

28TH COMPREHENSIVE EXAMINATION – FEBRUARY 2014

Marks

CASE # 1

To,

The Managing Director,

TonyToy Ltd.,

Subject: Report on the feasibility of temporary suspension or otherwise of the business for one year.

Sir,

I have been asked to submit a report on the feasibility of temporarily suspending operations for one year due to depressed market conditions or to operate at 50% capacity only. 1

There are two options available as mentioned above. The market research indicates that the depression will be over in a year and the management can effect a sale of Rs.9,000,000 utilising 75% of capacity. 2

I am giving below a statement of comparative profitability at 50% and 75% of capacity utilisation: 1

	Rs.		
	50%	75%	
Direct material $\{(50 \div 60) \times 1,800,000\}$	1,500,000	2,250,000	2
Direct labour $\{(50 \div 60) \times 2,400,000\}$	2,000,000	3,000,000	2
Production overhead	1,200,000	1,350,000	2
Administrative overhead	600,000	650,000	2
Selling and distribution overhead	650,000	725,000	2
Total cost	(5,950,000)	(7,975,000)	1
Sales	4,950,000	9,000,000	
Profit/ (Loss)	(1,000,000)	1,025,000	1

If operations are suspended, then total cost of reopening will be Rs.950,000 as detailed below:

	Rs.	
Fixed cost	400,000	
Settlement with labour	350,000	
Maintenance of plant	100,000	
Cost of reopening	100,000	
	950,000	1

The loss of Rs.1,000,000 will be offset in next year. Therefore, it will be better to operate at 50% capacity to retain the customers and goodwill of the business. 1

Workings:

Segregating semi-variable overhead:

	Rupees			
	Production Overhead	Administrative Overhead	Selling and Distribution Overhead	
For 80%	1,380,000	660,000	740,000	
For 60%	1,260,000	620,000	680,000	
For 20% (Variable)	120,000	40,000	60,000	3

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Breakup of variable and fixed overheads at 50% and 75% capacity:

Particulars	Rupees			
	Variable	Fixed	Total	
Production Overhead:				
For 60%: $\{(120,000 \div 0.2) \times 0.6\}$	360,000	$1,260,000 - 360,000 = 900,000$	1,260,000	1
For 50%	300,000	$1,260,000 - 360,000 = 900,000$	1,200,000	1
For 75%	450,000	$1,260,000 - 360,000 = 900,000$	1,350,000	1
Administrative Overhead:				
For 60%: $\{(40,000 \div 0.2) \times 0.6\}$	120,000	$620,000 - 120,000 = 500,000$	620,000	1
For 50%	100,000	$620,000 - 120,000 = 500,000$	600,000	1
For 75%	150,000	$620,000 - 120,000 = 500,000$	650,000	1
Selling and Distribution Overhead:				
	Production Overhead	Administrative Overhead	Selling & Distribution	
For 60%: $\{(60,000 \div 0.2) \times 0.6\}$	180,000	$680,000 - 180,000 = 500,000$	680,000	1
For 50%	150,000	$680,000 - 180,000 = 500,000$	650,000	1
For 75%	225,000	$680,000 - 180,000 = 500,000$	725,000	1

CASE # 2

(a) Profitability statement @ 80% level of capacity (480,000 bags):

Rs. '000'

Sales revenue (480,000 x 500)	240,000	1
Less: Cost of sales		
Raw Material:		
Gypsum (480,000 x 50)	24,000	1
Limestone (480,000 x 37.50)	18,000	1
Clay/ shale (480,000 x 37.50)	18,000	1
Packing material (480,000 x 25)	12,000	1
Direct labour (480,000 x 75)	36,000	1
Variable overhead (480,000 x 62.50)	30,000	1
Fixed overhead (480,000 x 37.50) (W-1)	18,000	1
Total cost	156,000	
Profit	84,000	½

W-1: New level of production @ 80%	= 60% x 33.33%	= 20%	
	= 360,000 ÷ 0.6		
	= 600,000 x 80%	= 480,000 bags	1
W-2: Per Unit fixed cost	= 360,000 x 50	= 18,000,000 ÷ 480,000	= 37.50 per unit
			½

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(b)	Statement showing determination of net working capital @ 480,000 bags:	Rs. '000'	
	(A) Current Assets:		
	Raw material:		
	Gypsum {480,000 x 50 x (2 ÷ 12)}	4,000	½
	Limestone {480,000 x 37.50 x (1 ÷ 12)}	1,500	½
	Clay/ shale {480,000 x 37.50 x (1.5 ÷ 12)}	2,250	½
	Packing material {480,000 x 25 x (1 ÷ 12)}	1,000	½
	Work-in-progress {480,000 x 85 x (1 ÷ 12)} (W-2)	8,500	1
	Finished goods {480,000 x 325 x (1 ÷ 12)} (W-3)	13,000	1
	Debtors {480,000 x 325 x (2 ÷ 12)}	26,000	1
	Cash – minimum balance required	195	
	Total current assets	56,445	1
	(B) Current Liabilities:		
	Creditors:		
	Gypsum {480,000 x 50 x (2 ÷ 12)}	4,000	1
	Clay/ shale {480,000 x 37.50 x (1 ÷ 12)}	1,500	1
	Packing material {480,000 x 25 x (1 ÷ 24)}	500	1
	Wages {480,000 x 75 x (1 ÷ 12)}	3,000	1
	Variable overhead {480,000 x 62.50 x (1 ÷ 12)}	2,500	1
	Fixed overhead {480,000 x 37.50 x (1 ÷ 12)}	1,500	1
	Total current liabilities	13,000	
	(C) Net Working Capital (A – B):	43,445	1
	W-2: Work-in-progress:		
	Raw material (100%) (50 + 37.50 + 37.50)	125.00	
	Conversion cost (50%) (75 + 62.50 + 37.50)	87.50	
		212.50	1
	W-3: Per unit cost for finished goods = Direct material + Packing material + Direct labour + Overhead		
		= 125 + 25 + 75 + 100 = 325	1
(c)	The continuing flow from cash to suppliers, to inventory, to accounts receivable and back into cash is what is called the operating cycle.		1
	The operating cycle consists of three phases.		
	1. Conversion of cash into inventory.		} 1
	2. Conversion of inventory into receivables.		
	3. Conversion of receivables into cash.		
	In Phase-1, cash gets converted into inventory. This includes purchase of raw materials, conversion of raw materials into work-in-progress, finished goods and finally the transfer of good to stock at the end of the manufacturing process.		1
	In Phase-2 of the cycle, the inventory is converted into receivables as credit sales are made to customers. Firms which do not sell on credit obviously not have Phase-2 of the operating cycle.		1
	The last phase, Phase-3, represents the stage when receivables are collected. This phase completes the operating cycle.		1

THE END