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**University Examinations 2015/2016**

FOURTH YEAR SECOND SEMESTER EXAMINATION FOR THE DEGREE

OF

BACHELOR OF COMMERCE

**BFC 3478: CONTEMPORARY ISSUES IN MANAGEMENT ACCOUNTING**

**DATE: APRIL 2016 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two***questions.

**QUESTION ONE (30 MARKS)**

1. Explain how a low-cost airline can use strategic management accounting in developing a business strategy for competing with the traditional airline. (10 marks)
2. Superior Leather Products, Inc., has two divisions: Travel Bags Division and Leather Accessories Division. The following table presents their performance for the most recent year.

|  |  |  |
| --- | --- | --- |
|  | Travel bags | Leather accessories |
| Total assets | Shs. 4,000,000 | Shs. 6,000,000 |
| Current liabilities | 174,000 | 8,000 |
| Operating income (before tax) | 600,000 | 1,200,000 |

**Required:**

Calculate:

1. The return on investment (ROI) for each division. (4 marks)
2. The residual income for each division. Assume the required rate of return on investment is 12%. (4 marks)
3. Superior Leather has outstanding long-term debt with a market value of shs. 3 million and an interest rate of 8%. Its equity capital has a market value of shs. 7 million. The cost of equity is 12%. The income tax rate is 30%. Calculate the economic value added for each division. (8 marks)
4. Which of the three measures would you recommend? Why? (4 marks)

**QUESTION TWO (20 MARKS)**

1. You are planning to start a business operating a tax service. Write a Balanced Scorecard containing two goals and two measurements of achieving the goals for each of the four sections of the Balances Scorecard (14 marks)
2. Explain the following terms relating to modern management accounting
3. Kaizen (3 marks)
4. Six sigma (3 marks)

**QUESTION THREE (20 MARKS)**

1. You have 50 cars available for hire. Some customers hire cars for one day; others take them for up to one week. Explain decisions that you might make as a manager, where accounting information would be helpful in making the decision. (8 marks)
2. Dairies Ltd operates a milk processing and delivery business. The retail distribution of milk is controlled by a regional head office which has overall responsibility for five geographical distribution areas. Each area is run by an area manager who has responsibility for ten depots. At each depot there is a depot manager in charge of 20 drivers and their milk floats. Milk is bottled at a central processing plant and sent to depots by lorry. All information regarding the operation of each depot and each area office is sent to the divisional head office accounting department. This department produces weekly reports to be sent to each depot manager, each area manager and the manager of the distribution division. A pyramidal system of reporting is in operation whereby each manager receives an appropriate weekly report containing the financial information on the operations for which he is responsible.

**Required:**

1. Explain what is meant by responsibility accounting. (4 marks)
2. List, giving reasons, the information which should be contained in the weekly reports to each of the three levels of manager specified. (8 marks)

**QUESTION FOUR (20 MARKS)**

1. In order to remain useful, modern management accounting techniques must keep abreast of changes in the business environment. Discuss various business environmental factors that caused the changes to tradition cost accounting techniques. (6 marks)
2. Dairy products Ltd has recently developed sales of cream in aerosol dispensers which are sold alongside the company’s traditional products of cartons of cream and packets of cheese. The company is now considering the sale of cream cheese in aerosol dispensers. It is company policy that any new product must be capable of generating sufficient profit to cover all costs, including estimated initial marketing and advertising expenditure of shs 1,000,000. Current weekly production, with unit costs and selling prices, is as follow:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Units of Output | Variable cost (kshs) | Fixed cost (Kshs) | Selling price (Kshs) |
| Cartons of cream | 400,000 | 0.45 | 0.15 | 0.75 |
| Aerosol cans of cream | 96,000 | 0.50 | 0.25 | 1.05 |
| Packets of cheese | 280,000 | 1.00 | 0.20 | 1.30 |

Sales volume is equal to production volume. A 50-week trading year is assume. Rates of absorption fixed costs are based on current levels of output. In order to produce cream cheese in aerosol dispensers, the aerosol machine would require modification at a cost of shs. 400,000 which is to be recovered through sales within one year.

Additional annual fixed costs of shs. 500,000 would be incurred in manufacturing the new product. Variable cost of production would be 50 pence per can. Initial research has estimated demand as follows:

|  |  |
| --- | --- |
| Price per can (shs) | Maximum weekly demand (cans) |
| 1.50 | 60,000 |
| 1.40 | 80,000 |
| 1.15 | 100,000 |

There is adequate capacity on the aerosol machine, but the factory is operating near capacity in other areas. The new product would have to be produced by reducing production elsewhere and two alternatives have been identified:

1. Reduce production of cream cartons by 20% per annum; or
2. Reduce production of packet cheese by 25% per annum.

The directors consider that the new product must cover any loss of profit caused by this reduction in volume. They are also aware that market research has shown growing customer dissatisfaction because of wastage with cream sold in cartons.

**Required:**

Prepare a memorandum to the board of directors of Dairy products Ltd showing the outcome of the alternative courses of action open to the company and make a recommendation on the most profitable. (14 marks)

**QUESTION FIVE (20 MARKS)**

The directors of Advanced plc. Are currently considering an investment in new production machinery to replace existing machinery. The new machinery would produce goods more efficiently, leading to increased sales volume. The investment required will be shs 1, 150, 000 payable at the start of the project. The alternative course of action would be to continue using the existing machinery for a further five years, at the end of which time it would have to be replaced.

The following forecasts of sales and production volumes have been made:

|  |  |  |
| --- | --- | --- |
| Sales (in units)  Year | Using existing machinery | Using new machinery |
| 1 | 400,000 | 560,000 |
| 2 | 450,000 | 630,000 |
| 3 | 500,000 | 700,000 |
| 4 | 600,000 | 840,000 |
| 5 | 750,000 | 1,050,000 |
|  |  |  |
| Production (in units)  Year | Using existing machinery | Using new machinery |
| 1 | 420,000 | 564,000 |
| 2 | 435,000 | 637,000 |
| 3 | 505,000 | 695,000 |
| 4 | 610,000 | 840,000 |
| 5 | 730,000 | 1,044,000 |

Further information:

1. The new machinery will reduce production costs from their present level of shs 7.50 per unit to shs 6.20 per unit. These production costs exclude deprecation.
2. The increased sales volume will be achieved by reducing unit selling prices from their present level of shs. 10.00 per unit to shs. 8.50 per unit.
3. The new machinery will have a scrap value of shs. 150,000 after five years.
4. The existing machinery will have a scrap value of shs. 30,000 at the start of year 1. Its scrap value will be shs 20,000 at the end of Year 5.
5. The cost of capital to the company, in money terms, is presently 12% per annum.

**Required:**

1. Prepare a report to the directors of Advanced plc on the proposed investment decision.

(15 marks)

1. List any further matters which the directors should consider before making their decision (5 marks)