

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**EXAMINERS' COMMENTS**

---

<b>SUBJECT</b>	<b>SESSION</b>
Cost Accounting	Intermediate Examination - Spring 2008

---

***Overall feedback***

The overall performance of the candidates was satisfactory. However, a common problem with most students was their inability to organize their replies properly which often resulted in loss of time and inability to complete the paper within the allocated time.

Q.1 This question required the recording of certain adjustments in stock (inventories). The adjustments were to be recorded in financial ledger as well as the stores ledger. The performance of the candidates was quite discouraging. It seemed that most of the candidates had not prepared for such a question as this area had not been tested in the past many attempts.

Common mistakes were as follows:

- Incorrect head of account was used. For example, increase in stock was debited in 'receipt account' and loss of stocks due to theft was credited in 'theft account'.
- Most of the candidates recorded the adjustments in stores ledger like entries in the books of a branch. They ignored the information given in the question that the valuation is carried out in the finance department using a memorandum record which exhibits that only quantity is recorded in the stores ledger.

Q.2 (a) Most of the students were able to explain the treatment of under/over applied factory overheads. These are treated as period costs and closed to Cost of Goods Sold or the Income Statement. Another valid treatment is their apportionment between inventories and Cost of Goods Sold.

(b) This part was quiet easy. It required the determination of revised machine hour rate and many candidates performed exceptionally well. However, following mistakes were observed in many scripts:

- Many students ignored the date of February 1, 2008 and made calculations on the basis of 12 months.
- Few students ignored the budgeted cost of existing machines while determining the revised rates.
- Many students incorrectly included the set-up and maintenance time in total productive machine hours.

Q.3 This was an easy question but somehow the students got confused. Apparently there was no reason to panic but probably because the format of the question was slightly different from the past papers, it ultimately proved to be the worst attempted question of this paper.

Brief comments on the performance of the students in this question are given below:

- A large number of students could not determine the sales i.e. by adding up all the costs and the profit earned, which worked out as Rs. 244,000 and Rs. 346,500 for 2006 and 2007 respectively.
- The next step was to work out the increase in profit due to increase in sales price i.e. Rs. 31,500 ( $346,500 \times 10/110$ ).
- The remaining difference in sales i.e. Rs.71,000 was on account of increase in sales volume. By applying the contribution margin percentage of 2006 i.e. 16.39% ( $40,000/244,000 \times 100$ ) on the above amount, the increase in profit due to increase in sales volume could have been found.
- Very few of the students could reach this stage, but those who did calculate the above correctly, went through the remaining part of the question easily as almost similar principle was applied in all the later steps.

Q.4 This was the easiest question of this paper, related to the concept of opportunity cost. It served as a lifeboat for many candidates. Various aspects of the students performance are discussed hereunder:

- The opportunity cost of material X, Y and Z was 80% of historical cost, NRV and Purchase Price respectively. Most of the students could ascertain them correctly.
- Skilled labour required for this contract could have been used to replace the semi-skilled workers who were working on other contracts and had been hired on temporary basis. The amount payable to such semi-skilled workers was Rs. 3.9 million ( $325,000 \times 12$ ). Consequently, many students took Rs. 3.9 million as the opportunity cost. In doing so, they ignored the information that even if the semi-skilled labour were laid off, 30 days salary would have to be paid to them and consequently the company will only be saving Rs. 3,575,000. On the other hand, many students erroneously took the opportunity cost as Rs. 4,225,000 i.e. equal to 13 months salaries of the unskilled labour.
- Fixed overhead were mostly ignored whereas the increase in such overheads, as a result of accepting the contract i.e. Rs. 875,000 should have been included as opportunity costs.
- Very few of the candidates worked out the variable cost correctly by deducting the fixed overhead i.e. Rs. 4,050,000 from the total overhead amounting to Rs. 8.5 million.

Q.5 This question required calculation of labour cost per unit under the weekly bonus and daily bonus options. Many students were able to secure good marks in this easy question. Two types of mistakes were common:

- Minimum wages for Saturday were calculated on the basis of 8 hours i.e. Rs. 24,000 instead of 5 hours i.e. Rs. 15,000.
- The amount of bonus worked out on daily basis was different from the amount worked out on weekly basis because in the latter case higher production on a particular day will be offset by lower production on other days. Most of the students failed to give the correct reason.

Q.6 It was a straight forward question on process costing and was well attempted by the majority. Following common mistakes were however observed in many answer scripts:

- The students could not work out the equivalent production units correctly. Some of the students made the whole calculation on the basis of units completed during the year i.e. 100,000 units. Many others adjusted the number of units in opening and closing inventory as if these were completed units i.e. ignored the fact that these were only partially complete as regards Labour and Overhead.

Many students did not include the abnormal loss in such calculation.

- Many candidates incorrectly deducted the scrap value of normal loss from material costs.
- Some students used weighted average cost to transfer the units to the next department instead of using the FIFO method.
- Some students had no idea of the method of costing and calculated the cost per unit by adding the unit costs of opening stocks to the current period's unit cost.

Q.7 This question required preparation of profit statements under marginal and absorption costing methods and reconciliation of these profits. The question was generally well attempted but the following mistakes were also observed in many scripts:

- Many students did not include the increase in overhead cost of Rs. 120,000 in the production costs. Surprisingly, some of them included the increase in Selling and Admin Expenses.
- Many candidates ignored the under applied factory overhead while preparing the profitability statement under absorption costing.
- Some of the candidates used the total production capacity for calculating fixed overheads per unit instead of using the normal capacity.
- Many students were unaware of the fact that the difference in profit worked out under the two systems is because the valuation of opening and closing stock in either case is different. They failed to reconcile the figures as they incorporated the under applied fixed overhead and/or the variable overhead in excess of budget i.e. Rs. 120,000 as reconciling items.

THE END