

General Comments

Performance on this paper was an improvement on the previous examinations. This was especially due to better performance in both parts of question 1, the multiple-choice questions (1.1 to 1.10) and particularly the short-form questions (1.11 to 1.21). Question 1 overall gave candidates every opportunity for success in this paper but this was too often not achieved due to poor performance in question 2 and, especially, questions 3 or 4.

Generally, candidates attempted question 1 first (compulsory Section A) and were able to complete most parts. Performance in the multiple-choice questions, in the first part of the question, was on average good although a number of candidates surprisingly failed to attempt all ten questions.

In the second part of question 1 (1.11 to 1.21) most candidates attempted all of the short-form sub-questions, although a common omission was 1.21. This contrasts with the November 2005 examination when several of the short-form questions were frequently not attempted. Reasonable average marks were gained on nearly all of these questions in this examination. Candidates seemed generally to be more comfortable with the numerical questions where they were able to apply learned techniques. In dealing with the short narrative questions, candidates tended to score less well because they seemed to have a less than adequate understanding and did not construct good, clear and concise answers.

Improved performance was also achieved in question 2 (compulsory Section B) but from a fairly low base. Part (c), however, presented candidates with special problems and was frequently omitted. Narrative answers too often indicated a failure to read questions carefully and a failure to focus on the specifics of the scenario presented or the questions asked.

The choice from the two questions in Section C (questions 3 and 4) was usually made last. While some excellent answers were submitted for both questions, many candidates provided poor or incomplete answers and performance overall was not good. There was clear indication that most candidates found these questions more problematic, or they were running out of time because on many occasions the numerical part (a) was not attempted. This very much repeated the disappointing performance seen in this section of the paper in the two previous sittings.

Candidates must try to manage the time they spend on questions in accordance with the marks available. They must also come to the paper with a good knowledge of all topic areas and must read questions carefully. They must then respond to the specifics of the question instead of simply writing generally about a topic. They must try to understand the practical implications of applying what they have learned and offer recommendations in their answers that adequately reflect question scenarios where this is required.

Section A – 50 marks

Question 1.1

Definition 1: “A system that converts a production schedule into a listing of materials and components required to meet the schedule so that items are available when needed.”

Definition 2: “An accounting system that focuses on ways by which the maximum return per unit of bottleneck activity can be achieved.”

Which of the following pairs of terms correctly matches definitions 1 and 2 above?

	<i>Definition 1</i>	<i>Definition 2</i>
A	Manufacturing resources planning (MRP2)	Backflush accounting
B	Material requirements planning (MRP1)	Throughput accounting
C	Material requirements planning (MRP1)	Theory of constraints
D	Supply chain management	Throughput accounting

(2 marks)

The answer is **B**

Question 1.2

Which of the following statements is/are true?

- (i) Enterprise Resource Planning (ERP) systems use complex computer systems, usually comprehensive databases, to provide plans for every aspect of a business.
 - (ii) Flexible Manufacturing Systems (FMS) are simple systems with low levels of automation that offer great flexibility through a skilled workforce working in teams.
 - (iii) Just-in-time (JIT) purchasing requires the purchasing of large quantities of inventory items so that they are available immediately when they are needed in the production process.
- A** (i) only
B (i) and (ii) only
C (i) and (iii) only
D (ii) and (iii) only

(2 marks)

The answer is **A**

Question 1.3

Which of the following statements apply to feedforward control?

- (i) It is the measurement of differences between planned outputs and actual outputs.
- (ii) It is the measurement of differences between planned outputs and forecast outputs.
- (iii) Target costing is an example.
- (iv) Variance analysis is an example.

- A** (i) and (iii)
- B** (i) and (iv)
- C** (ii) and (iii)
- D** (ii) and (iv)

(2 marks)

The answer is **C**

Question 1.4

The final stage of production adds Material Z to units that have been transferred into Process D and converts them to the finished product. There are no losses in Process D. Data for Process D in the latest period are shown below:

	<i>Units</i>
Opening work in progress	225
Material Z: 80% complete	
Conversion costs: 80% complete	
Units transferred in	500
Units transferred out	575
Closing work in progress	150
Material Z: 60% complete	
Conversion costs: 40% complete	

The equivalent units to be used in the calculations of the cost per equivalent unit for Material Z and Conversion Costs, assuming first-in-first-out (FIFO) costing are:

	<i>Material Z</i>	<i>Conversion costs</i>
A	485	455
B	485	500
C	575	455
D	575	500

(2 marks)

The answer is **A**

Workings

<i>Units</i>		<i>Equivalent Units</i>	
		<i>Material Z</i>	<i>Conversion cost</i>
225	To complete opening wip	45	45
350	Started and finished	350	350
150	Closing wip	<u>90</u>	<u>60</u>
	Total E. U.	485	455

Question 1.5

If the budgeted fixed costs increase, the **gradient** of the line plotted on the budgeted Profit/Volume (P/V) chart will

- A increase.
- B decrease.
- C not change.
- D become curvi-linear.

(2 marks)

The answer is **C**

Question 1.6

A company operates a standard costing system and prepares monthly financial statements. All materials purchased during February were used during that month. After all transactions for February were posted, the general ledger contained the following balances:

	<i>Debit</i>	<i>Credit</i>
	£	£
Finished goods control	27,450	
Materials price variance	2,400	
Materials usage variance		8,400
Labour rate variance	5,600	
Labour efficiency variance		3,140
Variable production overhead variance	2,680	
Fixed production overhead variance		3,192

The standard cost of the goods produced during February was £128,500.

The actual cost of the goods produced during February was

- A** £96,998
- B** £124,448
- C** £132,552
- D** £160,002

(2 marks)

The answer is **B**

Workings

Std cost of goods produced	£	£
		128,500
<i>Plus adverse variances</i>		
Materials price	2,400	
Labour rate	5,600	
Variable overheads	<u>2,680</u>	10,680
<i>Less favourable variances</i>		
Material usage	8,400	
Labour efficiency	3,140	
Fixed overheads	<u>3,192</u>	<u>(14,732)</u>
Actual cost of goods produced		<u>124,448</u>

Question 1.7

Overheads will always be over-absorbed when

- A** actual output is higher than budgeted output.
- B** actual overheads incurred are higher than the amount absorbed.
- C** actual overheads incurred are lower than the amount absorbed.
- D** budgeted overheads are lower than the overheads absorbed.

(2 marks)

The answer is **C**

Question 1.8

The following extract is taken from the production cost budget of L plc:

Output	2,000 units	3,500 units
Total cost	£12,000	£16,200

The budget cost allowance for an output of 4,000 units would be:

- A** £17,600
- B** £18,514
- C** £20,400
- D** £24,000

(2 marks)

The answer is **A**

Workings

			<i>Difference</i>
Output	2,000 units	3,500 units	1,500 units
Total cost	£12,000	£16,200	£4,200

Variable cost per unit = £4,200/1,500 = £2.80.

Fixed cost = £12,000 – (2,000 * £2.80) = £6,400 (Note: Alternatively you could have used the figures for 3,500 units).

Therefore the budget cost allowance for 4,000 units = £6,400 + (4,000 * £2.80) = £17,600.

Question 1.9

A company uses time series and regression techniques to forecast future sales. It has derived a seasonal variation index to use with the multiplicative (proportional) seasonal variation model. The index values for the first three quarters are as follows:

Quarter	Index value
Q1	80
Q2	80
Q3	110

The index value for the fourth quarter (Q4) is:

- A** -270
- B** -269
- C** 110
- D** 130

(2 marks)

The answer is **D**

Workings

The index values for a multiplicative model with four seasons add to 400.

Question 1.10

The budgeted profit statement for a company, with all figures expressed as percentages of revenue, is as follows:

	%
Revenue	100
Variable costs	30
Fixed costs	<u>22</u>
Profit	<u>48</u>

After the formulation of the above budget it has now been realised that the sales volume will only be 60% of that originally forecast.

The revised profit, expressed as a percentage of the revised revenue will be:

- A** 20%
- B** 33.3%
- C** 60%
- D** 80%

(2 marks)

The answer is **B**

Workings

Assuming the revenue was \$100 will lead to the following revised figures:

	<i>Original</i>	<i>Revised</i>
Revenue	100	60
Variable costs	30	18
Fixed costs	<u>22</u>	<u>22</u>
Profit	<u>48</u>	<u>20</u>

The following data are given for sub-questions 1.11 and 1.12 below

A company has a process in which three inputs are mixed together to produce Product S. The standard mix of inputs to produce 90 kg of Product S is shown below:

	\$
50 kg of ingredient P at \$75 per kg	3,750
30 kg of ingredient Q at \$100 per kg	3,000
20 kg of ingredient R at \$125 per kg	<u>2,500</u>
	<u>9,250</u>

During March 2,000 kg of ingredients were used to produce 1,910 kg of Product S. Details of the inputs are as follows:

	\$
1,030 kg of ingredient P at \$70 per kg	72,100
560 kg of ingredient Q at \$106 per kg	59,360
410 kg of ingredient R at \$135 per kg	<u>55,350</u>
	<u>186,810</u>

Question 1.11

Calculate the materials mix variance for March.

(3 marks)

Workings

Mix variance = \$500 favourable

	<i>Actual Mix</i>			<i>Standard Mix</i>		
	<i>Kg</i>	<i>\$</i>	<i>\$</i>	<i>Kg</i>	<i>\$</i>	<i>\$</i>
P	1,030	75	77,250	1,000	75	75,000
Q	560	100	56,000	600	100	60,000
R	<u>410</u>	125	<u>51,250</u>	<u>400</u>	125	<u>50,000</u>
	2,000		184,500	2,000		185,000

Question 1.12

Calculate the materials yield variance for March.

(2 marks)

Workings

Yield variance = \$196,305 – \$185,000 = \$11,305 favourable

Output was 1,910kg. The standard input for this should be $1,910/90\% = 2,122.22\text{kg}$

	<i>Standard mix of input</i>			<i>Standard mix for output</i>		
	<i>Kg</i>	<i>\$</i>	<i>\$</i>	<i>Kg</i>	<i>\$</i>	<i>\$</i>
P	1,000	75	75,000	1,061.11	75	79,583
Q	600	100	60,000	636.67	100	63,667
R	<u>400</u>	125	<u>50,000</u>	<u>424.44</u>	125	<u>53,055</u>
	2,000		185,000	2,122.22		196,305

Alternative method:

Standard cost of 1 kg of output is $\$9,250/90 = \102.78

Expected output was $2,000 * 0.9 = 1,800$ kg.

Actual output was 1,910 kg

There is a favourable yield of 110 kg.

Therefore the yield variance is $110 * \$102.78 = \$11,306$ favourable

Question 1.13

Division L has reported a net profit after tax of £8.6m for the year ended 30 April 2006. Included in the costs used to calculate this profit are the following items:

- interest payable of £2.3m;
- development costs of £6.3m for a new product that was launched in May 2005, and is expected to have a life of three years;
- advertising expenses of £1.6m that relate to the re-launch of a product in June 2006.

The net assets invested in Division L are £30m.

The cost of capital for Division L is 13% per year.

Calculate the Economic Value Added[®] for Division L for the year ended 30 April 2006.

(3 marks)

Workings

	<i>£m</i>	<i>£m</i>
Net profit after tax		8.6
Add		
Interest	2.3	
Development costs	6.3	
Advertising	<u>1.6</u>	<u>10.2</u>
		18.8
Less 1/3 development costs		<u>2.1</u>
		16.7
Less capital charge: 30*13%		<u>3.9</u>
EVA		<u>12.8</u>

Question 1.14

The following details have been taken from the debtor collection records of W plc:

Invoices paid in the month after sale	60%
Invoices paid in the second month after sale	20%
Invoices paid in the third month after sale	15%
Bad debts	5%

Customers paying in the month after the sale are allowed a 10% discount.

Invoices for sales are issued on the last day of the month in which the sales are made.

The budgeted credit sales for the final five months of this year are:

<i>Month</i>	<i>August</i>	<i>September</i>	<i>October</i>	<i>November</i>	<i>December</i>
<i>Credit sales</i>	\$80,000	\$100,000	\$120,000	\$130,000	\$160,000

Calculate the total amount budgeted to be received in December from credit sales.

(2 marks)

Workings

<i>Month of sale</i>	<i>Factor</i>	<i>Receive December</i>
		\$
November	60% * 90%	70,200
October	20%	24,000
September	15%	15,000
Total		<u>109,200</u>

Question 1.15

State four aims of a transfer pricing system.

Workings

1.15 Any four relevant aims. For example:

- Ensure optimal allocation of resources;
- Promote goal congruence;
- Motivate divisional managers;
- Facilitate performance measurement;
- Not stifle autonomy.

Question 1.16

Process 2 takes transfers from Process 1 and converts them to finished goods. Additional materials are added during the process. An abnormal loss occurred part way through the process in April. Output data for April are shown below:

	Kg	Equivalent units (Kg)		
		From P1	Materials	Conversion
Transferred to finished goods	2,800	2,800	2,800	2,800
Normal loss	200			
Abnormal loss	100	100	100	50
Closing work in progress	700	700	700	150

The losses cannot be sold.

Costs incurred during April were:

Transfer from Process 1	£34,200
Materials added	£16,200
Conversion costs	£26,700

There was no opening work in progress at the beginning of the month.

Calculate the value of the abnormal loss that will be debited to the abnormal loss account.

(3 marks)

Workings

	Kg	Equivalent units (Kg)		
		From P1	Materials	Conversion
Transferred to finished goods	2,800	2,800	2,800	2,800
Normal loss	200			
Abnormal loss	100	100	100	50
Closing work in progress	<u>700</u>	<u>700</u>	<u>700</u>	<u>150</u>
	3,800	3,600	3,600	3,000
Costs (£)		34,200	16,200	26,700
Cost per E.U. (£)		9.50	4.50	8.90

$$\text{Abnormal loss} = (100 \times £9.50) + (100 \times £4.50) + (50 \times £8.90) = £1,845$$

Question 1.17

D plc operates a retail business. Purchases are sold at cost plus 25%. The management team are preparing the cash budget and have gathered the following data:

1. The budgeted sales are as follows:

<i>Month</i>	<i>£000</i>
July	100
August	90
September	125
October	140

2. It is management policy to hold inventory at the end of each month which is sufficient to meet sales demand in the next half month. Sales are budgeted to occur evenly during each month.

3. Creditors are paid one month after the purchase has been made.

Calculate the entries for “purchases” that will be shown in the cash budget for

- (i) August
- (ii) September
- (iii) October

(3 marks)

Workings

All figures are £000

<i>Month</i>	<i>Sales</i>	<i>Cost of sales</i>	<i>Opening inventory</i>	<i>Closing inventory</i>	<i>Purchase</i>	<i>Paid</i>
July	100	80	40	36	76	
August	90	72	36	50	86	76
September	125	100	50	56	106	86
October	140	112	56			106

Question 1.18

ZY is an airline operator. It is implementing a balanced scorecard to measure the success of its strategy to expand its operations. It has identified two perspectives and two associated objectives. They are:

Perspective	Objective
Growth	Fly to new destinations
Internal capabilities	Reduce time between touch down and take off

- (i) For the “growth perspective” of ZY, recommend a performance measure and briefly justify your choice of the measure by explaining how it will reflect the success of the strategy.

(2 marks)

- (ii) For the “internal capabilities perspective” of ZY, state data that you would gather and explain how this could be used to ensure the objective is met.

(2 marks)

Workings

Fly to new destinations: percentage occupancy on flights to new destinations. This will show how popular the routes are.

Reduce ground time: measure baggage unloading/loading times, cleaning times, re-stocking meals and duty free, staff availability etc. This will identify the key factor.

The following data are given for sub-questions 1.19 and 1.20 below

Q plc uses standard costing. The details for April were as follows:

Budgeted output	15,000	units
Budgeted labour hours	60,000	hours
Budgeted labour cost	£540,000	
Actual output	14,650	units
Actual labour hours paid	61,500	hours
Productive labour hours	56,000	hours
Actual labour cost	£522,750	

Question 1.19

Calculate the idle time variance for April.

(2 marks)

Workings

Labour standard for 1 unit is 4 hours * £9 per hour

$$\begin{aligned}\text{Idle time variance} &= (61,500 - 56,000) * £9 \\ &= 5,500 * £9 \\ &= £49,500 \text{ adverse}\end{aligned}$$

Question 1.20

Calculate the labour efficiency variance for April.

(2 marks)

Workings

$$\begin{aligned}\text{Efficiency variance} &= (\text{std hours for actual output} - \text{actual hours}) * \text{std rate} \\ &= [(14,650 * 4) - 56,000] * £9 \\ &= (58,600 - 56,000) * £9 \\ &= £23,400 \text{ favourable}\end{aligned}$$

Question 1.21

S plc produces and sells three products, X, Y and Z. It has contracts to supply products X and Y, which will utilise all of the specific materials that are available to make these two products during the next period. The revenue these contracts will generate and the contribution to sales (c/s) ratios of products X and Y are as follows:

	<i>Product X</i>	<i>Product Y</i>
Revenue	£10 million	£20 million
C/S ratio	15%	10%

Product Z has a c/s ratio of 25%.

The total fixed costs of S plc are £5.5 million during the next period and management have budgeted to earn a profit of £1 million.

Calculate the revenue that needs to be generated by Product Z for S plc to achieve the budgeted profit.

(3 marks)

Workings

Budgeted profit = £1m. Therefore total contribution = £6.5m and contribution from Z must be £3m.

	<i>Product X</i>	<i>Product Y</i>	<i>Product Z</i>	<i>Total</i>
Revenue	£10 million	£20 million	£12 million	
C/S ratio	15%	10%	25%	
Contribution (£m)	1.5	2.0	3.0	6.5
Fixed costs (£m)				<u>5.5</u>
Profit (£m)				<u>1.0</u>

Section B – 30 marks

ANSWER ALL SIX SUB-QUESTIONS. EACH SUB-QUESTION IS WORTH 5 MARKS

Question 2(a)

A manufacturing company uses a standard costing system. Extracts from the budget for April are shown below:

Sales	1,400 units	
Production	2,000 units	
		\$
Direct costs		15 per unit
Variable overhead		4 per unit

The budgeted fixed production overhead costs for April were \$12,800.

The budgeted profit using marginal costing for April was \$5,700.

- (i) Calculate the budgeted profit for April using absorption costing. (3 marks)

- (ii) Briefly explain two situations where marginal costing is more useful to management than absorption costing. (2 marks)

(Total for sub-question (a) = 5 Marks)

Rationale

Covers learning outcome A(i) – *Compare and contrast marginal and absorption costing methods in respect of profit reporting and stock valuation.*

Suggested Approach

(i) The difference between profits calculated using absorption costing and marginal costing is due to fixed production overheads being absorbed when absorption costing is used. The first thing to do is to calculate the fixed production overhead absorption rate (OAR): given the data in the question the only way to do this is to base it on a rate per unit (this gives an OAR of \$6.40 per unit). Inventory has increased during the period by 600 units because production exceeds sales by that amount. Each unit of closing inventory, using absorption costing, will carry the absorbed fixed production overhead with it into the next period and therefore profit will be higher with absorption costing (because the fixed overhead absorbed in the closing inventory will not be charged against the profit for this period).

(ii) The question asks “more useful to management”. Consequently the approach should be to think about what management do (e.g. forecast, plan, control and make decisions) and then give examples of how marginal costing can be useful in those situations.

Marking Guide

	Marks
Calculation of OAR	1
Calculation of profit	2
Two explanations	2

Examiner's Comments

Relatively easy marks were available here for a reasonably prepared candidate, however success was mixed. Part (i) was generally fairly well answered but part (ii) was not well answered.

Common Errors

Part (i)

- deducting, rather than adding, the stock change;
- including all costs, not just fixed production overhead, in the adjustment.

Part (ii)

- focussing on the stock valuation issue, or on whether stock building is encouraged, rather than upon the usefulness for management.

Question 2(b)

The standard cost schedule for hospital care for a minor surgical procedure is shown below.

Standard Cost of hospital care for a minor surgical procedure

Staff: patient ratio is 0.75:1

	£
Nursing costs: 2 days x 0.75 x £320 per day	480
Space and food costs: 2 days x £175 per day	350
Drugs and specific materials	115
Hospital overheads: 2 days x £110 per day	<u>220</u>
Total standard cost	<u>1,165</u>

The actual data for the hospital care for one patient having the minor surgical procedure showed that the patient stayed in hospital for three days. The cost of the drugs and specific materials for this patient was £320. There were 0.9 nurses per patient on duty during the time that the patient was in hospital. The daily rates for nursing pay, space and food, and hospital overheads were as expected.

Prepare a statement that reconciles the standard cost with the actual costs of hospital care for this patient. The statement should contain **five** variances that will give useful information to the manager who is reviewing the cost of hospital care for minor surgical procedures.

(5 Marks)

Rationale

Covers learning outcome A(v) – *Apply standard costing methods within costing systems and demonstrate the reconciliation of budgeted and actual profit margins.*

Suggested Approach

The question asks for a reconciliation. Therefore candidates need to prepare a statement that starts with the standard (i.e. expected) cost for the two day procedure and then moves through to the actual cost of the three day stay.

The obvious difference is that there was an extra day. Therefore the first thing to do is to flex the cost to show what would be expected for a three day stay and then calculate the operational variances.

Marking Guide

Marks

Variances	2.5
Standard and actual costs	1.5
Format and follow through	1

Examiner's Comments

Candidates generally scored well here, invariably with a list of variances rather than with the layout presented in the Examiner's answer.

Common Errors

- not separating the total nursing cost variance;
- calculating the actual costs incorrectly;
- calculating variances but making no attempt at standard and actual cost reconciliation.

Question 2(c)

C plc uses a just-in-time (JIT) purchasing and production process to manufacture Product P. Data for the output of Product P, and the material usage and material price variances for February, March and April are shown below:

Month	Output (units)	Material usage variance	Material price variance
February	11,000	£15,970 Adverse	£12,300 Favourable
March	5,100	£5,950 Adverse	£4,500 Favourable
April	9,100	£8,400 Adverse	£6,200 Favourable

The standard material cost per unit of Product P is £12.

Prepare a sketch (not on graph paper) of a percentage variance chart for material usage and for material price for Product P for the three month period. (Note: your workings must show the co-ordinates of the points that would be plotted if the chart was drawn accurately.)

(5 Marks)

Rationale

Covers learning outcome B(ii) – Calculate and interpret material, labour, variable overhead, fixed overhead and sales variances.

Suggested Approach

A variance chart plots variances as percentages of the standards. The variances for usage and price, and the actual output are given. Therefore it is necessary to calculate the standard usage for the actual output and the standard price for the actual quantity purchased.

Marking Guide

Variances as percentages
 Plotting on graph

Marks

3
 2

Examiner's Comments

This part was poorly answered with relatively few candidates appreciating what was required. Candidates who understood the meaning of a % variance invariably had more success with the calculation of the usage % than with the price %.

Common Errors

- demonstrating an inability to calculate a % variance;
- failing to base the % on an appropriate cost value of material: for example, the price variance was frequently compared with the standard cost of output rather than with the standard cost of purchases;
- using inappropriate axes on the chart.

Question 2(d)

Briefly discuss **three** reasons why standard costing may **not** be appropriate in a modern business environment.

(5 Marks)

Rationale

Covers learning outcome B(i) – *Explain why and how standards are set in manufacturing and in service industries with particular reference to the maximisation of efficiency and minimisation of waste.*

Suggested Approach

The question states “in a modern business environment” . Therefore answers must be in the context of the modern business environment. Answers should state changes that have occurred in the business environment and then explain why those changes may lead to standard costing being inappropriate.

Marking Guide

Two marks per valid explanation (maximum 5)

Marks

5

Examiner’s Comments

There were some very good answers but many candidates failed to focus on the specific question asked.

Common Errors

- writing about standard costing generally with little or no mention of the modern business environment;
- discussing the implications of JIT for stock holding (with seemingly an implied impact on standard costing);
- focussing on service industries where standard costing has never been easily applied;
- discussing the implications for overhead apportionment and absorption of a change from labour intensity to capital intensity;
- mentioning TQM without explanation of the implications for standard costing.

Question 2(e)

Compare and contrast marginal costing and throughput accounting.

(5 Marks)

Rationale

Covers learning outcome A(iv) – *Explain the origins of throughput accounting as 'super variable costing' and its application as a variant of marginal or variable cost accounting.*

Suggested Approach

Define and explain the uses of marginal costing and throughput accounting and then compare and contrast them.

Marking Guide

One mark for each valid comment (maximum 5)

Marks

5

Examiner's Comments

Comparison and contrast were very rarely made clear in answers although there was a reasonable knowledge of how the 'contribution' was calculated in each case.

Common Errors

- demonstrating a lack of appreciation of how the two methods are used;
- failing to provide a clear contrast and comparison between the two methods

Question 2(f)

T plc is a large insurance company. The Claims Department deals with claims from policy holders who have suffered a loss that is covered by their insurance policy. Policy holders could claim, for example, for damage to property, or for household items stolen in a burglary. The Claims Department staff investigate each claim and determine what, if any, payment should be made to the claimant.

The manager of the Claims Department has decided to benchmark the performance of the department and has chosen two areas to benchmark:

- the detection of false claims
- the speed of processing claims

For each of the above two areas:

- (i) state and justify a performance measure
- (ii) explain how relevant benchmarking data could be gathered.

(5 marks)

Rationale

Covers learning outcome B(v) – *Prepare reports using a range of internal and external benchmarks and interpret the results.*

Suggested Approach

The question is in a specified context (the Claims Department of an insurance company). Therefore answers must focus on the stated context.

Marking Guide

	Marks
One mark for each performance measure	2
One mark for each valid explanation of data gathering (maximum 3)	3

Examiner's Comments

Many candidates scored reasonable marks but rarely focused their answers sufficiently to the specifics of the question.

Common Errors

- failing to identify any performance measures;
- describing how measures fit into the balanced scorecard which was not required;
- suggesting unrealistic/inappropriate sources of benchmark data;
- providing a generic listing of sources of benchmark data without reference to the specific scenario;
- believing that current actual data for the Claims Department is benchmarking data.

Section C – 20 marks

ANSWER ONE OF THE TWO QUESTIONS

Question 3(a)

Prepare, using the additional information that the Manager of the Assembly Department has given you, a budgetary control statement that would be more helpful to him.

(7 marks)

Rationale

Covers learning outcome C(xi) – *Evaluate performance using fixed and flexible budget reports.*

Suggested Approach

The starting point for this answer is to think “What is wrong with the current control statement?” The major problems are that it does not compare like with like (the budget is based on 6,400 hours but the actual results are for 7,140 hours), and that fixed and variable costs are not shown separately. It is therefore necessary to identify and separate the fixed and variable costs and then prepare a flexed budget. Variances should then be based on the flexed statement.

Marking Guide

Marks

Flexed costs	3.5
Variances	2
Format	1.5

Examiner’s Comments

Candidates did not find this part of the question easy. Sometimes they simply repeated the budget statement given in the question, rather than making any adjustments to it, or made no attempt at this part.

Common Errors

- demonstrating no understanding cost behaviour patterns;
- carrying out a simple application of the high/low method without any recognition of the step increase in fixed costs;
- failing to separate fixed from variable costs or controllable from uncontrollable costs in the statement.

Question 3(b)

- (i) Discuss the differences between **the format of the statement** that you have produced and that supplied by M plc. *(4 marks)*
- (ii) Discuss the assumption made by the central office of M plc that costs vary in proportion to assembly labour hours. *(3 marks)*

Rationale

- (b)(i) covers learning outcome D(ii) - *Prepare cost information in appropriate formats for cost centre managers, taking due account of controllable/uncontrollable costs and the importance of budget flexing.*
- (b)(ii) covers learning outcome C(vi) – *Evaluate and apply alternative approaches to budgeting.*

Suggested Approach

- (i) In Part (a) you did the thinking and then prepared the revised statement. Now you are required to explain why you did it!
- (ii) Think, “will costs vary with labour hours?” Is there any indication in the scenario that labour hours might not be the most appropriate base to use for flexing the budget?

Marking Guide

	Marks
(i) Explain the need to flex the budget	2
One mark per other valid comment	2
(ii) State and explain relevant evidence from the scenario	3

Examiner’s Comments

Many candidates appreciated the difference, in answer to part (i), resulting in a comparison of like with like, but generally provided little else that was relevant.

Common Errors

- failing to appreciate that it was only the cost of furniture packs and the other materials that were assumed in the question to vary in proportion to the number of assembly hours worked;
- failing to provide evidence from the question scenario to support the views expressed.

Question 3(c)

Discuss whether M plc should change to a system of participative budgeting.

(6 marks)

Rationale

Covers learning outcome C(xiii) - *Evaluate the impact of budgetary control systems on human behaviour.*

Suggested Approach

The question states “whether M plc should change”. Consequently candidates should think about issues that would arise in M plc if participative budgeting was introduced. A major theme throughout the scenario is that the Manager of the Assembly Department is new to the job but he does have many years’ experience as a supervisor and will therefore have considerable knowledge about assembling furniture.

Marking Guide

One mark for each valid point

Marks

6

Examiner’s Comments

This part was fairly well answered providing opportunity for candidates to summarise what they knew about participation in budget setting.

Common Errors

- describing, often at some length, what participation/bottom-up and top-down budgets are, rather than discussing the pros and cons of a change;
- failing to relate answers to the scenario described.

Question 4(a)

Calculate the individual profits of the Sales Department and the Service Department, and of FP as a whole *from the guarantee scheme* if:

- (i) The repairs are carried out by the Service Department and are charged at full cost plus 40%;
- (ii) The repairs are carried out by the Service Department and are charged at marginal cost;
- (iii) The repairs are carried out by RS.

(8 marks)

Rationale

Covers learning outcome D(vii) – *Identify the likely consequences of different approaches to transfer pricing for divisional decision making, divisional and group profitability, the motivation of divisional management and the autonomy of individual divisions.*

Suggested Approach

The answer requires the profits of the two departments and the company as a whole to be calculated using three different bases of charging for the repairs. To help with this it is first necessary to calculate the cost of the repairs under each of the three stated methods.

Marking Guide

Profit statements

Marks

8

Examiner's Comments

Some candidates gained full marks but most who attempted this part did not score well. A significant number, having chosen the question, made little or no attempt at this part.

Common Errors

- misunderstanding of the implications, for the two departments and for the company, of the three different scenarios;
- treating the fixed costs inconsistently in the analysis of the three scenarios;
- not realising that the profits/losses of FP are the sum of the profits/losses of the two departments.

Question 4(b)

- (i) Explain, with reasons, why a ‘full cost plus’ transfer pricing model may **not** be appropriate for FP. (3 marks)
- (ii) Comment on other issues that the managers of FP should consider if they decide to allow RS to carry out the repairs. (4 marks)

Rationale

Covers learning outcome D(vi) - *Explain the typical consequences of a divisional structure for performance measurement as divisions compete or trade with each other.*

Suggested Approach

- (i) The question states “for FP”. Consequently candidates should use evidence from the scenario to validate their answers.
- (ii) Answers need to be about the issues for “the managers of FP”.

Marking Guide

One mark for each relevant comment

Marks

7

Examiner’s Comments

This part was often answered briefly and candidates did not score highly. Part (ii) was generally much better answered than part (i).

Common Errors

- in part (i) failing to identify the two key issues – motivation and goal congruence;
- not developing an answer that applied to the case scenario given.

Question 4(c)

Briefly explain the advantages and disadvantages of structuring the departments as profit centres.

(5 marks)

Rationale

Covers learning outcome D(i) - *Discuss the use of cost, revenue, profit and investment centres in devising organisation structure and in management control.*

Suggested Approach

Again candidates need to think about the information given in the scenario and then use it to answer the question.

Marking Guide

One mark for each valid comment

Marks

5

Examiner's Comments

Candidates did have some idea here based on their general study of the subject area. This was generally the strongest part of answers to this question.

Common Errors

- explaining an insufficient number of advantages and disadvantages;
- discussing cost control.