

**INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS
OF PAKISTAN**

PROFESSIONAL-III EXAMINATION-SPRING (SUMMER), 2004

Monday, the 31st May, 2004

1045

STRATEGIC MANAGEMENT ACCOUNTING

Time Allowed—2 Hours 40 Minutes

Maximum Marks—90

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- (i) Attempt ALL questions.
- (ii) Answers must be neat, relevant and brief.
- (iii) In marking paper, the examiners take into account clarity of exposition, logic of arguments, effective presentation, language and use of clear diagram/chart where appropriate.
- (iv) Read the instructions printed on the top cover of answer script CAREFULLY before attempting the paper.
- (v) Use of non-programmable scientific calculators of: O Casio fx-82 LB, O Casio fx-82 Super, O Casio fx-350 D, O Casio fx350 HA models is allowed.
- (iv) DO NOT write your Name, Reg. No. or Roll No. any where inside the answer script.
- (vii) Question No. 1 "Multiple Choice Question" printed separately, is an integral part of this paper.
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- Marks
- Q. 2 (a) Capital budgeting has three phases: (1) identification of potential projects (2) selection of project, and (3) post audit of project. What is the role of a management accountant in each phase? 7
- (b) Reyshene Ltd. is considering five capital projects for the year, 2005 and 2006. The company is financed entirely by equity and its cost of capital is 12%. The expected cash flows of the projects are given below:

Project	Year and Cash Flows (Rs. '000)			
	2005	2006	2007	2008
A	(350)	175	175	100
B	(200)	(150)	225	275
C	(250)	(300)	350	400
D	-	(450)	275	325
E	(300)	100	200	250

Note: Figures in brackets represent cash out-flows. All projects are divisible i.e. size of investment can be reduced, if necessary in relation to availability of funds. None of the projects can be delayed or undertaken more than once.

P.T.O.

Required :

Compute which project Reyshene Ltd. should under-take if the capital available for investment is limited to Rs. 550,000 in 2005 and with no limitation in subsequent years. For your analysis, use the following present value factors:

16

Project	2005	2006	2007	2008
Factor (at 12%)	1.00	0.89	0.80	0.71

- Q. 3 (a) "Recovering sunk costs is a major objective in replacing equipment". Do you agree? Explain.
- (b) Pearl Electronic is engaged in the manufacture of an electronic card. It produces 24,000 such cards annually. The company also manufactures 24,000 units of electronic transformers.

7

The annual expenses are as under:

<u>Particulars:</u>	<u>Rs.</u>
Direct materials.	19,200,000
Direct labour.	7,680,000
Indirect labour.	3,600,000
Inspection and testing.	2,400,000
Lighting.	200,000
Power.	2,400,000
Insurance (Fixed).	150,000
Depreciation (Fixed).	480,000
Miscellaneous fixed expenses.	270,000

If the company stops manufacturing the electronic transformers and buys the same from market, the savings in departmental budget will be as under:

	<u>%</u>
Direct materials	20
Direct labour	25
Indirect labour	20
Inspection and testing	25
Power	25

The purchase price of the electronic transformer is Rs. 350 each.

Required :

Marks

- (i) State whether the company should make or buy the electronic transformers. Show all your workings. 8
- (ii) The company has received an offer for export of 12,000 units of the electronic cards at a price of Rs. 1,225 each. If the offer is accepted by the company, the capacity will be fully utilized and the electronic transformers have to be purchased from outside. Should the company then make or buy the electronic transformers? Show all your workings. 8
- Q. 4 (a) Differentiate between a master budget variance and a flexible budget variance. Illustrate your answer. 7
- (b) Monforts Engineering Ltd. has two divisions, North and South. North Division has a budget of selling 200,000 units of a particular component namely Ring Travellers to earn a return of 20% on the average assets employed.
The following particulars of North Division are also available:

Fixed overheads	Rs. 2.5 m
Variable cost	Rs. 5 per unit
Average Assets :	
Sundry debtors.	Rs.1.00 m
Inventories.	Rs. 2.5 m
Plant & equipments.	Rs. 2.5 m

However, there is a marketing constraint and only 150,000 units of the Ring Travellers can be directly sold to the market at the proposed price.

It has been gathered that the remaining 50,000 units of Ring Travellers can be purchased by South Division. North Division wants a price of Rs. 20 per unit of Ring Travellers, but South Division is prepared to pay Rs. 10 per unit.

North Division has another option on hand; which is to produce only 150,000 units. This will reduce the holding of assets by Rs. 1.00 m and fixed overheads by Rs. 125,000.

Required :

- Advise the most profitable course of action for North Division. Show all your workings. 15
- Q. 5 (a) "ABC and JIT are alternative techniques for achieving competitiveness". Do you agree? 7

P.T.O.

- (b) An investor is evaluating three firms for possible investment. Given below is the relevant data:

<i>Particulars</i>	<i>Firm A</i>	<i>Firm B</i>	<i>Firm C</i>
	<u>(Rupees in thousands)</u>		
Sales	100,000	100,000	100,000
Variable costs	20,000	60,000	80,000
Contribution Margin	<u>80,000</u>	<u>40,000</u>	<u>20,000</u>
Fixed Costs	70,000	30,000	10,000
Net Income	<u><u>10,000</u></u>	<u><u>10,000</u></u>	<u><u>10,000</u></u>

Required :

- (i) Ascertain operating leverage factor for the three firms. 5
- (ii) Consider the sensitivity of each firm in terms of profits when additional sales volume of Rs. 20,000 is predicted. 5
- (iii) Using the operating leverage factor, demonstrate the impact on net income following 35% increase in sales volume for each of the three firms. 5

THE END