



# Examiner's report

## MA2 Managing Costs & Finance

### For CBE and Paper exams covering January to June 2015

#### General Comments

The examination consists of 50 objective test questions, each worth 2 marks. The purpose of this report is to provide illustrations of questions which have especially posed problems for candidates.

The three sample multiple-choice questions below cover different aspects of the syllabus. The approach to correctly answering each question is explained and the common incorrect approaches, along with the misunderstandings which they indicate, are highlighted. Answering objective test questions requires candidates to have both a clear understanding of the subject matter being examined and a logical approach.

#### Sample Questions for Discussion

##### Example 1

Direct labour hours are used as the basis for overhead absorption in a production cost centre. The following data are available for a period:

|                                   |          |
|-----------------------------------|----------|
| Actual direct labour hours worked | 9,760    |
| Actual overheads incurred         | \$86,920 |
| Overhead under-absorption         | \$2,496  |
| Budgeted direct labour hours      | 10,000   |

**What was the overhead absorption rate in the period?**

- A \$8.65
- B \$9.16
- C \$8.44
- D \$8.94

This question tested candidates' understanding of overhead absorption, using actual data for a period to calculate the absorption rate that had been applied in the production cost centre. Overhead over or under absorption occurs when overheads are absorbed into product costs for a period using an absorption rate, determined before the period commenced, based on budgeted data.

In this question, the fact that overheads were under absorbed in the period indicates that the actual overhead expenditure was greater than the amount of overhead absorbed (actual direct labour hours  $\times$  overhead absorption rate). The overhead absorbed was, therefore, \$84,424 (\$86,920 - \$2,496). It follows that the overhead absorption rate in the production cost centre was \$8.65 (\$84,424 absorbed  $\div$  9,760 actual direct labour hours worked) and thus Option A is the correct answer.

Each of the three incorrect options were selected by a significant proportion of candidates. All of the absorption rates in the options included the actual overhead expenditure but the calculations added (rather than subtracted) the under absorbed amount and/or used budgeted (rather than actual) direct labour hours. Option B incorrectly added the under absorbed amount to the actual overhead expenditure. Option C incorrectly divided the correct total amount by the budgeted direct labour hours. Option D made both of the errors included in Options B & C.

### Example 2

**Which of the following statements, concerning inventory management, is TRUE?**

- A Setting a minimum control level seeks to ensure that a stockout does not occur
- B The reorder level is the amount purchased to replenish inventory
- C With a continuous stocktaking system there is a continuous record of the actual quantity of each item of inventory
- D Periodic stocktaking involves frequent counts and checks on a proportion of the inventory items

This question tested aspects of inventory management and the terminology used.

Option A is the correct answer. The minimum control level is defined as the level below which inventory should not fall in average circumstances. It is calculated as the inventory level at which a replenishment order is placed with a supplier (based on maximum expected usage and lead time) less the average usage and lead time. If the minimum control level is reached this is highlighted enabling the situation to be reviewed and action to be taken, if necessary, to avoid a stockout.

Option B is incorrect as the reorder level is the level of inventory at which a replenishment order is raised not the amount purchased. Option C describes a perpetual inventory system not a continuous stocktaking system. Option D describes continuous stocktaking not periodic stocktaking.

### Example 3

The following were the only transactions in the first trading period of a new business:

Credit sales: \$140,900

Receipts from customers: \$118,700

Credit purchases of goods: \$96,600 (there was no inventory at the end of the period)

Payments to suppliers of goods: \$72,000

Purchase of, and payment for, a machine: \$20,000 (the machine is depreciated on a straight-line basis over 20 periods, assuming nil residual value)

Expenses incurred and paid for: \$17,800

**Comparing accrual accounting and cash accounting, what is the difference in the surplus for the period?**

- A \$16,600
- B \$17,600
- C \$2,400

**D** \$3,400

This question tested knowledge of accrual accounting and cash accounting and required a calculation of the difference, in the surplus for an accounting period in a given scenario, between the two methods. All four options were selected by a significant proportion of candidates.

Using accrual accounting, transactions are recognised when they occur, which is not generally coincident with a cash flow taking place. The objectives are the matching of expenditure with income in order to determine profit or loss for a period and to prepare a statement of assets and liabilities. Cash accounting compares cash receipts and payments in order to determine the net cash flow for a period.

The accrual accounting profit for the first trading period of the new business is \$25,500 [sales \$140,900 – (cost of goods sold \$96,600 + expenses \$17,800 + depreciation \$1,000)]. The net cash inflow is \$8,900 [sales receipts \$118,700 – (payments to suppliers of goods and for expenses \$89,800 + payment for machine \$20,000)]. The difference in the surplus for the period, comparing accrual accounting with cash accounting, is \$16,600 (\$25,500 - \$8,900) and, therefore, Option A is the correct answer. This could alternatively have been calculated directly, using the differences between the methods, as unpaid sales \$22,200 + NBV of machine \$19,000 – unpaid suppliers \$24,600 = \$16,600.

Option B is incorrect because it fails to deduct \$1,000 for depreciation in calculating the accrual accounting profit. Option D is incorrect because it fails to deduct the payment for the machine in the calculation of net cash flow. Option C is incorrect because it fails to include both the depreciation (accrual accounting) and the payment for the machine (cash accounting).

## Summary

The three multiple-choice questions illustrated in this report reveal a number of misunderstandings, confusion or a lack of knowledge amongst candidates regarding the particular topics being examined. In many cases this may be symptomatic of a more widespread problem which can only be overcome by a rigorous study program and by practicing objective test questions. Candidates preparing for future examinations should try to ensure that they develop a clear understanding of the different areas of the syllabus, read questions carefully and think logically when answering them.