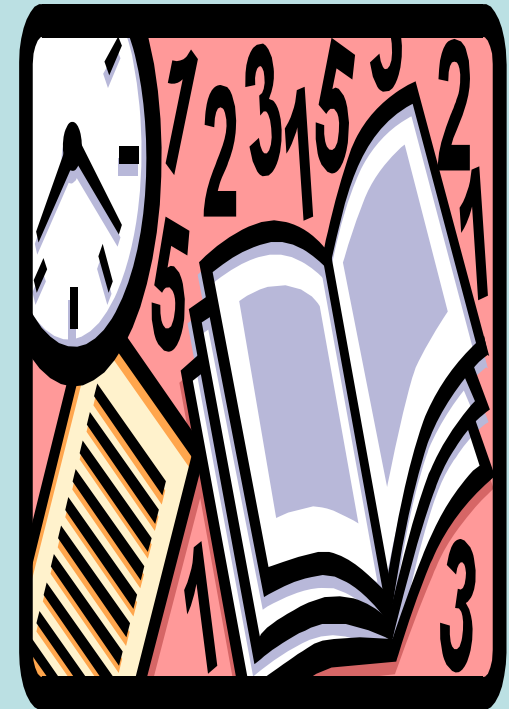


A-Level Principles of Accounts

- Paper 2 Mock Exam Review (2011)
- Tony Lim
- Department of Business Administration
- Institute of Vocational Education (Tuen Mun)
- 19/3/2011

(A) Paper 2 syllabus overview

- Costing -principles and methods
(eg Overheads absorption in Job Costing or Activity-based Costing)
- Planning and control
(eg Standard Costing, Budgeting)
- Decision making
(eg Marginal Costing, CVP, Investment Appraisal)
- Financial accounting theory



(B)Mock Exam-Principles of Accounts Paper 2

- Section A (60%):
TWO compulsory
- Section B (40%):
Any TWO out of three questions

Use two different answer books for
Section A and Section B in AL Exam.

(C) General Comments

- 1) Do not use pencil in answering.**
- 2) Lack of workings (e.g. steps for calculations) based on scenarios given, or unclear presentation.**
- 3) Broad understanding of the topics in the syllabus, and able to analyse the scenarios given in questions.**

(E) 2011 Mock Paper 2

Question One (30 marks)

Topics related:

1) Costing systems: process costing

Under FIFO inventory method

Normal loss vs Abnormal loss

16 marks

2) Cost-volume-profit (CVP) analysis

Break-even point and decision making

14 marks

Mock Exam-Question 1 (30%)

- 1a) Most students failed to consider the ‘Opening WIP’ leading to wrong “Product **started and completed** in the period-\$161,400”. They mixed it up with “Product **completed** in the period-\$181,400”.

(a) Production data

	Units	
Work-in-progress, opening	20,000	
Add: Transferred-in from Process 2	180,000	
	<u>200,000</u>	
Work-in-progress, opening	20,000	
Units started and finished in Process 3 (bal.fig.)	161,400	
Normal loss	600	
Work-in-progress, closing	18,000	
	<u>200,000</u>	
		(1 mark)

Mock Exam-Question 1 (30%)

1b&c) Ignored the requirement of decimal places in
‘Production Cost per Unit Calculation, and lack of
workings.

Calculation of production cost per unit							
	Cost	WIP, Opening	Normal loss	Started & Finished	WIP, Closing	Total equiv. units	Cost per unit
	\$	Units	Units	Units	Units	Units	\$
Transferred-in	5,706,000	-	600	161,400	18,000	180,000	31.7
Materials	*1,418,340	6,000	600	161,400	16,200	184,200	7.7
Conversion	**1,044,960	12,000	600	161,400	12,600	186,600	5.6
	<u>8,169,300</u>						<u>45.0</u>
*Materials = \$1,428,900 – (600 x \$22) x 80% = \$1,418,340 (0.5 mark)							
**Conversion = \$1,047,600 – (600 x \$22) x 20% = \$1,044,960 (0.5 mark)							

Mock Exam-Question 1 (30%)

1b&c) Ignored the requirement of decimal places in 'Production Cost per Unit Calculation, and lack of workings.

Alternative workings: Calculation of production cost per unit							
	Cost	Finished Goods	Normal loss	WIP, Closing	Less: WIP, Opening	Total equiv. units	Cost per unit
	\$	Units	Units	Units	Units	Units	\$
Transferred-in	5,706,000	181,400	600	18,000	(20,000)	180,000	31.7
Materials	*1,418,340	181,400	600	16,200	(14,000)	184,200	7.7
Conversion	**1,044,960	181,400	600	12,600	(8,000)	186,600	5.6
	<u>8,169,300</u>						<u>45.0</u>
*Materials = \$1,428,900 – (600 x \$22) x 80% = \$1,418,340 (0.5 mark)							
**Conversion = \$1,047,600 – (600 x \$22) x 20% = \$1,044,960 (0.5 mark)							

Mock Exam-Question 1 (30%)

- 1b) “It is the company policy to have the cost of normal loss entirely absorbed by the finished goods.”

Shortcut Method is not allowed here and normal loss should be included in the value of finished goods.

Value of finished goods:

	\$	
Opening WIP	867,400	0.5
Cost to complete – Materials (6,000 x \$7.7)	46,200	1
– Conversion (12,000 x \$5.6)	67,200	1
Started and completed in Process 3 (161,400 x \$45)	7,263,000	0.5
Normal loss (600 x \$45)	27,000	1
	<u>8,270,800</u>	

(4 marks)

Mock Exam-Question 1 (30%)

1c) Wrong treatment of normal loss scrap value

→ Wrong Process Accounts Calculated.

(c)	Process 3 account						
		Units	\$		Units	\$	
0.5	WIP b/d	20,000	867,400	Normal loss	600	13,200*	0.5+1
1	Period costs:	180,000		Finished goods (W1)	181,400	8,270,800	0.5
	- Transferred in		5,706,000	WIP c/d (W2)	18,000	765,900#	0.5+3
	- Materials		1,428,900				
	- Conversion		1,047,600				
		200,000	9,049,900		200,000	9,049,900	

* 600 units x \$22 = \$13,200

(7 marks)

Mock Exam-Question 1 (30%)

1d) Most candidates did not know how to treat abnormal loss. Many of them misunderstood 'the nearest cents'.

(d) Total abnormal loss to be reported in the financial statement:

	\$	
Abnormal loss (600 x \$45.07)	27,042	3
Less: Scrap value (600 x \$22)	13,200	1
	13,842	or \$13,842.89

(4 marks)

Workings for part d:

If approx. is taken only in the final step

Calculation of production cost per unit							
	Cost	WIP, Opening	Abnormal loss	Started & Finished	WIP, Closing	Total equiv. units	Cost per unit
	\$	Units	Units	Units	Units	Units	\$
Transferred-in	5,706,000	-	600	161,400	18,000	180,000	31.7
Materials	1,428,900 *	6,000	600	161,400	16,200	184,200	7.76
Conversion	1,047,600**	12,000	600	161,400	12,600	186,600	<u>5.61</u>
	<u>8,182,500</u>						<u>45.07</u>

Mock Exam-Question 1 (30%)

1e) At breakeven point: **Contribution = Total Fixed Costs**
Many candidates omitted the common fixed cost **\$85,000**

Also many did not really understand the term
- **direct fixed costs**

Fixed costs:

Production overheads		300,000
Selling overheads		400,000
Admin. overheads	(\$85,000) (\$170,000)	<u>255,000</u>
		<u>955,000</u>

Break-even point:

In units =

<u>Fixed costs</u>	<u>955,000</u>
Unit contribution	25
	= <u>38,200 units</u>

Mock Exam-Question 1 (30%)

- 1f) Most candidates overlooked the instruction to “calculate the contribution per pack and breakeven in packs for each proposal.”

(f)	Proposal A		Proposal B		Proposal C		Marks
	\$	\$	\$	\$	\$	\$	
Selling price per unit		322*		350		350	
Variable costs per unit:							
Material costs	136		136		136		
Labour costs	60		60		55#		
Production overheads	44		44		44		
Sales commission	15	255	50	290	15	250	
Contribution/unit of GINO		67		60		100	
Contribution/ 2 units of HINO		50		50		50	
Contribution per pack		117	1	110	1	150	1
* \$350 x (1-8%) = \$322 # \$60 - \$5 = \$55							

Mock Exam-Question 1 (30%)

- 1f) Most candidates overlooked the instruction to “calculate the contribution per pack and breakeven in packs for each proposal.”

Fixed costs:	\$	\$	\$	
Production overheads	679,000	679,000	763,000*	
Selling overheads	998,800#	1,155,600@	1,080,000	
Admin. overheads	<u>255,000</u>	<u>255,000</u>	<u>255,000</u>	
	<u>1,932,800</u>	<u>2,089,600</u>	<u>2,098,000</u>	1+1+1
# \$680,000+\$400,000-\$81,200 = \$998,800				
@ \$680,000+\$400,000+\$75,600 = \$1,155,600				
* \$379,000+\$300,000+\$7,000x12 = \$763,000				
Break-even point:				
In packs =				
<u>Fixed costs</u>	<u>1,932,800</u>	<u>2,089,600</u>	<u>2,098,000</u>	
Contribution per pack	117	110	150	
	<u>16,520 packs</u>	<u>18,997 packs</u>	<u>13,987 packs</u>	1

Mock Exam-Question 1 (30%)

- 1g) Almost all candidates ignored the limited capacity.
 Half of the spare capacity = 28,000 packs →
 Full capacity = 2 x 28,000 packs = 56,000 packs
 Sales volume cannot be increased to 58,000 packs in
 Proposal A.

(g)	Proposal A	Proposal B	Proposal C	Marks
	\$	\$	\$	
Sales volume (in packs)	*56,000	56,000	45,000	
Contribution per pack	<u>117</u>	<u>110</u>	<u>150</u>	
Total contribution	6,552,000	6,160,000	6,750,000	
Less: Fixed costs	<u>1,932,800</u>	<u>2,089,600</u>	<u>2,098,000</u>	
Budgeted profit	<u>4,619,200</u>	<u>4,070,400</u>	<u>4,652,000</u>	1+1+1
Proposal C is recommended (0.5) as its budgeted profit is the highest (0.5) among the three proposals.				

Mock Exam-Question 1 (30%)

1g) (Continued)

---Lack of separate workings of each proposal.

---Poor workings presented.

---Incorrectly calculating the sale volume under different proposals.

2011 Mock Paper 2

Question Two (30 marks)

Topics related:

- | | |
|--------------------------------|----------|
| 1) Material Budget | 9 marks |
| 2) Cash Budget | 19 marks |
| 3) Budgetary Control in budget | 5 marks |

Mock Exam-Question 2(30%)

2a) Some students failed to score marks, because of lack of workings shown (in columnar form), e.g. no Production Budget prepared before Material Purchases Budget, and their final answers were wrong.

(a)		Week 1	Week 2	Week 3
Production Budget		Units	Units	Units
Rx	Sales in unit	850	400	400
	Targeted closing stock	200	180	150
	Total needed	1,050	580	550
	Opening stock	(100)	(200)	(180)
(A)	Units to be produced	<u>950</u>	<u>380</u>	<u>370</u>
HD	Sales in unit	300	220	180
	Targeted closing stock	20	50	50
	Total needed	320	270	230
	Opening stock	(50)	(20)	(50)
(B)	Units to be produced	<u>270</u>	<u>250</u>	<u>180</u>

Mock Exam-Question 2(30%)

2a) Continued: The Material Purchases Budget prepared after the Production Budget, and some ignored the 'Target Closing Stock'.

Direct Material Purchases Budget		Week 1	Week 2	Week 3
		Kg	Kg	Kg
Grande Alloy required for Rx	(A)*8	7,600	3,040	2,960
Grande Alloy required for HD	(B)*12	3,240	3,000	2,160
		10,840	6,040	5,120
	Targeted closing stock	1,600	1,900	2,200
	Total needed	12,440	7,940	7,320
	Opening stock	(800)	(1,600)	(1,900)
	Material to be purchased without strike	11,640	6,340	5,420
	Purchases re-allocated to week 1	11,760	(6,340)	(5,420)
	Grande Alloy to be purchased	23,400		
	Cost per kg	\$40		
	Grande Alloy in \$ to be purchased(with strike)	\$ 936,000		
	Grande Alloy in \$ to be purchased(without strike)	<u>\$465,600</u>	<u>\$253,600</u>	<u>\$216,800</u>

Mock Exam-Question 2(30%)

- 2b) Most failed to include the Material Closing Stock.
Some were carelessly to ignore the labour hours in
Fixed Overheads absorption.

(b) Inventory as at end of week 3

Grande Alloy	2,200kg * \$40		88,000
Rx	DM 150units * 8kg * \$40	48,000	
	DL 150units * 4hr * \$60	36,000	
	FOH 150units * 4hr * \$45	27,000	111,000
HD	DM 50units * 12kg * \$40	24,000	
	DL 50units * 6hr * \$60	18,000	
	FOH 50units * 6hr * \$55	16,500	58,500
Inventory at end of Week 3			257,500

Mock Exam-Question 2(30%)

2c) In Cash Budget preparation, most students were able to present:

-- the correct opening bank balance

--the calculation of receipts from customers, but lacking of workings shown.

Unable to present:

--the payments to suppliers, and labour,

--the payments of Fixed Overheads,

--(Repaid to)/ Reimbursed by director

Mock Exam-Question 2(30%)

2c) Continued.

(c) Cash budget

		Week 1	Week 2	Week 3
	Opening cash balance	615,000	911,400	1,021,800
	Receipt from debtor			
W1	From last week sales (30%)	165,000	364,500	207,000
W1	From this week sales (70%)	850,500	483,000	441,000
	Total receipts	1,015,500	847,500	648,000
	Payments			
W2	To supplier	319,000	261,000	936,000
W3	To labour	105,000	325,200	181,200
W4	For overhead	260,100	150,900	126,000
	Total payments	684,100	737,100	1,243,200
	Closing cash balance	946,400	1,021,800	426,600
	Reimbursed by / (Repaid to) director	(35,000)	-	73,400
	Adjusted cash balance	911,400	1,021,800	500,000

Mock Exam-Question 2(30%)

2d)

- (d) - Reduce the weekly targeted closing inventory.
- Tightening credit control of the debtors
 - Arrange to extend the credit payment period
 - Negotiate with the bank for a lower minimum cash balance
- (Other valid answers may be accepted.)**

Mock Exam-Question 2(30%)

2e)

(e)

Liquidity means 'cash' in a company's daily operation. It is essential for the proper carrying out of business activity in a short term of time.

(1 mark)

By the preparation of production budget, Acrylic Ltd can forecast the amount of resources (i.e. Grande Alloy) would be required in Week 1 (0.5) which can prepare for the shortage in weeks 2 and 3 if there is a strike (1). This is a kind of forward control in the company. (0.5)

(2 marks)

As a result, Acrylic Ltd can plan for the materials purchased (0.5) and fixing loan in advance (i.e. loan from director) in view of the cash deficit found in cash budget in week 3 (1). This can improve the overall liquidity position. (0.5)

(2 marks)

2011 Mock Paper 2

Question Three (20 marks)

Topics related:

Accounting Concepts

- 1) Prudence Concept **5 marks**
- 2) Research and Development Cost **5 marks**
- 3) Revenue Recognition **5 marks**
- 4) Revised Net Profit **5 marks**

Mock Exam-Question 3a) i)

- (i) In October 2010, a 2-year-old baby vomited after chewing and sucking a teether produced by BabyCare Ltd. His parents Mr. and Mrs. Smith blamed the unpleasant smell from the teether made their son sick. In addition, Mr. and Mrs. Smith suspected that there were some toxic materials releasing from the teether. As a result, the parents decided to go into **litigation against BabyCare Ltd to ask for a compensation of \$100,000.**

The internal legal department in BabyCare Ltd advised that it is **highly probable that the parents would win the case.** In the meantime, the management spent **\$80,000 on testing the batch of unsold teethers.** The result will be obtained in January 2011. **If the result shows that there are leakages** of toxic materials from using teethers, BabyCare Ltd will arrange the recall and refund for buyers. It is estimated that the **total cost of \$220,000** will be incurred. The book-keeper only recognized \$220,000 as expenses into the profit and loss account as this is the largest amount.

Mock Exam-Question 3(20%)

3a)

- i) Unsatisfactory, unable to apply the Prudence Concept correctly within the case.
 - Have the provision of \$100,000 for the legal claim without explanation
 - Failed to identify the contingent liability of \$220,000.
 - Unaware of the disclosure of contingent liability in the notes to the accounts

Mock Exam-Question 3(20%)

3a) i)

(a)	(i)	- The provision of \$100,000 should be made for the legal claim as there is a present obligation resulting from the past event.
		- It is because the professional advised that there is a high chance to pay the compensation.
		- The \$80,000 used in product testing was incurred in the accounting period and should be recognized as expenses in the current income statement.
		- The estimated cost of \$220,000 for total recalls and refund is not yet confirmed upon the release of result in next year, so no provision should be made in this accounting period.
		- Therefore it is a contingent liability and should be disclosed as a note to the accounts.
		(1 mark each, max 5 marks)

Mock Exam-Question 3a) ii)

(ii) BabyCare Ltd has invested a significant amount in research on the new style of stroller named “Urban Carry”. The characteristics include light weight design, folding design, four automatic swivel wheels and the function of operation with one hand. **The research cost \$1,490,000** had been incurred until 1 November 2010.

On 1 December 2010, BabyCare Ltd proved that the **technical feasibility** of completing the “Urban Carry” and it will be **available for use or sale for generating future economic benefit**. BabyCare Ltd had **strong intention and financial ability to promote the new product**. The **development cost of \$500,000** was spent in December 2010.

BabyCare Ltd is confident that there is an active market for “Urban Carry”. The company formed a new marketing team in order to boost up the sales volume. Salesmen were trained to be familiar with different functions of “Urban Carry”. **A training cost of \$480,000 was incurred.**

Mock Exam-Question 3a) ii)

The management team considered the impact of research cost on the net profit is huge and decided to capitalised it. On the contrary, the development cost was recognized in profit and loss account to represent as expenses of “Urban Carry”. Finally, the training cost was regarded as prepaid commission under current assets.



Mock Exam-Question 3(20%)

3a)

ii) Unsatisfactory, unable to distinguish clearly the treatments for Research costs and Development costs.

- Unable to identify the wrong action to avoid research cost in order to manipulate the net profits
- Training cost has been charged to expense without explanation
- Fail to explain the reasons to capitalize the development costs.

Mock Exam-Question 3(20%)

3a) ii)

(ii)	- The research cost of \$1,490,000 cannot be revoked after the date of the intangible assets meet all those criteria, regardless the amount. It has to be charged to the income statement as an expense.
	- It is wrong to avoid the research cost so as to manipulate the net profit.
	- The development cost of \$500,000 must be capitalized upon the date when the intangible assets meet all those criteria.
	- Even the company is optimistic about the existence of an active <u>market</u> , the training cost cannot be regarded as prepaid expenses in current assets as it is still uncertainty about the future sales.
	- The training cost should be recognized immediately as expenses in current financial year,
	(1 mark each, 5 marks)

Mock Exam-Question 3a) iii)

- (iii) The company started to operate the business on franchise. On 1 January 2010 it sold the right to open a new outlet to Mr. Cody. The franchise is for five years. The company received **an initial fee of \$50,000 for the first year** and will **receive \$6,000 per annum for each of the five years**. The company has **continuing service obligations on its franchise** for advertising and product development that **amount to approximately \$8,000 per annum** for a franchised outlet. A reasonable **profit margin** on the provision of the continuing services is deemed to be **20% of revenues received**. The bookkeeper has only recorded the initial fee of \$50,000 as revenue from franchise business.

Mock Exam-Question 3(20%)

3a)

iii) Worst performance among the three cases. Unable to apply the realisation concept during revenue recognition.

- Unable to deal with the loss making contract.
- Without the concept of deferred revenue over the life of the contract.
- Didn't allow for the profit margin in the coming years.

Mock Exam-Question 3(20%)

3a) iii)

(iii)	- Year 2 to 5 of the franchise contract would be loss making and part of the initial fee of \$50,000 should be deferred over the life of the contract.
	- Since the company should be making a profit margin of 20% on this type of arrangement, annual revenues of \$10,000 will be required to match against the cost of \$8,000 per annum.
	- The company will receive the annual franchise fee of \$6,000 p.a. and it should be recognized as revenue for the year of receipt.
	- However, a further $\$(10,000-6,000)*4$ years for year 2 to 5 = \$16,000 of the initial fee should be treated as deferred income on the balance sheet as at 31 December 2010.
	- $\$50,000 - \$16,000 = \$34,000$ can be recognized as revenue in the first year.
	(1 mark each, 5 marks)

Mock Exam-Question 3(20%)

3b) The necessary adjustments required:

<i>A Statement to calculate the revised net profit or loss</i>	
	<i>\$</i>
Draft net profit before adjustment	3,050,000
(i) Provision for the legal claim	(100,000)
(i) Expenses on testing	(80,000)
(i) Total cost of recalls and refund	220,000
(ii) Research costs to be written off as expenses	(1,490,000)
(ii) Development cost to be capitalized	500,000
(ii) Training cost to be charged to P&L	(480,000)
(iii) Annual franchise fee earned	6,000
(iii) Unearned income deferred to coming years	(16,000)
Revised net profit	<u>1,610,000</u>

2011 Mock Paper 2

Question Four (20 marks)

Topics related:

Investment Appraisal

- | | |
|------------------------------|---------|
| 1) Net present value method | 9 marks |
| 2) Payback period | 3 marks |
| 3) Accounting rate of return | 8 marks |
| 4) Analysis and appraisal | 3 marks |

Mock Exam-Question 4(20%)

- 4) Generally, some students failed to take care the requirements of insurance premium and the rising of servicing and fuel charges :

Insurance premiums are to be paid **at the start of each year** and are expected to rise over the next three years. Insurance for each fleet is expected to cost:

	Year 1	Year 2	Year 3
	\$	\$	\$
Armada	7,000	8,050	9,255
<u>Carioka</u>	10,500	11,075	13,888

Servicing and fuel charges are also expected to rise over the next three years. Servicing and fuel charges for each fleet are expected to cost:

	Year 1	Year 2	Year 3
	\$	\$	\$
Armada	4,050	4,155	4,270
<u>Carioka</u>	6,700	6,870	7,057

All cash flows except insurance arise **at the end of the relevant year**.

Mock Exam-Question 4(20%)

- 4a) Fairly answered. Some failed to calculate correctly due to ignorance of purchase discounts, disposal value, and insurance premiums.

Model Armada						
End of the year	Year 0	Year 1	Year 2	Year 3	Total	
	\$	\$	\$	\$	\$	
Cost $7\,000 \times 5 \times 95\%$	(33,250)		-			
Insurance	(7,000)	(8,050)	(9,255)			
Fuel & servicing		(4,050)	(4,155)	(4,270)		
Hire fees		30,000	30,000	30,000		
Disposal value				<u>12,500</u>	$2\,500 \times 5$	
	(40,250)	17,900	16,590	38,230		
DF=12%	*1	*0.8929	*0.7972	*0.7118		
	(40,250)	15,983	13,226	27,212	16,171	

Mock Exam-Question 4(20%)

4a) Continued.

Model Carioka

End of the year	Year 0	Year 1	Year 2	Year 3	Total
	\$	\$	\$	\$	\$
Cost $\$16\,000 \times 5 \times 85\%$	(68,000)				
Insurance	(10,500)	(11,075)	(13,888)		
Fuel & servicing		(6,700)	(6,870)	(7,057)	
Major repair			(50,000)		
Hire fees		66,000	66,000	66,000	
Disposal value				<u>35,000</u>	$\$7\,000 \times 5$
	(78,500)	48,225	(4,758)	93,943	
DF=12%	<u>*1</u>	<u>*0.8929</u>	<u>*0.7972</u>	<u>*0.7118</u>	
	(78,500)	43,060	(3,793)	66,869	27,636

Mock Exam-Question 4(20%)

- 4b) Most students failed to recognise how to apply the payback period, and the adjustment of insurance premium.

	Model Armada	Model Carioka
Initial investment	\$ 33,250	\$ 68,000
Cash flows within the year		
Year 1	$30,000 - 7,000 - 4,050 = 18,950$	$66,000 - 10,500 - 6,700 = 48,800$
Year 2	$30,000 - 8,050 - 4,155 = 17,795$	$66,000 - 11,075 - 6,870 = 48,055$
Year 3	$30,000 - 9,255 - 4,270 + 12,500 = 28,975$	$66,000 - 13,888 - 7,057 - 50,000 + 35,000 = 30,055$
Payback period for Armada		Payback period for Carioka
$= [1 + (33,250 - 18,950)/17,795]$ years		$= [1 + (68,000 - 48,800)/48,055]$ years
$= [1 + 14,300/17,795]$ years		$= [1 + 19,200/48,055]$ years
= 1.80 years		= 1.40 years

Mock Exam-Question 4(20%)

- 4c) Students mixed up with previous a and b, and got lost in the preparation of Income Statement.

(c) **Income Statement** in columnar form for Armada

For year ended	Year 1	Year 2	Year 3	Total
Revenue	\$ 30,000	\$ 30,000	\$ 30,000	
Insurance	(7,000)	(8,050)	(9,255)	
Fuel & servicing	(4,050)	(4,155)	(4,270)	
Depreciation $(33,250-12,500)/3$	<u>(6,917)</u>	<u>(6,917)</u>	<u>(6,916)</u>	
Net profit	12,033	10,878	9,559	32,470

Mock Exam-Question 4(20%)

4 c) Continued.

Income Statement in columnar form for Carioka

For year ended	Year 1	Year 2	Year 3
	\$	\$	\$
Revenue	66,000	66,000	66,000
Insurance	(10,500)	(11,075)	(13,888)
Fuel & servicing	(6,700)	(6,870)	(7,057)
Major repair			(50,000)
Depreciation $(68\,000 - 35\,000) / 3$	<u>(11,000)</u>	<u>(11,000)</u>	<u>(11,000)</u>
Net profit/ (Loss)	37,800	37,055	(15,945)

Mock Exam-Question 4(20%)

- 4d) Unfamiliar to apply the average accounting rate of return method.

Accounting rate of return for Armada:

$$\text{Average net profit} = \$(12,033 + 10,878 + 9,559) / 3 = \$32,470 / 3 = \$10,823.33$$

$$\text{Average capital} = \$(33,250 + 12,500) / 2 = \$22,875$$

$$\text{Accounting rate of return} = \$10,823.33 / \$22,875 * 100\% = \mathbf{47.32\%}$$

Accounting rate of return for Carioka:

$$\text{Average net profit} = \$(37,800 + 37,055 + 15,945) / 3 = \$58,910 / 3 = \$19,636.67$$

$$\text{Average capital} = \$(68,000 + 35,000) / 2 = \$51,500$$

$$\text{Accounting rate of return} = \$19,636.67 / \$51,500 * 100\% = \mathbf{38.13\%}$$

Mock Exam-Question 4(20%)

- 4e) Unable to mention about any reservation of using NPV in evaluating a project. Some ignored the use of payback period for evaluation.

(e) On financial grounds, Andre should purchase the fleet of Carioka cars. This fleet gives the **higher** NPV value and it has the **shorter payback** period. The accounting rate of return for Carioca is 38.13% which is lower than Armada but the method of accounting rate of return did not account for the reason of time value of money which is important for investment appraisal. The feasibility of net present value method depends on the accuracy of the discount rate. The rate is affected by the market interest rate, inflation, risk preference, uncertainty of the investment involved etc, therefore, it may be rather subjective to rely on net present value method to evaluate an investment. (3 marks)

2011 Mock Paper 2

Question Five (20 marks)

Topics related:

Standard Costing – Variance Analysis

- 1) Interpretation of variances **3 marks**
- 2) Standard Contribution **3 marks**
- 3) Calculation of variances **8 marks**
- 4) Reconciliation statement **4 marks**
- 5) Standard costing vs Budgetary Control **2 marks**

Mock Exam-Question 5(20%)

5a)

Last month, January 2011, the management meeting revealed that some concerns about the interpretation of the variances had been identified. They are as follows:

(i).	The Procurement Manager considered himself performing well by attaining favorable Material Price Variance in January 2011;
(ii)	The Production Chief Officer claimed his decision being right (i.e. by allowing a general wage increase in January 2011 because of poor morale and pressure from external job market), with much money saved.

All other favourable variances were positively adopted as a basis for bonus sharing.

The variances for January, 2011 were as follows:

	\$'000
Material Price Variance	320 (F)
Material Usage Variance	560 (A)
<u>Labour Rate Variance</u>	250 (A)
<u>Labour Efficiency Variance</u>	490 (F)
Sales Price Variance	400 (A)
Sales Volume Variance	100 (A)
(F) = <u>Favourable</u> ; (A) = Adverse	

Mock Exam-Question 5(20%)

5a) Fairly answered, but ignored to apply the fact ‘purchase of inferior quality materials’.

	<u>Marks</u>
(a) With the emphasis to consider whole company, and interrelationship of variances: --Procurement Manager. The fact that cheaper product purchased, with <u>saving of \$320,000</u> in purchase price may be due to the purchase of inferior quality materials . The reductions in quality may cause an abnormal increase in the input of raw materials (i.e. with the result of adverse variance of <u>\$560,000 in usage</u>).	1
--Production Chief Officer. The total <u>labour cost variances</u> are \$240,000 (F), which has been due to the adverse variance of <u>labour rate variance</u> of \$250,000, and <u>favourable labour usage variance</u> of \$490,000. The higher motivation by improving the workers' pay has got <u>favourable result (i.e. better productivity)</u> and it has outweighed the negative impact of increased <u>labour rate</u> .	1
Since the supply market for corn has been relatively stable , the drop in sales volume should be attributed to the poor product quality in relation to the cheaper material purchased. It may be due to customers' worry of poor product quality.	1

Mock Exam-Question 5(20%)

5 b)

	Production and Accounting Department	Engineering Department
Materials	8 Kg of corn at a cost of \$15 per Kg	4% allowance for waste/ loss which is acceptable to the existing material used.
Labour	2 labour hours at \$40 per hour	From the past experience, 5% allowance given for labour efficiency purpose.

	Description	Notes
Actual sales and production(quantity)	\$1,963,500 of 5,100 litres	Including sales returns of 520 litres due to poor packing, subsequently repacked and distributed.
Labour	Paid for 8,900 hours, costing \$366,680	Including the incentive allowance of \$26,080 .
Material of corn used	50,920 Kg used costing \$721,612	Before the material returns of 2,420 Kg costing \$32,912 due to clerical mistake.

Mock Exam-Question 5(20%)

- 5 b) Failed to take into account of allowance factors,
which would affect the unit standard cost calculation.

(b) The standard contribution per litre of Com Oil

	\$	\$
Sales price		350
Less:		
Raw material – Com (<u>8 Kg x \$15 x 1.04</u>)	124.8	
Direct Labour (<u>2 hr x \$40 x 1.05</u>)	84.0	
Variable overhead (\$10/litre)	10.0	218.8
Standard contribution per litre		<u>131.2</u>

Mock Exam-Question 5(20%)

- 5c) Unfamiliar with the variances calculation by including the allowance factors, and using contribution margin to calculate Sales Volume Variance.

1 Sales Price Variance

$$[(\$1,963,500/5,100^*)-\$350] \times 5,100 \quad 178,500 \text{ (F)}$$

→*sales returns of 520 litres must be considered

2 Sales Volume Variance (using the contribution margin)

$$(5,100-5,800) \times \$131.2 \quad 91,840 \text{ (A)}$$

→sales returns of 520 litres must be considered

Mock Exam-Question 5(20%)

3 Material Price Variance

$$[(\$688,700^* / 48,500) - \$15] \times 48,500 \text{ Kg} \quad \mathbf{38,800 (F)}$$

$$*\$721,612 - \$32,912 = \$688,700$$

$$50,920 \text{ Kg} - 2,420 \text{ Kg} = 48,500 \text{ Kg}$$

→ material returns must be included

4 Material Usage Variance

$$(5,100 \times 8 \text{ Kg} \times 1.04 - 48,500 \text{ Kg}^*) \times \$15 \quad \mathbf{91,020 (A)}$$

→ *4% allowance for waste/loss

Mock Exam-Question 5(20%)

5 Labour Rate Variance

$$[\$40 - (\$366,680 / 8,900 \text{ hr})] \times 8,900 \text{ hr} \quad 10,680 \text{ (A)}$$

→ labour allowance must be included

6 Labour Usage Variance

$$(5,100 \times 2 \text{ hr} \times 1.05 - 8,900 \text{ hr}) \times \$40 \quad 72,400 \text{ (F)}$$

→ labour efficiency allowance of 5% must be included

Mock Exam-Question 5(20%)

5d) Overallly poor knowledge about the reconciliation statement.

	\$ Adverse	\$ Favorable	\$
Budget contribution (5,800x\$131.2)			760,960
Less: Budget fixed overhead			203,000
Budget profit			<u>557,960</u>
Variances:			
Sales price		178,500	
Sales volume	(91,840)		
Material price		38,800	
Material usage	(91,020)		
Labour rate	(10,680)		
Labour efficiency		72,400	
Total Variances	<u>(193,540)</u>	<u>289,700</u>	96,160
Increase in fixed overheads over budget (\$250,000-\$203,000)			<u>(47,000)</u>
Actual profit			<u><u>607,120</u></u>

Mock Exam-Question 5(20%)

5e) Poor concept to identify the difference of Standard Costing and Budgetary Control

(e) The differences between Standard Costing and Budgetary Control System

	Standard Costing	Budgetary Control
Aims	To control and eliminate wastes in the production of Cost Units (e.g. products/ services).	To establish budgets (or plans) for Cost Centres (e.g. departments) with the purpose to achieve company's objectives.
Control yardsticks	Setting up attainable standard of costs for manufacturing to follow in relation to each product. To identify variances for analysis	Setting up quantified plan of action for a department or cost centre to attain in the forthcoming accounting period. To provide a framework of responsibility accounting.
Feedforward control process	Not available	Available (e.g. cash budget)

(F) Review of external examiners' comment(a)

1. To have clear presentation of workings/ steps helped candidates to gain marks. It is specially important when complicated calculations involved or when the decision logic needs explanation. Facts and assumptions must be read

clearly before answering.

2. To practise writing effectively, mastering the correct terminology, and giving precise answer.

3. Step marks would be deducted to a decision without supporting calculations.

4. A few did not label the variances properly

(F)Review of external examiners' comment

5. To read questions carefully in order to answer correctly.
6. The topics included in syllabus are analytical tools to assist a manager to make better decisions.
7. Students must analyse questions from the management's perspective.

(G) Before examination

- Plan: Study and Revision
- Center location
- Stationery: Calculator and ball pens
- Good sleep for at least two nights before exam

During Examination

- Scan all questions
- Keep time
- Answer the most familiar questions first
- Keep time
- *After the morning examination
- Take a rest during lunch

- Try hard & good luck !
- Thank you.
- IVE (Tuen Mun).