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Topic Break Down

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QUESTION NO: 1

A medium-sized manufacturing company, which operates in the electronics industry, has employed a firm of consultants to carry out a review of the company's planning and control systems. The company presently uses a traditional incremental budgeting system and the inventory management system is based on economic order quantities (EOQ) and reorder levels. The company's normal production patterns have changed significantly over the previous few years as a result of increasing demand for customized products. This has resulted in shorter production runs and difficulties with production and resource planning.

The consultants have recommended the implementation of activity based budgeting and a manufacturing resource planning system to improve planning and resource management.

Select ALL the benefits for the company that could occur following the introduction of an activity based budgeting system.

A. Under an activity based budgeting system, resource allocation is linked to the strategic plan is prepared after considering alternative strategies. This approach ensures that new activities that are required to meet the company's strategic objectives are included in the budget.

B. Under an activity based budgeting system the focus is on existing resources and operations. Adjustments are then made for changes in activity and price which results in past inefficiencies being perpetuated. Under a traditional budgeting system, only resources that are needed to perform activities required to meet the budgeted production and sales volumes are included.

C. Activity based techniques including activity based budgeting focus on the outputs of a process rather than the input to the process. This approach provides a clear framework for understanding the link between costs and the level of activity. It allows the ranking of activities and the determination of how limited resources should be allocated across competing activities.

D. ABB systems present costs under functional headings i.e. the emphasis is on the nature of the cost. The weakness of this approach is that it gives little indication of the link between the level of activity and the cost incurred.

E. The approach under an activity based system is to make arbitrary cuts in order to meet overall financial targets.

F. Activity based budgeting allows the identification of value added and non-value added activities and ensures that cuts are made to non-value added activities. ABB is also useful for review of capacity utilization.

ANSWER: A C F

Explanation:

Activity based budgeting starts with the forecast demand for products or services and identifies the activities needed to provide that output. It then determines the resources required for those activities. Consequently, resource allocation can be linked to the strategic plan and can accommodate alternative strategies, including new activities needed to deliver strategic objectives. This is particularly valuable where greater customisation and shorter production runs have altered the pattern and volume of production-support activities.

By focusing on activities and their cost drivers, activity based techniques provide a structured understanding of the relationship between activity levels and resource consumption. Managers can therefore assess and prioritise activities when resources are constrained, rather than simply carrying forward previous spending patterns. The activity analysis also makes it possible to distinguish value-added work from non-value-added work. This supports more informed cost management and process improvement, while capacity requirements and utilisation can be reviewed in relation to planned activity volumes.

These features align with the P1 management accounting emphasis on using cost and activity information to support planning, control, and resource decisions. See the CIMA Professional Qualification overview and the AICPA & CIMA management accounting resources.

QUESTION NO: 2

QR uses an activity based budgeting (ABB) system to budget product costs. It manufactures two products, product Q and product R. The budget details for these two products for the forthcoming period are as follows:

	Product Q	Product R
Budgeted production (units)	80,000	120,000
Number of machine set ups per batch	4	2
Batch size (units)	5,000	4,000

The total budgeted cost of setting up the machines is $74,400.

What was the budgeted machine set up cost per unit of product Q?

A. $0.39 per unit

B. $0.56 per unit

C. $0.37 per unit

D. $0.48 per unit

ANSWER: D

Explanation:

$0.48 per unit is the budgeted machine set-up cost for product Q. Under activity-based budgeting, machine set-up costs are assigned using the activity that causes them: the number of machine set-ups. The $74,400 total budgeted set-up cost is therefore first converted into a cost per budgeted set-up by dividing it by the total number of set-ups required for both products. Product Q is then allocated its share of that total cost according to its budgeted number of set-ups. Finally, the set-up cost allocated to product Q is divided by product Q's budgeted production volume. Applying the budgeted set-up and production figures in the table gives a unit cost of $0.48.

This approach reflects the central ABC/ABB principle that overhead costs should be traced to products through an appropriate cost driver rather than spread using a broad volume measure alone. Set-ups are a batch-level activity: the cost is driven by the number of production runs requiring preparation, not directly by the number of units made. Consequently, deriving a set-up activity rate and then expressing the resulting allocation per unit gives the relevant budgeted cost for product Q. Further background on activity-based costing is available from BCcampus Open Education and CIMA learning resources are available from AICPA & CIMA.

QUESTION NO: 3

A company produces trays of pre-prepared meals that are sold to restaurants and food retailers. Three varieties of meals are sold: economy, premium and deluxe.

Extracts from the budget for last year are given below:

	Economy	*Premium*	*Deluxe*
Sales quantity (trays)	180,000	360,000	260,000
Selling price per tray	$2.80	$3.20	$4.49
Total sales revenue	$504,000	$1,152,000	$1,167,400
Direct material cost per tray	$1.00	$1.60	$2.20
Total direct material cost	$180,000	$576,000	$572,000
Direct labour cost per tray	$0.50	$0.50	$0.50
Total direct labour cost	$90,000	$180,000	$130,000

Overhead costs for the budget were estimated using the high-low method based on the total overhead costs for three previous years.

Output	720,000 trays	680,000 trays	840,000 trays
Total overheads	$1,016,000	$992,000	$1,096,000

Actual results for last year were as follows:

	Economy	*Premium*	*Deluxe*
Sales quantity (trays)	186,000	396,000	278,000
Selling price per tray	$2.82	$3.21	$4.50
Total sales revenue	$524,520	$1,271,160	$1,251,000
Direct material cost per tray	$1.10	$1.50	$2.10
Total direct material cost	$204,600	$594,000	$583,800
Direct labour cost per tray	$0.52	$0.54	$0.48
Total direct labour cost	$96,720	$213,840	$133,440
Variable overhead per tray	$0.64	$0.66	$0.63
Total variable overheads	$119,040	$261,360	$175,140
Actual fixed overheads: $546,000			

The company operates a just-in-time system for purchasing and production and does not hold any inventory.

Ignore inflation.

Discuss the benefits of flexible budgeting for planning and control purposes. Select all the true statements.

A. A fixed budget will provide meaningful control information when actual activity differs from budget and variable costs are significant.

B. If actual sales revenue is compared to a fixed budget it is possible to tell whether a favourable sales variance is due to an increase in units sold or an increase in sales price.

C. If sales volumes were well above budget, adverse variable cost variances will probably be reported, against the fixed budget, since more variable costs have to be incurred to support the higher level of activity.

D. Reporting against a fixed budget tells management nothing about the efficiency of operations.

E. If a flexible budget is prepared then the budget variances calculated will provide a better indication of performance since actual results will be compared against an appropriate benchmark.

F. The fixed budget however provides more insight into actual performance.

ANSWER: C D E

Explanation:

If sales volumes are substantially above budget, comparing actual variable costs with a fixed-budget amount will commonly report an adverse cost variance. The higher output requires additional variable inputs, such as ingredients, packaging and direct labour, even where those inputs have been used efficiently. This demonstrates why an unadjusted fixed budget is not a suitable operational-control benchmark when activity differs materially from plan.

Reporting against a fixed budget therefore does not isolate operational efficiency: the reported difference combines the effect of changed activity with any difference in resource use or unit prices. Management needs a budget restated for the actual level and mix of activity before it can make a meaningful like-for-like assessment of performance. A flexible budget makes this adjustment by recalculating variable costs, revenues and relevant stepped costs using actual output volumes. The resulting variances provide a more appropriate benchmark and support management attention on genuine price, usage, sales-price and efficiency effects rather than volume alone. This use of flexible budgets is consistent with the planning,

budgeting and control focus of the CIMA P1 syllabus; see CIMA Professional Qualification Syllabus and the explanation of flexible budgets in The Open University's budgeting materials.

QUESTION NO: 4

A company operates a decentralised structure in which Division A supplies a component to Division B. There is no external market for the component. Division A has spare capacity and the variable cost of producing the component is $24 per unit.

Which of the following statements about transfer pricing are correct?

Select ALL the correct answers.

A. The relevant incremental cost to the group of an internal transfer is $24 per unit.

B. Division A sacrifices external contribution if it supplies Division B.

C. A transfer price equal to variable cost gives Division A no contribution towards its fixed costs.

D. A negotiated transfer price may assist in reconciling divisional objectives.

E. The transfer price must be based on an external market price.

ANSWER: A C D

Explanation:

Where a supplying division has spare capacity and there is no external market, the minimum transfer price from the perspective of the group is normally the supplying division's variable cost. Producing an additional component for the receiving division uses resources that would otherwise be idle, so no external contribution is sacrificed. The relevant group cost is therefore $24 per unit.

A transfer price of $24 enables Division B to make an appropriate decision for the group if it is deciding whether to obtain the component internally. However, a price at variable cost provides Division A with no contribution towards fixed costs and may not provide its manager with an appropriate performance incentive. A negotiated transfer price may be used to balance divisional autonomy, motivation and goal congruence. Transfer pricing is included in the CIMA Professional Qualification syllabus.

QUESTION NO: 5

THS produces two products from different combinations of the same resources. Details of the products are shown below:

	E per unit	R per unit
Selling price	$99	$159
Material A ($2 per kg)	3 kgs	2 kgs
Material B ($6 per kg)	4 kgs	3 kgs
Machining ($7 per hour)	2 hours	3 hours
Skilled labour ($10 per hour)	2 hours	5 hours
Maximum monthly demand (units)	unlimited	1,500

THS is preparing the production plan for next month. The maximum resource availability for the month is:

Material A	5,000 kgs
Material B	5,400 kgs
Machining	3,000 hours
Skilled labour	4,500 hours

Identify, using graphical linear programming, the optimal production plan for products E and R to maximize THS's profit in the month.

A. The solution (from the graph0 is to produce 675 units of E and 470 units of R.

B. The solution (from the graph0 is to produce 495 units of E and 670 units of R.

C. The solution (from the graph0 is to produce 475 units of E and 770 units of R.

D. The solution (from the graph0 is to produce 375 units of E and 750 units of R.

E. The solution (from the graph0 is to produce 375 units of E and 870 units of R.

F. The solution (from the graph0 is to produce 495 units of E and 470 units of R.

ANSWER: D

Explanation:

The solution (from the graph0 is to produce 375 units of E and 750 units of R. This is the optimal production plan because graphical linear programming identifies the feasible region created by all resource-capacity and demand constraints, then evaluates the objective function at its corner points. The relevant iso-contribution line is moved outward, in the direction of increasing total contribution, while remaining within the feasible region. Its final point of contact is the corner represented by production of 375 units of E and 750 units of R. At that point, the available constrained resources are allocated in the combination that gives the maximum monthly contribution (and therefore maximum profit where fixed costs are unchanged). This approach reflects the CIMA management-accounting treatment of limiting factors and optimisation: when multiple scarce resources apply, the best mix must be determined simultaneously rather than by considering each product independently. Graphical linear programming is appropriate here because there are two decision variables, enabling the constraints and the maximum-contribution point to be plotted and inspected visually. See CIMA's Professional Qualification syllabus and the CIMA study resources for the management-accounting context of decision-making and optimisation techniques.

QUESTION NO: 6

A company manufactures three products using the same skilled labour resource. The labour resource is in short supply.

The following information relates to the products:

Product A: contribution per unit $36; skilled labour hours per unit 3 hours.

Product B: contribution per unit $28; skilled labour hours per unit 2 hours.

Product C: contribution per unit $45; skilled labour hours per unit 5 hours.

Which of the following statements are correct?

Select ALL the correct answers.

A. Product A earns a contribution of $12 per skilled labour hour.

B. Product B should be ranked first if demand is sufficient.

C. Product C should be ranked first because it has the greatest contribution per unit.

D. The production priority is Product B, Product A and Product C.

E. The products should be ranked using their selling prices per unit.

ANSWER: A B D

Explanation:

Where a limiting factor exists, products should be ranked by contribution earned per unit of the scarce resource, not by total contribution per unit. Product A earns $12 per skilled labour hour ($36 ÷ 3), Product B earns $14 per skilled labour hour ($28 ÷ 2), and Product C earns $9 per skilled labour hour ($45 ÷ 5).

Product B should therefore receive priority, followed by Product A and then Product C, subject to demand constraints. Product C has the highest contribution per unit, but it uses relatively more of the scarce labour resource and so provides the lowest contribution per constrained hour.

This is an application of limiting-factor analysis and contribution maximisation. Further background is available from OpenStax on contribution and profitability analysis.

QUESTION NO: 7

A major company sells a range of electrical, clothing and homeware products through a chain of department stores. The main administration functions are provided from the company's head office. Each department store has its own warehouse which receives goods that are delivered from a central distribution center.

The company currently measures profitability by product group for each store using an absorption costing system. All overhead costs are charged to product groups based on sales revenue. Overhead costs account for approximately one-third of total costs and the directors are concerned about the arbitrary nature of the current method used to charge these costs to product groups.

A consultant has been appointed to analyses the activities that are undertaken in the department stores and to establish an activity based costing system. The consultant has identified the following data for the latest period for each of the product groups for the X Town store:

	Product Group		
	Clothing	*Electrical*	*Homeware*
Sales revenue	$4,400k	$3,300k	$1,100k
Cost of sales	$2,800k	$2,300k	$600k
Number of deliveries	104	52	26
Number of pallets per delivery	50	20	10
Number of inventory items	20,000	14,000	6,000
Number of customers	2,100k	1,050k	350k
Number of requisitions	522	243	135

The consultant has also obtained the following information about the support activities:

Activity	*Cost driver*	*Overheads*
		$000
Customer service	Number of customers	1,100
Warehouse receiving	Number of pallets delivered	700
Warehouse issuing	Number of requisitions	300
In-store merchandising	Number of inventory items	400
Central administration	Sales revenue	316

Calculate the total profit for each of the product groups:

…. using the current absorption costing system;

A. The profit or loss in $ was…. Clothing 122; Electrical 56; Homeware (178)

B. The profit or loss in $ was…. Clothing (175); Electrical 86; Homeware 22

C. The profit or loss in $ was…. Clothing 85; Electrical 36; Homeware (28)

D. The profit or loss in $ was…. Clothing 192; Electrical (56); Homeware 148

ANSWER: D

Explanation:

The profit or loss in $ was…. Clothing 192; Electrical (56); Homeware 148 is correct. Under the current absorption-costing system, the store's total overhead is allocated between the three product groups solely in proportion to each group's sales revenue. First, total the sales revenues and calculate each product group's revenue percentage. Apply those percentages to the total overhead cost to obtain the overhead absorbed by Clothing, Electrical, and Homeware. This is a revenue-based absorption rate, so warehouse deliveries, floor-space use, purchase orders, and other activity measures identified by the consultant are not used for this part of the calculation.

For each product group, deduct its directly attributable costs and its share of absorbed overhead from sales revenue. Applying the stated revenue-based allocation produces a profit of $192 for Clothing, a loss of $56 for Electrical, and a profit of $148 for Homeware. The three results should also reconcile to the store's total profit after total direct costs and all

overhead have been deducted from total sales revenue. This illustrates the purpose of an absorption-costing result: all production or operating overhead included in the analysis is fully assigned to the relevant cost objects using the organisation's selected allocation basis. CIMA's management-accounting syllabus covers the application and evaluation of costing methods, including traditional absorption approaches and activity-based costing; see CIMA Professional Qualification resources. For a concise explanation of allocating overhead through a predetermined allocation basis, see OpenStax's discussion of overhead allocation.

QUESTION NO: 8

A company has budgeted to produce 5,000 units of Product B per month. The opening and closing inventories of Product B for next month are budgeted to be 400 units and 900 units respectively. The budgeted selling price and variable production costs per unit for Product B are as follows:

	$ per unit
Selling price	20.00
Direct costs	6.00
Variable production overhead costs	3.50

Total budgeted fixed production overheads are $29,500 per month. The company absorbs fixed production overheads on the basis of the budgeted number of units produced. The budgeted profit for Product B for next month, using absorption costing, is $20,700.

Prepare a marginal costing statement which shows the budgeted profit for Product B for next month.

What was the difference between the profit calculation using marginal costing and the profit calculation using absorption costing?

A. $2870

B. $3010

C. $2950

D. $3610

E. $2750

ANSWER: C

Explanation:

$2950 is correct. Fixed production overhead is absorbed at $5.90 per unit, calculated as total budgeted fixed production overhead of $29,500 divided by the 5,000 budgeted units produced. Inventory increases from 400 units at the start of the month to 900 units at the end, an increase of 500 units. Under absorption costing, fixed production overhead is included in each unit's inventory cost. Therefore, the $5.90 fixed overhead attached to the additional 500 units remains in closing inventory rather than being charged against this month's profit. The fixed overhead deferred is 500 × $5.90 = $2,950.

Under marginal costing, all fixed production overhead for the period is charged in full against the month's contribution. Consequently, where inventory has increased, the absorption-costing profit is $2,950 higher than the marginal-costing profit. This reconciliation follows the core management-accounting distinction that inventory valuation under absorption costing includes fixed production overhead, whereas marginal costing treats fixed production overhead as a period cost. Further guidance on cost behaviour and marginal analysis is available from AICPA & CIMA's CGMA Finance Leadership Program and the IAS 2 Inventories overview.