

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Management Accounting	Final Examination - Winter 2007

General Comments:

The performance of the candidates left much to be desired. The answers were not well co-ordinated. In most of the cases the students did not plan their answers. They were not sure how will they conclude their answers and achieve the final objective. For example in the question related to holding/ordering costs many of them started by calculating the EOQ whereas its calculation was not required anywhere.

The question-wise comments are given below:

- Q.1 (a) The requirement of the question was to determine whether to use a different raw material i.e. FFS, instead of DDM, which was currently being used. A very poor performance was witnessed in this question. Most of the examinees started answering the question without a proper plan as to what they wanted to achieve.

The key points which were to be noted and to be worked upon were as follows:

Both the options were similar in respect of the following:

- Type of products to be produced (3 products in either case).
- Sales prices per unit.
- Production processes i.e. there were two processes. In the first process the products were processed jointly whereas in the 2nd process, further processing was carried out on each product.
- Total input into the first process was to remain the same.
- Fixed costs remained the same.
- Cost of further processing, per unit of output remained the same.
- Normal loss in the first process remained the same i.e. 20%.

The key differences in the two options were as follows:

- Evaporation losses in the 2nd process were lower by 20%.
- Ratio of output in the 2nd process was changed.
- Prices of raw material (DDM/FFS) per unit were higher by 33.33%.

The key points which were important and where the students went wrong were as follows:

- The input quantity was not given and should have been worked out by applying the formula $\frac{100}{100 - loss\%} \times$ output. This was the first step and a large number of the students could not do it altogether whereas many of them did it incorrectly as they applied the loss percentage on the output.

- While evaluating the first option, many students worked out the evaporative losses by applying the specified percentage on the output, instead of working back and applying it on the input quantity.
- The basic assumption that input in the first process will remain the same, was ignored. As a result, while evaluating the second option, many students tried to work out the budgeted production which was not required. As clearly stated in the question, the final production, when FFS was used, should have been determined by using the ratio 7:8:1 for Products A, B and C respectively.
- The cost of raw material consumed in either case was not given in the question. However, as mentioned in the question, for DDS, it should have been calculated as 75% of the processing costs i.e. 75% of 480 thousand i.e. 360 thousand. The cost of FFS could have been arrived at by applying a 33.33% increase thereon. The remaining processing costs i.e. $480 - 360 = 120$ thousand should have remained the same in either case.
- Cost of further processing needed to be changed in line with the change in quantity of production of each product. Many students overlooked this aspect probably because the total input into the 2nd process had not changed.

Q.2 About 12% of the students did not attempt the question and 25% obtained no marks indicating selective study. The question was however easy for those who had cared to study the concept of shadow pricing and a large number was able to secure full marks also. The most common error was that most students did not test all the corner points for arriving at the optimum output.

Q.3 It has been observed in a wide range of subjects that the students tend to offer satisfactory replies when the answers are required to be framed in a relatively simple form by way of straight presentations from the context and general illustrations. However, the students experience serious problems when the skills of application of the concepts, or logical step-by-step deductive analysis and drawing of meaningful conclusions are involved. Same was the case in this question. The deficiencies generally noted in the answers were as follows:

- Many students calculated irrelevant ratios. The ratios that could have been relevant were, return on investments, return on assets employed, market share, increase in market share, contribution ratio, net income to sales and gross profit ratio. Many students calculated various other ratios in addition to those that were actually required. Some students went to the extent of calculating 15 to 20 different ratios. They failed to realize that the examiners did not want to test the knowledge of various ratios. The examinees were actually required to display their understanding as to which ratio will be relevant in a particular situation. Consequently those who calculated almost every ratio in the book, could not secure any mark.
- Additional measures for evaluation of managers' performance may have included: residual income, new product development, personnel development and motivation and market conditions among others. These were pointed out by very few. The deficiency mentioned in the above paragraph was also apparent in this part also.

- In evaluating the performance of the two divisions, an important factor was that decision E had only been formed recently and its achievement was qualitatively superior as it must have confronted the disturbances which are often felt in the early years of new operations. Most of the students failed to highlight this point.

Q.4 This question on holding and ordering costs of inventory was the worst attempted and a number of mistakes and omissions were made by the examinees. It was again observed that most students had memorized the formulas but had not carried an in-depth study of the concept. The students are encouraged to understand that each time the above topic is tested at the final level, the situation given, is vastly different. They will have to carry out a sustained in-depth study of the related concepts, to be able to respond appropriately.

The commonly observed errors were as follows:

- Many examinees took the lead time to be 40 days instead of 45 days as they overlooked the 5 days which were required to process the order.
- Many students worked out EOQ which was not required as the quantities to be ordered were specified in the question.
- Many students took average stock in hand as 50% of quantity per order plus 50% of buffer stock. The proper calculation was 50% of quantity per order plus the whole of buffer stock.
- Many students included Sales Tax in calculating the cost of purchase. This was incorrect as it was clearly given in the question that Sales Tax is subsequently recovered as input tax.
- Since the sales tax was recoverable within one month, the time for which funds were tied up in Sales Tax was different from the time for which the funds were tied up in stocks. Very few students could comprehend this aspect.
- The payments against LCs were made prior to the receipt of goods. Therefore, in addition to the cost of financing the average stock, PCL had to finance the advance payments also. This aspect was also missed by majority of the students.

Q.5 This question was poorly attempted and only 13% of the students could secure passing marks. According to the scenario given in the question a company (SIL) had received an order but it was not possible for it to carry out the full production itself. It had therefore decided to sub-contract the work. The product which had to be produced consisted of three components i.e. X,Y and Z. SIL had to decide between the following options:

- Produce maximum possible completed units and sub-contract the remaining.
- Produce as many components and sub-contract the remaining.

Evaluating the first option was easy. The procedure was to calculate the number of units that can be produced internally with the available capacity and give the rest to the sub-contractor.

The second option was relatively complex. The procedure was to compute the cost saved in producing each component internally and dividing it by number of hours required to produce it, to arrive at the savings per hour. The components with the higher savings per hour should then be produced internally as far as possible.

The students lacked the concepts as well as the practice to solve such questions. Most of them knew various individual steps but were not able to co-ordinate all the steps in a meaningful way. Consequently, most of them were lost in the process and did not know where to start and how to conclude the question.

Q.6 In the question the students performed well and about 70% got passing marks. The shortcomings in the answers were as follows:

- Most of the students got confused between material mix and material usage variances. Many calculated mix variance but named it usage variance. Some calculated both the variances in the same manner with the same answer showing that they did not know either of them.
- Very few students correctly calculated material yield variance.
- Students did not cross-tie the variances with each other that would have helped them to identify their mistakes.
- Here again, it was noted that most of the students had memorized the formulas but did not know the concepts. Consequently, there were lot of errors as quiet often they mixed up one formula with the other. Had it not been the case, the result could have been much better as the concepts involved were not very difficult.

(THE END)