[This question paper contains 13 printed pages.]

2105 *Your Roll No.* ....

M.Com. / Sem. IV **A**

Paper – 6201 : Managerial Accounting

(Admissions of 2009 and onwards)

Time : 3 Hours *Maximum Marks : 70*

(Write your Roll No. on the top immediately on receipt of this question paper.)

Attempt **all** *questions.*
Question No. **1** *carries* **ten** *marks and remaining questions carry* **fifteen** *marks each.*

1. (I) The Commissioner of Municipal Corporation, Delhi is dissatisfied with rising costs and deteriorating quality of the services provided by the municipal workers, particularly in the Public Works Department (PWD) : paving roads, repairing potholes, and cleaning the streets. He is contemplating privatizing these services by outsourcing the business to independent, private contractors. The Commissioner has demanded that his staff develop an activity – based cost system for municipal services. However, before proceeding with his privatization initiative, he stated, "Introducing competition and privatization

to government service requires real cost information. You can not compete out if you are using fake cost." Currently, the accounting and financial system of Delhi government report only how much is being spent in each department, by type of expenditure payroll, benefits, materials, vehicles, equipment (including computers and telephones) and supplies.

Required :

(a) Before out sourcing to the private sector, why does the Commissioner want to develop activity – based cost estimates of the current cost of performing these municipal services ?

(b) After building activity-based cost models, should this information be shared with the municipal workers ? Why or why not ?

(6)

(II) Select the correct answer for the following multiple choice questions :

(i) Cost drivers are

(a) Activities that cause costs to increase as the activity increases

(b) Accounting techniques used to control costs

(c) Accounting measurement used to evaluate whether performance is proceeding according to plan.

(d) A mechanical basis such as machine hours, computer time, size of equipment, or square footage of factory, used to assign costs to activities.

(ii) A manufacturing company prepares income statements using both absorption and variable costing methods. At the end of a period, actual sales revenue, total gross profit and total contribution margin approximated budgeted figures, whereas net was substantially greater than the budgeted amount. There were no beginning or ending inventories. The most likely explaination of the net income increase is that, compared to budget, actual

(a) Manufacturing fixed costs have increased.

(b) Selling and administrative fixed expenses had decreased.

(c) Sales prices and variable costs had increased proportionately.

(d) Sales prices had declined proportionately less than variable costs.

(iii) What is the opportunity cost of making a component part in a factory given no alternative use of the capacity ?

(a) Variable manufacturing cost of the component.

(b) Total manufacturing cost of the component.

(c) Total variable cost of the component.

(d) Zero

(iv) Which of the following statements regarding budgets is false ?

(a) They are formal documents that quantify a company's plans.

(b) They enhance communication and coordination.

(c) They are useful in planning but not in control.

(d) They provide a basis for evaluating performance. (4)

2. (a) "Activity-based costing is the wave of the present and the future: All companies should adopt it." Do you agree ? Explain. (8)

(b) "Management accounting is nothing else but financial and cost accounting tailored to the requirements of management." Defined or criticise the statement. Give reasons. (7)

OR

(a) Discuss several areas of decisions for which the use of variable costing would be more appropriate than use of absorption costing. (8)

(b) Explain behavioural dimensions of budgeting. (7)

3. (a) What are the objectives of transfer pricing ? Explain market-based and negotiated transfer prices. (8)

(b) What advantages and disadvantages are shared by ROI and Residual Income ? What can be done to overcome this problem ? (7)

OR

The following is the income statement of a company for three years prepared on absorption costing basis.

(Rs.)

	Year 1	Year 2	Year 3
Sales	8,00,000	6,40,000	8,00,000
Cost of goods sold :			
Opening inventory	0	0	2,00,000
Cost of goods manufactured	5,80,000	6,00,000	5,60,000
Goods available for sales	5,80,000	6,00,000	7,60,000
Less : Closing inventory	0	2,00,000	1,40,000
Cost of goods sold	5,80,000	4,00,000	6,20,000
Gross margin	2,20,000	2,40,000	1,80,000
Selling & Administrative expenses	1,90,000	1,80,000	1,90,000
Net income (loss)	30,000	60,000	(10,000)
Production units	50,000	60,000	40,000
Sales units	50,000	40,000	50,000

Additional information :–

(a) Variable manufacturing costs (direct materials, direct labour and variable manufacturing overhead) total Rs. 2 per unit, and fixed manufacturing costs total Rs. 4,80,000 per year.

(b) Fixed manufacturing costs are applied to units of product on the basis of each year's production (that is, a new fixed manufacturing overhead rate is computed each year).

(c) Variable selling and administrative expenses were Re 1 per unit sold in each year. Fixed selling and administrative expenses totalled Rs. 1,40,000 each year.

(d) The company uses a FIFO inventory flow assumption.

Required :

(i) Prepare income statement for each year under variable costing.

(ii) Reconcile the variable costing and absorption costing net income for each year. (15)

4. Rakesh, an entrepreneur, runs two departmental stores, one in Delhi and the other in NOIDA. Operating income for each store in 2011 is as follows :

	Rs.	
	Delhi Store	NOIDA Store
Sales	1,07,00,000	86,00,000
Operating costs :		
Cost of goods sold	75,00,000	66,00,000
Lease rent (renewable each year)	9,00,000	7,50,000
Labour costs (paid on hourly basis)	4,20,000	4,20,000
Equipment depreciation	2,50,000	2,20,000
Utilities (electricity heating)	4,30,000	4,60,000
Allocated corporate overhead	5,00,000	4,00,000
Total operating costs	1,00,00,000	88,50,000
Operating income/loss	7,00,000	(2,50,000)

The equipment has zero disposal value. Mohan, the accountant, makes the following comment : "Rakesh can increase his profitability by closing down the NOIDA store or by adding another store like it."

Required :

(i) By closing down the NOIDA store, Rakesh can reduce overall corporate overhead costs by Rs. 4,40,000. Calculate Rakesh's operating income if he closes the NOIDA store. Is Mohan's statement about the effect of closing the NOIDA store correct ? Explain.

(ii) Calculate Rakesh's operating income if he keeps the NOIDA store open and opens another store with sales revenues and costs identical to the NOIDA store (including a cost of Rs. 2,20,000 to acquire equipment with a one-year useful life and Zero disposal value). Opening this store will increase corporate overhead costs by Rs. 40,000. Is Mohan's statement about the effect of adding another store like the NOIDA store correct. Explain.

OR

The management of Reliance Manufacturing company at the beginning of 2010 anticipated (i) decrease in sales as compared with 2009 because of production time lost in converting to new products and (ii) smaller profit margin due to higher material and labour costs. The controller was asked to prepare a cash budget based on estimated 2010 sales of Rs. 24 lakhs (a decrease of Rs. 3,00,000) and to forecast the cash position at the close of 2010.

The forecast of certain balance sheet and other items was as follows :

Accounts receivable (net)	Rs. 35,000	decrease
Accounts payable	20,000	decrease
Inventories	17,000	increase
Addition to plant (gross)	1,25,000	
Addition to retained earnings	25,000	
Income for 2010 (after depreciation but before income taxes)	95,000	
Depreciation expense, 2010	48,000	
Income taxes for 2010 (payable in 2011)	45,000	
Divident payments (at 2009 rates)	30,000	

The cash balance on January 1, 2010 was Rs. 54,000 and the tax liability on that date, arising from 2009 taxable income, amounted to Rs. 93,000.

Required :

(i) Assuming that any balance sheet items not listed above would be unchanged, prepare a schedule of forecast cash receipts and cash disbursements for 2010 and determine the expected cash balance as on December 31, 2010.

(ii) What action would you expect management to take when it sees the cash flow estimates for the year. (15)

5. Hero Cycles has two divisions, A and B, which manufacture expensive bicycles. Division A produces the bicycle frame and Division B assembles the rest of the bicycle onto the frame. There is market for both the subassembly and the final product. Each division has been designated as a profit centre. The transfer price for the subassembly has been set at the long run average market price. The following data are available for each division.

Selling price for final product	Rs. 3,000
Long run average selling price for intermediate product	Rs. 2000
Incremental costs for completion in division B	Rs. 1,500
Incremental costs in division A	Rs. 1,200

The manager of division B has made the following calculation :

Selling price for final product	Rs. 3,000
Transferred-in-costs	(2,000)
Incremental costs for completion	(1,500)
Contribution (loss) on product	(500)

Required :

(i) Should transfer be made to division B if there is no unused capacity in division A. Is the market price the correct transfer price ? Show your computations.

(ii) Assume that division A's maximum capacity for this product is 1000 units per month, and sales to the intermediate market are now 800 units. Should 200 units be transferred to division B ? At what transfer price ? Assume that for a variety of reasons, division A will maintain Rs. 2000 selling price indefinitely. That is, division A is not considering lowering the price to outsiders even if idle capacity exists.

(iii) Suppose division A quoted a transfer price of Rs. 1500 for upto 200 units. What would be the contribution to the company as a whole if a transfer were made. As manager of division B, would you be inclined to buy at Rs. 1,500. Explain. (15)

OR

(I) A cost accountant of a company was given the following information regarding the overheads for February 2011.

(i) Overhead cost variance Rs. 1400 Adverse

(ii) Overhead volume variance Rs. 1000 Adverse

(iii) Budgeted hours 1200 hours

(iv) Budgeted overheads Rs. 6000

(v) Actual rate of recovery of overheads, Rs. 8 per hour

You are required to assist him in computing the following variances for February 2011.

(a) Overhead expenditure variable

(b) Actual overheads incurred

(c) Actual hours for actual production

(d) Overheads capacity variance

(e) Overheads efficiency variance

(f) Standard hours for actual production

(9)

(II) Amit was recently appointed as vice-president of operations for Reliance Company. In a conversation with Pradeep, Reliance's Chief

Financial Officer, Amit suggested that segment managers be evaluated on the basis of segment data appearing in Reliance annual financial report. This report presents revenues, earnings, assets and depreciation for each segment for a five-year period. Amit believes that evaluating segment managers by criteria similar to those used to evaluate the company's top management would be appropriate. Pradeep expressed his reservations about using segment information from the annual reports for this purpose and suggested that Amit consider other ways to evaluate the performance of segment managers.

Required :

(i) Explain why the segment information prepared for public reporting purposes may not be appropriate for the evaluation of segment managers performance.

(ii) Identify and describe several types of financial information that would be more appropriate for Amit to review when evaluating the performance of segment managers. (6)