handy Blend as it is the first such launch with a partner. The figures for this project are not to be included in the business plan figures above, as they will be incorporated into the financial results by the financial accountant.

The management accountant has reviewed the available data and summarised the situation as follows:

Price	Demand (units)
€100	10,000
€110	9,000
€120	8,000

The manufacturing of the Handy Whisk will be carried out by the Chinese company who will supply the market ready product at €25 per unit and the sales end will be handled by Handy Blend. The variable selling costs are expected to be €10 per unit and total fixed costs (all sales and administration) for the joint venture entity are budgeted at €400,000 per annum. The Chinese partner has explicitly stated that they favour the maximisation of profits and want a price set for this to happen.

Handy Blend Limited’s sales director believes this is unrealistic as it does not reflect the market based competition of prices of similar products despite the innovative nature of the new product. She is also concerned having recently read newspaper articles about patent infringement by Chinese companies and is worried that if the Handy Whisk proves successful that Handy Blend Limited will be excluded by their new partner. She has prepared some figures if they were to manufacture and sell themselves. The variable production cost per unit would be €40 per unit plus fixed production overhead of €250,000. The variable selling cost would be halved and the other fixed costs would be reduced to €100,000. She recommends a price of €95 based on competition in the market place for similar products.

The managing director is unhappy with these concerns having been a prime mover in the setting up of the joint venture. He is prudent enough however to consider the suggestion.

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Section A: Answer all questions

Question 1

(a) Prepare an operating income statement for each of the three years for the company using an absorption method of accounting.

(8 Marks)

(b) Prepare an operating income statement for each of the three years for the company using a variable/marginal method of accounting.

(8 Marks)

(c) Prepare a reconciliation statement that reconciles the annual profit under each of the methods and explain why the difference occurred.

(4 Marks)
(Total 20 Marks)

Question 2

(a) Using the optimal pricing model calculate the optimal price for the Handy Whisk in order to maximise profits and state the profit at this price.

(10 Marks)

(b) Calculate the profit of the Handy Whisk based on the sales directors figures and recommend whether this course of action should be adopted. You may assume the price elasticity of demand as per part (a) is applicable.

(6 Marks)

(c) Advise what other pricing strategies the company should consider before the launch.

(4 Marks)
(Total 20 Marks)

Question 3

(a) Discuss how the use of strategic management accounting and modern business tools can help Handy Blend Limited survive the current difficulties and ensure that they can successfully deliver on the business plan, and advise what other improvements they could implement to ensure better profitability and liquidity.

(16Marks)

(b) The sales director's plan for the Handy Whisk project raises some ethical issues. Discuss what you consider these issues to be and advise as to what course of action you would take as management accountant.

(4 Marks)
(Total 20 Marks)

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Section B: Answer any two questions

Question 4

As the newly appointed management accountant within Zack Limited you have been reviewing the last monthly management report. The company produces and sells a single product and uses standard absorption costing. The report is presented below.

April 2012	Budget	Actual	Variance
Sales (Units)	5,000	6,000	1,000 F
Production (Units)	5,000	6,000	1,000 F
	€	€	€
Sales	500,000	588,000	88,000 F
Direct Materials	100,000	155,000	55,000 U
Direct Labour	100,000	118,800	18,800 U
Variable Production Overhead	50,000	50,500	500 U
Fixed Production Overhead	50,000	55,000	5,000 U
Fixed Non-production Overhead	100,000	115,000	15,000 U
Profit	100,000	93,700	6,300 U

There is no opening or closing inventory. The standard cost card for the single product is as follows:

		€ per unit
Selling Price		100.00
Direct material	5 kgs @ €4 per kg	20.00
Direct Labour	2 hours @ €10.00 per hour	20.00
Variable Production Overhead	2 hours @ €5.00 per hour	10.00
Fixed Production Overhead	Absorbed on a per unit basis	10.00

A review of the actual data has revealed that:

Total materials bought and used: 31,000 kgs
Total direct labour hours worked: 11,000 hours

It has also come to light that the market price of materials for the last three months has been €6 per kg.

Required:

(a) Explain the weaknesses with the current monthly management report, and recommend the changes you would implement in order to improve the reporting.

(4 Marks)

(b) Prepare a reconciliation of budgeted profits with actual profits showing all relevant variances.

(12 Marks)

(c) Prepare the operational variances for direct materials.

(4 Marks)
(Total 20 Marks)

Question 5

Gameshop Ltd had undertaken a major expansion programme throughout Ireland over the last ten years. The financial results over the last three years have been poor due to the economic recession and a move to on-line shopping. Management is reviewing the performance of the smaller stores. The most recent set of results for the Athlone store for the year just ended are as follows:

	€000
Revenue	5,000
Cost of sales	(2,800)
Gross profit	2,200
Selling and distribution expenses	(800)
Administration expenses	(1,300)
Operating Profit	100

The future viability of the store is in doubt due to the low net margin return. An auctioneer has valued the site at a net €1,000,000 if sold in the next six months.

The store manager has asked for your assistance in analysing the accounts to see if there is financial benefit in remaining open. Your investigation reveals that the store has been allocated group overhead amounting to 20% of the selling and distribution overheads and 20% of administration overheads and the balance of these costs are 50% variable and 50% fixed. Costs of sales are all variable costs. Further investigation by you indicates that with a little re-organisation that savings of 20% of annual fixed costs are achievable. This re-organisation would cost €100,000 payable up front to cover voluntary redundancy and payments for changes in work practices.

Required:

(a) Prepare a report to the financial director outlining whether the Athlone store should be closed and sold or allowed to continue to operate in its re-organised state. Your report should be supported by financial analysis and also by an explanation of how you expect your plan of re-organisation to be implemented.

(15 Marks)

(b) What other qualitative factors should be considered before making the decision on whether to close the store.

(5 Marks)

(Total 20 Marks)

Question Six

(a) Discuss how the application of relevant costing principles can lead to different decisions than the use of established financial accounting principles.

(10 Marks)

(b) The current economic downturn has seen many businesses implement cost reduction programmes. Describe the various types of 'crash' programmes of cost reduction a company may implement and the role of the management accountant in such programmes.

(10 Marks)

(Total 20 Marks)