

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Cost Accounting	Intermediate Examinations - Autumn 2008

Overall Feedback

The overall performance of the candidates was average. It was commonly noted that adequate attention was not given towards reading and understanding the questions, which is vital for achieving better results. It has been a consistent feature of the students performance that they do well in questions where formulas and formats are to be used in a straightforward manner or with little or no variation. However, when it comes to solving questions, which require quick and on the spot analysis of facts and figures, the performance is extremely poor. One of the reason for the same may be the lack of practice but the most important factor is too much reliance on memorizing the formula and very little effort on understanding the concepts involved and specially the basic mathematical concepts.

The poor performances in Questions 2 (b), 3 and 7 were ample proof of such deficiencies.

Question-wise Comments:

Q.1 This question required the candidates to apportion the joint costs among three products and decide whether to sell product B in packaged form or in an unpackaged form. Many students secured full marks in this question. However, following common mistakes were noted in many scripts:

- Many students incorrectly allocated the joint costs on the basis of final sales value, ignoring the requirement of the question which clearly stated that allocation should be made on the basis of estimated sales value at split off point. Probably many of them didn't know how to calculate the sales value at split off point and therefore tried to follow this approach hoping to secure at least some of the marks.
- A large number of candidates allocated the fixed packing costs between product B and C on the basis of square feet of packing material consumed per unit instead of total packing material consumed in packaging the entire units.
- In part (b) the candidates were required to calculate the profit that the company could earn by accepting the offer of selling product B in unpackaged form and then comparing it with the profit that could have been earned in the usual way i.e. by selling it in packaged form. Many candidates arrived at the conclusion only on the basis of the first part of the calculation. Many others, incorrectly deducted the fixed costs of operating the machine while calculating the profitability of product B, for the purpose of above comparison.

- Q.2 It was a good question on stock ordering. Part (a) was well attempted by majority of the candidates. However, few students made calculation errors resulting in loss of easy marks.

Part (a) was a routine question on Economic Order Quantity (EOQ) and almost all the candidates were successful in calculating EOQ using the formula as all the related figures were clearly available in the question. However, it proved a bit difficult to calculate the total Ordering Costs, although it was also quite simple i.e. by using the formula $\text{Annual Requirements}/\text{EOQ} \times \text{Ordering Costs per Order}$.

In Part (b) the students' performance was below average. Many students got confused probably because they had not practiced such questions and also because they didn't have in-depth understanding of the concepts involved. The steps involved and brief comments on the common mistakes are given hereunder:

- If the company was ready to take 20% risk of being out of stock meant that it needed to keep sufficient safety stock to ensure that it would only be out of stock if the lead time reached 13 days or in other words it would need to re-order when 12 days stock was left i.e. the re-order point should be 12 days. Very few of the students could adopt this logic.
- The average usage per day was 450 units ($162,000 \div 360$).
- Since the usual lead time was 11 days therefore safety stock should be equal to $12 - 11 = 1$ day's stock i.e. 450 units and re-ordering point was $450 \times 12 = 5400$ units.

Similar logic could have been applied to ascertain the safety stock where the company was ready to take only 10% risk of being out of stock.

The students are advised to understand that the only way to be able to solve such questions is to understand the concepts involved and how various figures are interlinked. They cannot succeed simply by memorizing the formulas.

- Q.3 (a) This was another question which exposed the conceptual weaknesses of the candidates. The performance was quite unsatisfactory as most of the students seemed to have memorized the formulas but did not know which formula was to be used in a particular situation.
- (b) In this part, the performance of the candidates was average. However, few candidates wasted their time in explaining the procedure for calculating the given variances, which was not required.

- Q.4 It was an easy question on decision making and well attempted by majority of the candidates. Some of the common mistakes noted in some scripts are described below:

- The question did not specify whether any part of fixed general overheads could have been saved if the company decided to purchase from the external supplier. Therefore the better option for the students was to ignore these for the purpose of decision making. Another option was to include these but in that case they should have given a note explaining their assumption. Many of those who used the latter option did not explain their assumption.

- Instead of adding the depreciation on equipment, full cost of equipment was added, while determining the profitability of Option A.
- Some candidates ignored the depreciation on the new machine as it was a fixed cost. Their argument was partially correct because no doubt the depreciation constitutes a fixed cost, it was, nevertheless, a relevant cost because it could have been avoided if the circuit boards were purchased from the external supplier.

In part (c) of the question the candidates were required to list down the **other factors** which the company would consider before making a decision. The performance in this part was quite poor as very few of the candidates could mention points related to quality control, dependability and subsequent increase in requirement etc.

Q.5 This question required calculation of break-even points and contribution margin ratios in different situations. It was well attempted and served as a lifeboat for many students. Most of the mistakes were the result of errors committed due to carelessness and on account of failure to comprehend the exact requirement of each situation. The performance in each part of the question is discussed below:

- (a) Most of the students easily calculated the break-even point in rupees by dividing the fixed costs with contribution margin ratio of 40%. The candidates were not as successful when it came to calculating the margin of safety.
- (b) The revised contribution margin was calculated by almost all those who had done part (a) correctly but two types of mistakes were generally witnessed while calculating the break even, as enumerated below:
 - Some students couldn't differentiate between the requirements of Part (a) and (b) and calculated the break-even in rupees instead of units.
 - Some of them computed the break-even in units by dividing the break even computed in part (a) of the question by the price per unit.

Further, for calculating the revised selling price which could maintain the same contribution margin ratio, the easiest method was to divide the revised variable cost per unit i.e. Rs. 3300 by 0.6 (1 - 40%). But only about 20% of the students could do it correctly.

- (c) Here again the procedure was quite simple, consisting of the following steps:
 - Calculating the revised contribution margin ratio after reducing the variable costs by 50%.
 - Dividing the sum of the revised Fixed Expenses and the Target Profit, by the new contribution margin ratio.

Most of the students computed it easily.

Q.6 This was an easy question on overhead absorption rates and well attempted by many candidates. In fact there was very little that could have gone wrong, yet two types of mistakes were quite common:

- Single overhead absorption rate which should have been calculated by dividing the **Total Estimated Overheads** by **Estimated Total Direct Labour Hours**. Instead, it was calculated by adding the overhead rates of each department.
- Cost of raw material and labour was also included in the calculation of overhead rates.

Q.7 This question required evaluation of a proposal to increase the wages to motivate the workers to avoid wastage of time and improve production inefficiency. There were quite a few methods of solving the question i.e. by comparing the two options as regards the following:

- labour cost per unit.
- contribution margin per week.
- contribution margin per unit.

The first of the above methods was the shortest. Since the contribution margin excluding the labour cost, under each of the above options was the same, the decision could have been based on labour cost per unit, which may have been calculated as follows:

At current wages	$30 \times 3 \times 54/45 \div 74\% =$	Rs. 145.92
After increase in wages	$35 \times 3 \times 54/49 \div 88\% =$	Rs. 131.49

In the above formulas 54/45 and 54/49 represent the ratio between total hours per week and the actual hours that were worked.

A vast majority of the students was not clear enough to adopt the above simple approach and instead, adopted a much lengthy method, i.e. by calculating the contribution margin per week. However, while doing so, most of them were unable to deal with the issue of production efficiency correctly. Many of them ignored it altogether.

Many candidates answered the question by discussing the benefits of increasing the wages and did not show any working. It seemed that they did not bother to read the requirement of the question carefully.

(THE END)